



## CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

August 24, 2012

### **S. 3085** **Responsible Homeowner Refinancing Act of 2012**

*As introduced in the United States Senate on May 10, 2012*

#### **SUMMARY**

The Home Affordable Refinance Program (HARP) is administered by the Federal Housing Finance Agency (FHFA) to assist certain homeowners with refinancing mortgages that are guaranteed by Fannie Mae and Freddie Mac, also known collectively as the housing government-sponsored enterprises, or GSEs. S. 3085 would require the FHFA to expand the number of homeowners that are eligible to participate in HARP and reduce the initial costs of the program to homeowners. The bill also would:

- Relieve lenders of certain representation and warranty liabilities on mortgages that they agree to refinance under HARP;
- Require junior lien holders or mortgage insurers that block a mortgage from being refinanced under HARP to pay 5 percent of the first mortgage balance except in some cases; and
- Allow lenders to choose whether to confirm the employment status of borrowers seeking refinancing under HARP.

CBO estimates that enacting S. 3085 would cause more homeowners to refinance their mortgages through HARP than would be expected under current law. Those additional mortgages would affect the federal budget in two ways.

First, we expect that more newly refinanced mortgages would lower costs to the GSEs because with lower mortgage payments, fewer homeowners would be expected to default. Although the GSEs are legally private firms, CBO has considered their operations to be a part of the federal budget since the firms entered conservatorship controlled by the Federal Housing Finance Agency in September 2008. CBO's estimates of future budget deficits include the estimated net present value of mortgage guarantees expected to be made by the GSEs, including an adjustment for market risk.

Second, entities that hold a financial interest in the mortgages guaranteed by Fannie Mae and Freddie Mac through the mortgage-backed securities (MBS) they have issued would see a decline in the value of that financial interest as more mortgages were refinanced under S. 3085. The Federal Reserve is one of the largest holders of MBS guaranteed by the GSEs. Income from those holdings totaled \$39 billion in 2011. That income is largely remitted to the Treasury and reported in the budget as revenues. Under the bill, revenues from that source would decline. In the same way, the value of individual mortgages and MBS held in the portfolios of the GSEs would decline in value if they were refinanced under S. 3085.

CBO estimates that the net budgetary impact of enacting S. 3085 would be insignificant over the 2013-2022 period because the net savings to the GSEs—about \$500 million in 2013—would be about the same as the reduction in revenues from the Federal Reserve over the same period. Because the legislation would affect direct spending and revenues, pay-as-you-go procedures apply.

S. 3085 would impose intergovernmental and private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA), but CBO estimates that the costs of mandates would fall below the annual thresholds for intergovernmental and private-sector mandates established in UMRA (\$73 million and \$146 million in 2012 respectively, adjusted annually for inflation).

## **ESTIMATED COST TO THE FEDERAL GOVERNMENT**

The estimated budgetary impact of S. 3085 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

	By Fiscal Year, in Billions of Dollars											
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2013-2017	2013-2022
<b>CHANGES IN DIRECT SPENDING</b>												
Estimated Budget Authority	-0.5	0	0	0	0	0	0	0	0	0	-0.5	-0.5
Estimated Outlays	-0.5	0	0	0	0	0	0	0	0	0	-0.5	-0.5
<b>CHANGES IN REVENUES</b>												
Estimated Revenues	-0.1	-0.2	-0.1	-0.1	*	*	*	0	0	0	-0.4	-0.5
<b>NET INCREASE OR DECREASE (-) IN THE DEFICIT</b>												
Change in Deficit	-0.4	0.2	0.1	0.1	*	*	*	0	0	0	-0.1	*

Notes: Components may not sum to totals because of rounding. Negative changes in direct spending indicate lower spending; negative changes in revenues indicate lower revenues.

\* = between -\$50 million and \$50 million.

## BASIS OF ESTIMATE

For this estimate, CBO assumes that S. 3085 will be enacted late in calendar year 2012. Under the bill, the program to expand HARP would expire on December 31, 2013, the same time that HARP is scheduled to end.

### Background on the Home Affordable Refinance Program

HARP was created in 2009. Under the program, FHFA, Fannie Mae, Freddie Mac, and participating banks provide a streamlined refinance process for borrowers who are otherwise unable to refinance their mortgages. The criteria to participate in the program were expanded with the implementation of HARP 2.0 on December 1, 2011. FHFA reports that about 1.4 million mortgages have been refinanced under HARP from 2009 through June of 2012—about 12 percent of total refinancings completed by the GSEs during that period.

S. 3085 would require FHFA to further amend HARP eligibility criteria to make the program available to more borrowers. Under the bill, homeowners could participate in HARP if:

- Their mortgage is held or guaranteed by the GSEs and was sold to the GSEs on or before May 31, 2010;

- Their mortgage has a current loan-to-value (LTV) ratio below 80 percent (homeowners with mortgages that have LTV ratios greater than or equal to 80 percent are already eligible to refinance under existing HARP guidelines); and
- Their last six months of mortgage payments were made on time, and they have no more than one delinquent mortgage payment in the past 12 months.

Under current law, CBO expects that the HARP will continue to yield refinancing of some mortgages until the program expires. To estimate the cost of S. 3085, CBO considered the number and value of such mortgages expected to be refinanced through the HARP before it expires and the incremental number and value of refinancings that would occur under the legislation.

From January 2012 through June 2012, the GSEs refinanced an average of about 350,000 mortgages each month. About 70,000 of those refinancings were completed under HARP each month during that quarter. CBO's estimate of the number and value of additional financings that would occur under the bill was prepared by judging how individuals would respond to changes made by the bill, including expanding the eligible time period for loans sold to the GSEs by one year, lowering initial costs, and removing certain obstacles that may have blocked some homeowners from refinancing. CBO estimates that under the bill, the number of HARP refinancings would increase by about 20,000 per month—roughly a one-third increase in monthly HARP volume—until the program expires on December 31, 2013.

We expect that most of the additional refinancings under S. 3085 would occur because homeowners whose mortgages were sold to the GSEs after June 1, 2009—the existing deadline for eligibility under HARP—but before the later deadline under the bill of May 31, 2010, would be eligible to participate in the program. Some homeowners also would benefit from lower appraisal and origination costs, more lenient mortgage delinquency standards, and other changes to the program specified by the legislation.

Under the bill, the average guarantee fees charged by the GSEs to future HARP participants could not be lower than fees under current law.<sup>1</sup> The GSEs also would be prohibited from charging up-front guarantee fees under the bill. However, they would be required to fully recover the equivalent of those fees over several years by charging higher annual guarantee fees in future years because the bill would require that HARP participants be charged no less than the average guarantee fees that were charged in 2012.

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1. The average guarantee fee is the annual guarantee fee plus the annual equivalent of any up-front fee amortized over the estimated average life of a mortgage.

## **Budget Impact on Fannie Mae and Freddie Mac**

Fannie Mae and Freddie Mac—through their role in the secondary mortgage market—purchase mortgages originated by banks, retaining some for their portfolio and packaging the rest into mortgage-backed securities, which they guarantee against default. Even though recent mortgage interest rates have been at historically low levels, some borrowers continue to pay higher interest rates because they are unable or unwilling to refinance their mortgages.

CBO estimates that, under the bill, more borrowers would refinance, which would cause their original mortgages to be repaid earlier than under current law. Those earlier repayments and lower rates would reduce default costs on the MBSs that the GSEs guarantee but would generate some loss in the value of the mortgages and MBS they hold in their portfolios. On balance, however, CBO expects that the GSEs would realize net savings.

The GSEs' default costs would be lower under the bill because homeowners who would be able to refinance would have lower monthly payments on new mortgages and would be less likely to default. Lower default costs would generate budgetary savings—assuming average guarantee fees charged for the new mortgages would not be lower than those charged in 2012 as required by the bill.

Losses on GSE portfolios from earlier-than-expected repayments would occur because homeowners who refinance are typically paying above-market interest rates on their original mortgages. Thus, the current market value of those mortgages is greater than the payoff that the GSEs would receive to retire those mortgages.

The total budgetary impact of those effects would be recorded in the federal budget in fiscal year 2013 because, under procedures specified in the Federal Credit Reform Act, changes in the net present value of existing credit obligations that are attributable to legislative action are recorded in the budget in the year the law is enacted. In fiscal year 2013, CBO estimates that enacting S. 3085 would reduce direct spending by about \$500 million.

## **Costs to the Federal Reserve**

The Federal Reserve currently holds about \$850 billion in MBS issued by the GSEs. The increased refinancing activity that would occur under the bill would cause mortgages in those MBS to be repaid earlier than they would otherwise, reducing the value of those securities. CBO expects that the reduced value of the MBS held by the Federal Reserve would lead the Federal Reserve to replace those MBS investments with lower-yielding assets. Such an action would result in reduced income, and therefore, reduced remittances

to the Treasury. CBO estimates that those revenue losses would total about \$500 million over the 2013-2022 period, with most of that impact falling in the next four years.

## **PAY-AS-YOU-GO CONSIDERATIONS**

The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending or revenues. The net changes that are subject to those pay-as-you-go procedures are shown in the following table.

**CBO Estimate of Pay-As-You-Go Effects for S. 3085 as introduced in the United States Senate on May 10, 2012**

	By Fiscal Year, in Billions of Dollars												
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2012-2017	2012-2022
<b>NET INCREASE OR DECREASE (-) IN THE DEFICIT</b>													
Statutory Pay-As-You-Go Impact	0.0	-0.4	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	0.0

## **INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT**

The bill would impose intergovernmental and private-sector mandates on holders of junior liens and issuers of mortgage insurance. If the holder of a junior lien or a mortgage insurer takes an action that would prevent the refinancing of an eligible mortgage through HARP, they would be required to pay an assessment under some conditions. Because most holders of junior liens and mortgage insurers allow refinancings—usually in an effort to improve the likelihood that they will receive loan payments or forestall insurance payouts—the bill’s requirements would affect a limited number of refinancing cases. Consequently, CBO estimates that the costs of mandates would fall below the annual thresholds for intergovernmental and private-sector mandates established in UMRA (\$73 million and \$146 million in 2012, respectively, adjusted annually for inflation).

**ESTIMATE PREPARED BY:**

Federal Costs: Aurora Swanson, Mitchell Remy, and Barbara Edwards  
Impact on State, Local, and Tribal Governments: Elizabeth Cove Delisle  
Impact on the Private Sector: Paige Piper/Bach

**ESTIMATE APPROVED BY:**

Theresa Gullo  
Deputy Assistant Director for Budget Analysis

Frank Sammartino  
Assistant Director for Tax Analysis