FEDERAL HOUSING FINANCE AGENCY OFFICE OF INSPECTOR GENERAL

Temporary Interest Rate Buydowns

Buydowns

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Temporary interest rate buydowns have increased in the higher interest rate environment

After more than 10 years of record-low interest rates, mortgage rates doubled in 10 months–from about three percent in November 2021 to over six percent in September 2022.

Source: Freddie Mac

6.96
percent
weekly average
as of July 13, 2023

The rising interest rate environment has continued through 2023.

Monthly mortgage payments for a typical home increased due to higher interest rates and rising prices

$750

Monthly mortgage payments on the median asking price the week ending July 6, 2023, were $750 higher than in January 2022, according to Redfin data.

Temporary buydowns allow borrowers to reduce their monthly mortgage payment contributions for a limited period.

Buydowns

How a Temporary Buydown Works

- A lump sum of money, sometimes called a subsidy, is deposited into a buydown account.
- The subsidy can be funded by:
  - Lender
  - Property Seller
  - Borrower
  - Borrower's employer
  - An interested party
- Each month, a portion of the subsidy is released to reduce the borrower's payment contribution.
- The borrower must pay the full mortgage payment once the subsidy is depleted.

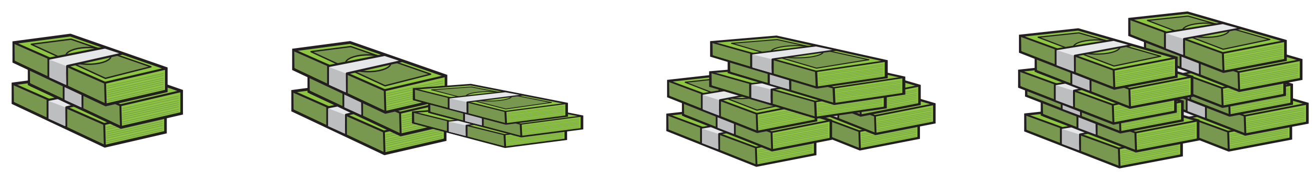
– Information from [Fannie Mae]

One type of temporary buydown plan is a 3-2-1 buydown, where the mortgage interest rate is subsidized 3 percentage points in the first year, 2 points in the second year, and 1 point in the third year.

Illustrative Example of Borrower Contribution

With a 3-2-1 temporary buydown

$1,900 | $2,150 | $2,400 | $2,650



Year 1 | Year 2 | Year 3 | Years 4-30

The subsidy decreases throughout years 1 – 3 until it is depleted, and the borrower makes the full payment starting in year 4.

No temporary buydown

Contribution:

$2,600

Years 1-30

The lender may charge a higher interest rate on loans with buydown agreements, resulting in higher mortgage payments.

Buydowns

Temporary Buydowns and the Enterprises

- Fannie Mae and Freddie Mac (the Enterprises) purchase certain fixed-rate and adjustable-rate mortgages with temporary buydown plans.
- As an example, the maximum rate reduction is 3 percent and the maximum annual rate increase is 1 percent (3-2-1 buydown).
- The Enterprises do not acquire loans with buydown plans for cash-out refinances and investor properties.

Freddie Mac buydown activity (July 2023)[1]

2 percent of volume

34 percent concentrated among 3 sellers

Average **0.06** percentage points higher note rate than non-buydown loans

Fannie Mae buydown activity (July 2023)[1]

About **2 percent** of volume

About **22 percent** concentrated among 3 sellers

Average **0.06** percentage points higher note rate than non-buydown loans

Source: The Enterprises.

[1] Based on loan count.

Uncertainty and Risk Considerations

Payment Shock

A borrower qualifies for a fixed-rate mortgage at the **full interest rate** but may be unable to adjust spending behavior for the full payment after the buydown period.

Multiple Risk Characteristics

Both Enterprises report buydown mortgages generally exhibit certain riskier characteristics, such as higher loan-to-value ratios.

Prepayments

One Enterprise reports borrowers charged a higher interest rate on a buydown might be more likely to pre-pay their mortgages, potentially reducing investor payments. The Enterprises limit the volume of certain buydowns in specific securities.

Volume and Concentration

Although still relatively small as of mid-2023, the Enterprises' share of buydowns grew from nearly zero in the second half of 2022. Freddie Mac acquisitions are concentrated among a few non-bank lenders.

Key Takeaway: Although not a new product, the limited history on loans with temporary interest rate buydowns reduces available performance and risk data, making a full risk analysis more challenging.

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