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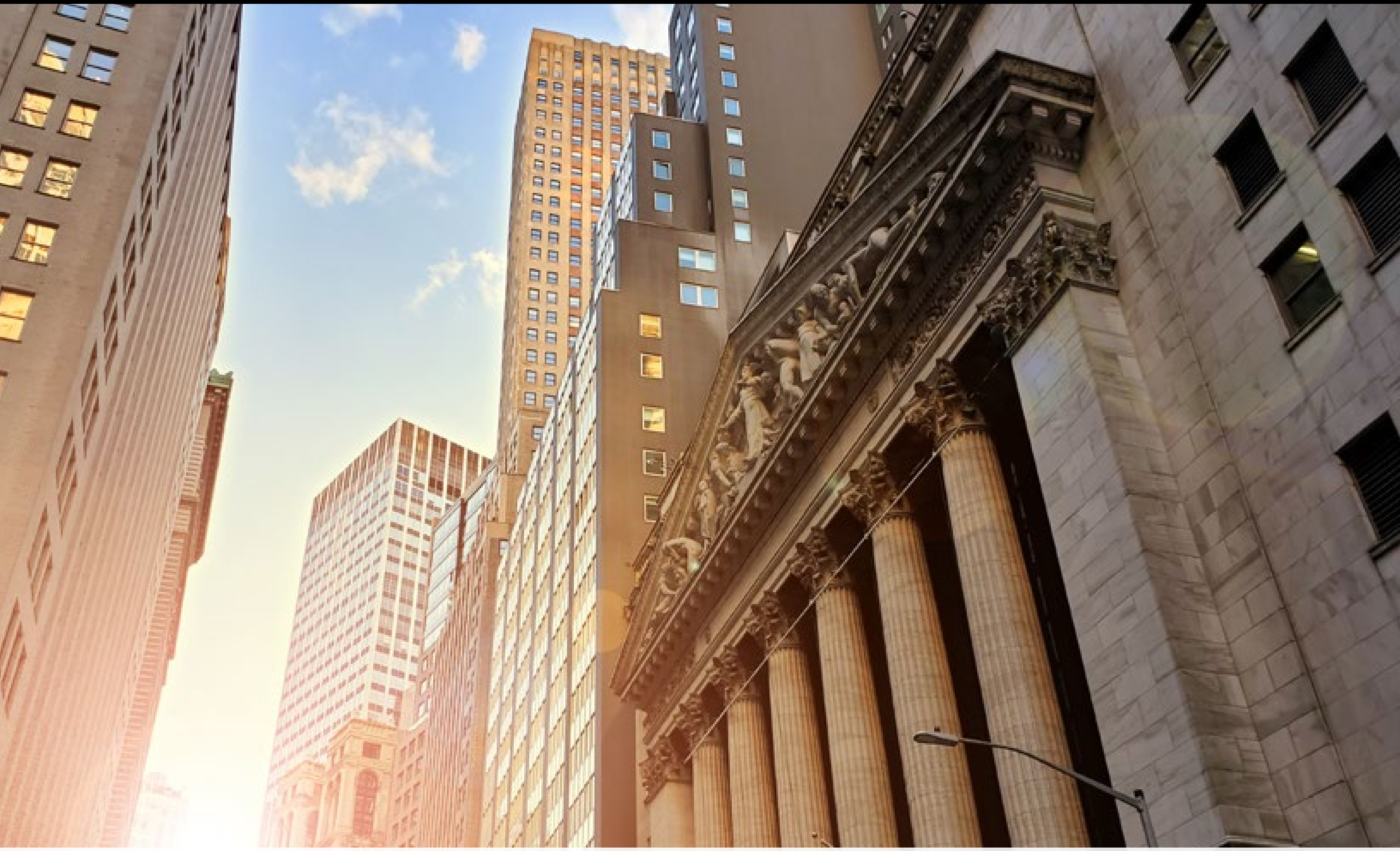

Ginnie Mae EBO Securitization

A MARKET-BASED SOLUTION TO MITIGATE ISSUER LIQUIDITY RISK

27013

MBA.ORG/EBO

MORTGAGE BANKERS ASSOCIATION

Executive Summary

Over the past 15 years, the growth in independent mortgage bankers' (IMBs) market share of residential mortgage originations and servicing, particularly among issuers of Government National Mortgage Association (Ginnie Mae) mortgage-backed securities, has brought regulatory focus on the adequacy of issuer liquidity to make servicing advances during a financial crisis and/or a sustained period of increased mortgage delinquency. While IMB servicers are well-capitalized through Ginnie Mae's counterparty standards and have developed enhanced access to diverse funding sources, additional options that can reduce liquidity strains in the event of market stress should be considered.

Industry stakeholders have proposed multiple strategies in recent years to address the inherent timing mismatch in the Ginnie Mae program — the discrepancy between when monthly principal and interest funds must be remitted to investors by servicers and when servicers are reimbursed for those advances.

Though many of these proposals remain viable, progress on them has stalled. MBA believes additional liquidity sources must be developed to mitigate federal regulators' concerns that an IMB issuer could exhaust its liquidity sources in the face of market stress or economic shock.

MBA proposes the development of a new, private sector source of liquidity — a new Ginnie Mae-wrapped security comprised of non-performing Federal Housing Administration (FHA), U.S. Department of Veterans Affairs (VA), and U.S. Department of Agriculture (USDA) loans bought out of traditional Ginnie Mae pools (early-buyouts or EBOs). In this proposed securitization, the issuer/servicer is no longer required to make monthly principal and interest advances, thereby mitigating liquidity strain. End investors would receive an accrual of the scheduled principal and interest payments when the loan resolves through either reperformance or liquidation.

The proposal provides a new execution option for all Ginnie Mae issuers in addition to leaving the loan in the original pool and continuing to advance with private financing or working capital. This strategy could increase the marketplace appetite for government lending while also establishing infrastructure for a smaller issuer to more quickly and efficiently limit advancing burdens by buying out delinquent loans and issuing an EBO security. By stabilizing liquidity sources for IMBs that account for more than 85% of Ginnie Mae issuance volume, it would also provide significant benefit to first-time and low-to moderate-income borrowers.

Ginnie Mae can implement this proposal without legislative action. The time has never been better for Ginnie Mae to explore options to enhance issuer liquidity due to record funding levels and increased personnel at Ginnie Mae for Fiscal Year 2025, favorable market conditions, and encouragement from other federal agencies.

Introduction

For over five decades, Ginnie Mae has facilitated affordable homeownership for millions of Americans, reducing the cost of financing for first-time, underserved, and veteran buyers by providing a full faith and credit government guarantee of timely payment to Ginnie Mae mortgage-backed securities investors on all FHA-insured, VA-guaranteed, and USDA-guaranteed home loans in those securities. To carry out this important mission, Ginnie Mae relies on hundreds of mortgage lenders ("issuers") who originate and service government loans, pool these loans into securities they issue with Ginnie Mae's guarantee, and stand between the homeowner and the end investor, advancing monthly principal and interest payments — regardless of whether the payments are received from the homeowner. Ginnie Mae's guarantee is intended to kick in only should that issuer be unable to continue advancing payments when they are not received from the borrower.

Under this "scheduled/scheduled" remittance structure (where the issuer must advance payments regardless of whether they receive payments from borrowers), there are no caps or time limits on the advances. This structure distinguishes Ginnie Mae from the servicing of other types of federally related mortgage bonds. By comparison, while servicing of Freddie Mac-backed UMBS is generally scheduled/scheduled, any loans sold to Freddie Mac through the cash window follow a "scheduled/actual" regime, where servicers must advance scheduled interest payments regardless of whether they are received, but only principal that is actually received. Meanwhile, Fannie Mae remittance requirements vary widely based on delivery channel. Importantly, since April 2020, servicers of loans backed by Fannie Mae or Freddie Mac (the Government Sponsored Enterprises or GSEs) are only required to advance four months of scheduled payments on any delinquent loan, substantially limiting liquidity exposure for the servicer and improving the servicer's ability to forecast actual liquidity needs.

In contrast, a Ginnie Mae issuer servicing a delinquent FHA, VA, or USDA loan today faces the prospect of advancing unreceived principal and interest payments indefinitely until a loan reperforms or goes to foreclosure and liquidation — which could be months or years. The protracted advancing obligation in the Ginnie Mae program design creates outsized strain on the servicer's liquidity position and difficult modeling challenges. This is compounded by the fact that the loans that comprise Ginnie Mae securities generally experience higher delinquency rates than those in GSE securities.

The GSEs' ability to facilitate non-scheduled remittance options, as well as their implementation of a four-month cap for loans with scheduled remittance, is feasible given their respective cash reserves, balance sheet capital, and current line of credit from the U.S. Treasury. Unlike the GSEs, Ginnie Mae does not have a balance sheet to repurchase and/or hold loans that are not performing. As a result, Ginnie Mae must lean entirely on the strength of its issuer base as a stopgap in the event of a market-wide spike in delinquencies, and therefore, understandably, it places great emphasis on issuer oversight and eligibility requirements.

Fundamentally, the structure of Ginnie Mae servicing produces an inherent timing mismatch. Servicers of delinquent FHA, VA, and USDA loans make good on the Ginnie Mae timely payment guarantee to investors and are ultimately made whole by those insuring agencies on any uncollected principal advances, compensated at a debenture rate for any uncollected interest advances, and reimbursed for property tax and home insurance (i.e., escrow) payments. However, the lag between when the servicer advances these funds to investors and when it ultimately receives claim proceeds from the government agencies is the source of the liquidity strain. This timeline is further prolonged by the widespread use of forbearance and government regulations that significantly lengthen the foreclosure process.

In the early years of Ginnie Mae, the majority of both its issuer base and servicing volume was represented by traditional depository institutions. Over the past 15 years, however, a larger share of Ginnie Mae servicing has shifted toward IMBs — non-bank financial companies with expertise in the origination, sale/securitization, and servicing of mortgage loans utilizing a revolving line of credit from lenders, usually depositories, that are known as "warehouse lenders." Although IMBs do not have access to insured deposits or other government-backed sources of liquidity, they are subject to rigorous oversight by Ginnie Mae, the GSEs, the Consumer Financial Protection Bureau (CFPB), FHA, VA, USDA, their warehouse lenders and other counterparties, and all state regulators and state attorneys general where they do business.

According to MBA data, the percentage of FHA loans serviced by IMBs has grown from 9 percent in 2008 to over 64 percent in 2024. This shift in share away from depository institutions can be attributed to multiple factors — including punitive bank capital requirements that discourage holding mortgage servicing rights (MSRs) on a balance sheet, litigation risk around FHA origination, and increased regulatory cost that has reduced the attractiveness of the mortgage sector relative to other business channels within financial services.

The emergence of IMBs as the dominant participant within the Ginnie Mae program has brought about increased federal regulatory attention, in large part because they are not banks, and the corresponding perception among federal regulators that IMBs are more vulnerable to a sudden liquidity crisis in the event of either a company-level or market-wide downturn given that they cannot access the Fed discount window, the Federal Home Loan Bank system, or other government-backed sources of liquidity. Regulatory action to date has included a steady increase in issuer liquidity and net worth requirements as well as calls from certain federal officials as recently as this year to designate the largest IMBs as "systemically important financial institutions" subject to supervision by the Federal Reserve.[1] Notwithstanding this heightened scrutiny, IMB issuers have generally performed quite well throughout recent market cycles, including the 2020 COVID-19 crisis where, despite an unprecedented spike in mortgage delinquency and long-term forbearance, IMB issuers navigated the resulting liquidity strain and barely utilized the emergency Pass-Through Assistance Program (PTAP) facility established by Ginnie Mae — described in greater detail below.

While the financial performance of the IMB sector through recent cycles has proven durable, prudent risk management suggests that opportunities to expand liquidity by addressing the structural timing mismatch within the Ginnie Mae program should be seriously considered. Doing so will mitigate risk, minimize program friction, and reduce transaction costs for homebuyers. As noted previously, although many solutions have been proposed by industry stakeholders in recent years, this paper proposes an innovative new solution that addresses the liquidity concerns and can be implemented relatively quickly by Ginnie Mae, without any need for federal appropriation or additional authority from Congress. The proposal creates a new class of Ginnie Mae-wrapped security comprised of non-performing government-backed loans for which the servicer is no longer required to advance monthly principal or interest.

As the saying goes, it is better to repair a roof while the weather is sunny. Accordingly, it makes sense for market participants and Ginnie Mae to seriously consider this proposed solution now, when the market is stable with low delinquency rates and comparatively low trading volume. In fact, in a May 2024 report, the Financial Stability Oversight Council (FSOC) explicitly encouraged Ginnie Mae to "explore ways to facilitate financing for relieving liquidity pressures for solvent issuers,"[2] as MBA and its members have also emphasized for many years. Importantly, Ginnie Mae received a significant increase in its Fiscal Year 2025 appropriation from Congress, allowing the agency to hire a significant number of new full-time employees and have the capacity to explore additional major policy changes or initiatives. The timing has never been better for Ginnie Mae to explore opportunities to expand servicing liquidity, thereby improving the efficiency of the program overall, as well as enhance its impact for the communities it serves.

1. https://2thepoint.blog/2023/10/31/fsocs-bid-to-regulate-non-bank-firms-will-harm-consumers-mortgage-sector/

2. https://home.treasury.gov/system/files/261/FSOC-2024-Nonbank-Mortgage-Servicing-Report.pdf

Issue Statement

In today's market, if an FHA, VA, or USDA borrower stops making their monthly mortgage payment and/or enters a period of mortgage forbearance, the Ginnie Mae issuer must step in to advance monthly principal and interest payments to the investor of the mortgage-backed security (MBS), even when they are not received. The issuer must also continue to make timely escrow account outlays for property tax and homeowner's insurance premium payments on the borrower's behalf. Whether the loan eventually reperforms, is modified, or goes to foreclosure, the issuer is ultimately reimbursed by the borrower or out of FHA, VA, or USDA claim payment and/or foreclosure sale proceeds for most of the funds that are advanced. For example, in the FHA program, which represents the majority of Ginnie Mae volume, issuers are reimbursed for any principal, tax, and insurance advances, while they are compensated for any interest advanced at a debenture rate that generally tracks the 10-year U.S. Treasury yield.

Crucially, the time between when issuers advance funds and when they are reimbursed can drag out for months — or even years — if the borrower does not reperform and the property is located in a judicial foreclosure state where timelines to complete the foreclosure process are longer. The result of this timing mismatch is a drain on an issuer's cash position, which is particularly concerning at scale when there is a market-wide spike in delinquency. This dynamic, as well as the associated risk of an issuer failure, reduces the value of Ginnie Mae MSRs and therefore ultimately increases financing costs for FHA, VA, and USDA borrowers at the point of origination. Unlike the GSEs, Ginnie Mae has limited ability to provide any cap or relief on an issuer's advancing obligations.

Ginnie Mae program guidelines currently provide issuers the option, but not the obligation, to buy out a non-performing loan from the pool at par value (i.e. an early-buyout or EBO) when the borrower has missed payments for 90 days or more. Thus, when faced with a non-performing FHA, VA, or USDA loan today, an issuer has two options: continue to make advances indefinitely or buy the loan out of the pool. The latter option is even more liquidity-intensive, and the issuer must come up with the entire loan amount in cash to buy it out. To do so, an issuer typically obtains financing from their warehouse lender or another financial institution. However, such financing can be difficult to find, hard to implement during periods of strain, and expensive — with smaller issuers likely paying the most.

This much is clear: any ability to finance EBOs more cheaply, reduce the cost of advancing, or eliminate the need for advancing altogether would benefit every stakeholder, from consumers and issuers to MBS investors, simply by mitigating the timing mismatch, reducing pressure on issuers, and insulating them from liquidity risk. Moreover, this proposal would tap into private capital sources without changing aggregate taxpayer exposure to Ginnie Mae guarantees.

EBO Securitization Proposal

MBA proposes an additional option for any Ginnie Mae issuer considering the tradeoff between continuing to make monthly advances on a non-performing loan or buying it out of the pool. Under this new approach, the loan is purchased at par out of the original pass-through security and contemporaneously pooled into a new class of security comprised entirely of non-performing EBO loans (i.e., an "EBO security" or "EBO securitization") wrapped with Ginnie Mae's explicit guarantee. Unlike a typical Ginnie Mae security based on pools of insured or guaranteed residential mortgage loans, the Ginnie Mae EBO security would not be based on a modified pass-through structure. Instead, it would be similar to Ginnie Mae HMBS (backed by FHA-insured reverse mortgage loans), where the investor is paid an accrued sum at the time the loan resolves.

The security provides crucial liquidity by relieving the issuer of the requirement to advance monthly principal and interest payments (though they must continue to make required tax and insurance payments). The investor in this security does not receive a monthly remittance of principal and coupon-rate interest, but rather receives an accrual of this value that is ultimately advanced in lump sum from claim and/or liquidation proceeds when the loan in the underlying security either reinstates, reperforms through a modification, or goes to foreclosure sale. The issuer is reimbursed out of these same proceeds for any periodic payments of property taxes and insurance, and it uses these proceeds to advance a single lump sum payment of accrued principal and interest to the investor.

As with other Ginnie Mae-wrapped bonds, the EBO security would receive a zero-risk weight under current capital requirements due to its government guarantee, thus allowing investors to provide liquidity support to the issuer for a substantially lower capital charge than either providing a line of credit, closed-end loan, or purchasing whole-loan EBOs and holding them on balance sheet. In exchange for providing its guarantee, Ginnie Mae would be compensated at its typical rate of 6 basis points per year, except that this fee is also paid as a lump sum at the same time the loan resolves and the investor is paid.

Issuers of all sizes would be able to benefit from this new execution option. Any issuer could buy out any non-performing government loan within its existing servicing portfolio at par using short-term warehouse borrowing or working capital, contemporaneously pool it, and issue a new EBO security, thereby cutting off principal and interest advancing obligations for the loan. Pools would be issued by a single issuer and could consist of a single EBO or multiple EBOs. As an alternative to an issuer executing its own securitization, it could instead buy out an individual EBO and sell it to a larger specialty servicer at a small discount. The larger specialty servicer could then pool and issue an EBO security, while also functioning as the master servicer. Depending on market conditions, a larger servicer might be willing to pay up to acquire certain types of EBOs, thereby reducing the amount of discount to the original issuer and improving the economics of this "third-party" execution option versus the smaller issuer electing to securitize on its own. The "third-party" option also provides important infrastructure for a smaller issuer to quickly sell a large portion, or all, of its non-performing government loans, should the need arise to do so.

Should an individual loan within an EBO securitization eventually reperform, the issuer would be required to purchase the loan out of the pool, meaning that the issuer generally carries some interest rate risk during the period that the EBO is pooled. However, in general, MBA anticipates that

The security provides crucial liquidity by relieving the issuer of the requirement to advance monthly principal and interest payments.

any loans pooled through this program will be less likely to reperform and more likely to skew toward jurisdictions with longer foreclosure timelines (i.e., in judicial foreclosure states). Thus, a participating issuer would be able to control this interest rate risk somewhat. MBA believes this tendency toward adverse selection is a feature rather than a bug within the program. This is because it functionally provides issuers with the benefit of pool-splitting, the election to continue advancing on loans that are likely to reperform, while avoiding the uncertainty of protracted advancing obligations for loans that are unlikely to reperform and/or will take a long time to resolve. It better aligns outcomes with the expectations of MBS investors, provides liquidity relief to issuers, and considerably reduces the risk for Ginnie Mae of an issuer collapse.

DISCUSSION

Based on conversations with its members, MBA is confident that investor appetite in EBO securitization would be robust. This is particularly true among certain participants in the warehouse lender community who are seeking a more capital-efficient mechanism of providing additional liquidity to their clients as discussed in greater detail in the modeled pricing section below. Unlike other classes of Ginnie Mae securities, issuers of EBO securities would likely know the identity of the take-out investor in advance. MBA does not expect an enormous trading volume of EBO securitization. Relevant loans will represent not only the subset of FHA, VA, and USDA loans that are non-performing, but a further subset of those loans that carry a note rate and expected duration of non-performance that make EBO securitization a better execution than other strategies.

MBA is also confident that Ginnie Mae has sufficient statutory authority and operating precedents to implement an EBO securitization program without the need for Congress to act. Currently, any government-insured or guaranteed mortgage loan through FHA, VA, or USDA is eligible for the Ginnie Mae guarantee, regardless of whether the loan is performing or in a delinquent status. This is what enables, for example, a delinquent FHA loan to remain indefinitely in its original Ginnie Mae pool. Ginnie Mae already guarantees small, single-issuer "custom pools" today, demonstrating the sophisticated ability of the private capital markets to effectively model and price for characteristics like geography and loan duration. Ginnie Mae has a precedent for guaranteeing pools consisting of a single loan, such as within its bond financing program (BFP).[3] Ginnie Mae also has a very recent precedent for guaranteeing securities without a monthly cash flow and with an uncertain duration. Its HMBS program similarly provides issuers with the option to purchase Home Equity Conversion Mortgage (HECM) loans out of their original pool and re-pool them into a new class of security, providing operating liquidity until the issuer has resolved any issue with the loan that prevents its assignability to FHA. We believe the rollout of the new HMBS 2.0 program could provide a logistical template for Ginnie Mae staff as they establish the terms and criteria of a potential EBO securitization product rollout.

MBA recognizes that the loan-level viability of this option depends in part on the note rate of the EBO in question relative to the current market interest rate. For example, it would not make sense to purchase an EBO with a 3.5 percent note rate out of a 3.0 percent MBS coupon in a market where 6.5 percent MBS coupons trade at par. In this situation, the issuer could expect a 15 to 20 percent discount to securitize that EBO, which would not make any economic sense. Meanwhile, continuing to advance at a 3 percent coupon rate is comparatively cheap, and the issuer might even be reimbursed for interest advances at a debenture rate that is higher than the rate that was advanced (i.e., a positive interest rate carry). Alternatively, in a scenario where an EBO is purchased out of an MBS coupon that is relatively close to where the market currently trades (i.e., a level-interest rate environment), the EBO security becomes a competitive execution option. In a market where interest rates have improved relative to the loan in question, the issuer may be able to realize a premium through this approach — again, regardless of whether it reperforms or not.

MBA emphasizes that this proposal is not attempting to solve for such circumstances described above where the loan in question has a below-market interest rate, nor are we suggesting the EBO security will always be the best execution option. Rather, this proposal adds another tool in the toolbelt — a permanent fixture within the Ginnie Mae program — that increases the number of potential execution strategies and thereby enhances market-wide liquidity.

MBA expects that utilization of this option would ebb and flow based on interest rate movement. However, it would provide a significant new private sector liquidity source to

3. https://www.ginniemae.gov/issuers/program_guidelines/MBSGuideLib/Chapter_24.pdf

issuers, especially during challenging market cycles and sudden shifts in performance. In the event of a sudden market-wide spike in delinquency, the EBO securitization channel would already be established and accessible to an issuer — and probably at a better price than PTAP — to alleviate liquidity pressures. Additionally, since the viability of this option increases when interest rates improve, it likely also correlates with periods of market turmoil, where future rates are more likely to be reduced by the Federal Reserve. Without an EBO security today, an issuer must endeavor to line up unsecured financing or whole loan EBO sales, which may be difficult to find and too slow to activate. Provided below is an overview of the benefits of this proposal for each Ginnie Mae stakeholder.

BENEFIT TO GINNIE MAE

The principal benefit of the proposal for Ginnie Mae is the extent to which it can provide a market-based solution using private capital sources to mitigate the risks of issuer default — especially in the case of a sudden downturn — while reducing the need for Ginnie Mae to stand up and/or maintain an emergency facility. It provides a vehicle for traditional depository institutions to expand their indirect support of the Ginnie Mae program without risking lien extinguishment. It would also mitigate the advancing burden on standby servicers to whom non-performing servicing assets are assigned in the event of an issuer failure, by providing an execution option that turns off monthly remittance of scheduled principal and interest. This proposal can be promulgated using existing federal regulatory authority and implemented entirely through the private marketplace.

BENEFIT TO ISSUERS

Participating issuers benefit from the elimination of monthly principal and interest advancing obligations, thereby providing crucial liquidity relief. Smaller issuers that may not have the ability to access private debt markets would be able to avail themselves of this established infrastructure quickly, providing greater ability to move delinquent loans off their servicing books and respond more quickly to market crises. It would also eliminate the risk of a secured creditor declaring an issuer in default and accelerating outstanding amounts due on a line of credit.

BENEFIT TO INVESTORS/ WAREHOUSE LENDERS

Due to the substantially improved risk weighting provided by the Ginnie Mae EBO guarantee, warehouse lenders would be able to offer considerably more liquidity for their warehouse clients by purchasing EBO securitizations issued by those clients rather than offering a commercial loan with an inferior risk weight and/or extinguishable security interest. The purchase of EBO securitizations offers a new opportunity for warehouse lenders to provide value to their clients and compete for business. Bank-owned EBO securities should also be eligible to pledge as collateral to Federal Home Loan Banks — an advantage that may not apply to loans made on a traditional warehouse line.

BENEFIT TO CONSUMERS

Lower liquidity strain and default risk among issuers will result in greater market confidence, improved Ginnie Mae MSR valuation, and increased attractiveness of the Ginnie Mae MSR asset — benefits that ultimately flow to the consumer through improved loan pricing, helping home affordability at zero cost to taxpayers. This improvement in MSR value would likely be most pronounced for lower credit quality (i.e., lower FICO) borrowers due to altered assumptions about the cost of servicing somewhat higher-risk borrowers through delinquency. In other words, the greatest price improvement would occur for the types of consumers the FHA, VA, and USDA home loan programs are intended to serve — those that are traditionally underserved and/or may not qualify for conventional financing.

Modeled Pricing

We anticipate the marketplace is likely to price a potential EBO securitization based primarily on three factors: 1) the duration that the loan will remain in a non-performing status prior to resolving (and reducing the value of the security to account for the corresponding discounted cash flow); 2) the note-rate interest of the EBO, and the extent to which that interest rate varies from current market pricing; and 3) the difference between the coupon-rate interest of the EBO security and the applicable debenture rate at which the issuer is ultimately reimbursed for interest advances. In many instances, the delta between the coupon-rate and the debenture rate will create a negative-carry cost for the issuer — i.e., the promised interest rate accrual to the investor exceeds the rate of reimbursement to the issuer — meaning that increased loan duration will increase net costs to the issuer.

Regardless of whether an issuer chooses to continue advancing, buy the loan out and hold on balance sheet, or buy out and securitize the EBO, the net economics for the issuer will worsen in jurisdictions with slower loss mitigation timelines (i.e., in judicial foreclosure states). However, when EBO securitization is pursued, the longer the foreclosure timeline is, the greater the marginal benefit is to an issuer's liquidity position relative to the other strategies. For example, the liquidity relief from avoiding five years of monthly P&I advances far exceeds the liquidity relief from avoiding two years of monthly P&I advances. The economics of any EBO securitization can sharply improve for the issuer in the event of a market interest rate rally, creating the potential to buy the loan out at par and concurrently re-pool at a premium given the improved rate environment.

On the investor side, all else being equal, MBA expects an EBO securitization to trade at a slight discount to an ordinary Ginnie Mae MBS due to the accrual structure and absence of a monthly cash flow of principal and interest. As the expected loan duration prior to resolution increases, the discount will also increase to capture the discounted cash flow to the investor. For a current warehouse lender assessing how to optimally provide liquidity to its clients, the purchase of an EBO security issued by its client provides a significantly improved risk weight than if it were to provide a commercial loan or line of credit, enabling it to provide significantly more liquidity to the market. Based on MBA's conversations with member companies in the warehouse lending community, there is significant interest around the concept of leveraging the Ginnie Mae sovereign guarantee on the EBO security to provide a more capital-efficient approach to supporting their IMB customers. MBA believes this dynamic could even create a circumstance where certain warehouse lenders are willing to bid up to purchase EBO securitizations issued by their clients, thus improving the economics for the issuer beyond the projections in our model.

Provided below is a scenario to demonstrate how both an issuer and investor might evaluate an EBO securitization versus other strategies. In the case of an issuer, MBA compares the economics of three options:

- continuing to advance,
- buying the loan out of the pool, or
- buying it out and pooling it as an EBO securitization.

When EBO securitization is pursued, the longer the foreclosure timeline is, the greater the marginal benefit is to an issuer's liquidity position relative to the other strategies.

In the case of a warehouse lender/EBO security investor, MBA looks at the tradeoff between providing a commercial loan to their client and purchasing an EBO security issued by their client.

For this example, MBA takes a delinquent FHA-insured $200,000 mortgage loan with a 6.5 percent note interest rate currently pooled in a 6.0 percent coupon-rate Ginnie Mae MBS. The issuer was also the originator of this loan and is the master servicer. The loan is unlikely to reperform, the expected time to foreclosure and resolution is 24 months, and the issuer complies with all applicable FHA servicing requirements such that it avoids curtailment or any other type of penalty. MBA makes the following assumptions, based on a snapshot of the market on July 1, 2024:

Ginnie Mae 6.0 percent coupons trade at par;

- the one-year Secured Overnight Financing Rate (SOFR), representing a bank's cost of funds, is 5.40 percent;
- an IMB's funding cost is the one-year SOFR rate plus a margin of 360 basis points, or 9.0 percent in total; and
- the 10-year U.S. Treasury yield, and therefore debenture rate within the FHA program, is 4.50 percent.

Assumptions

Same issuer — own book

- **$200,000** FHA loan, unlikely to reperform
- **6.5%** note rate
- **6%** pass-through / coupon
- Current market: **GNMA 6.00% is priced at 100.00**
- 1-year SOFR = bank cost of funds: **5.40%**
- IMB cost of funds = 1-year SOFR + 3.60 margin = **9.00%**
- 10-Year Treasury = debenture rate: **4.50%**
- Advances for tax, insurance, and foreclosure-related costs = **200 bps per year**
- Time to foreclosure: **24 months**
- **No curtailments**
- EBO security trades at **50 bp discount** to same-coupon Ginnie II MBS per year
- Interest rate risk X probability of reperformance = **25 bps per year**

Issuer Best Execution Analysis

CONTINUE ADVANCING FOR 24 MONTHS	Principal advances: ($5,064) Interest advances: ($23,715) Tax and insurance advances: ($8,000) **At resolution:** Reimburse principal: $5,064; earn interest at debenture rate: $18,000; reimburse T&I $8,000 *Cash position prior to resolution: ($36,779)* *Net value: ($5,715)*
BUY OUT LOAN FOR 24 MONTHS	Loan buyout: ($200,000) Tax and insurance advances: ($8,000) **At resolution:** Collateral value + reimbursed principal: $200,000; earn interest at debenture rate: $18,000; reimburse T&I $8,000 *Cash position prior to resolution: ($208,000)* *Net value: $18,000*
BUY OUT LOAN AND ISSUE EBO SECURITY	Loan buyout: ($200,000) Sell EBO security (1-point haircut for discounted cash flow): $198,000 Tax and insurance advances: ($8,000) Hedge cost for interest rate risk × probability of reperformance: ($1,000) **At resolution:** Principal proceeds due to investor; cost of negative carry = interest accrual to investor minus reimbursement at debenture rate = 6.00 – 4.50 = 150 bps per year × 2 years = 300 bps = ($6,000); GNMA 6 bp guarantee fee × 2 years = 12 bps = ($240); reimburse T&I $8,000 *Cash position prior to resolution: ($11,000)* *Net value: ($9,240)*

Issuer Best Execution Analysis

		Loan to IMBs to Finance Advances		Purchase EBO Security
Loan amount		$200,000		$200,000
Financing %	90%	$180,000	100%	$200,000
Cash from IMB		$20,000		
Cost of funds — 1 year SOFR		5.4%		5.4%
Loan rate/Investment margin		3.6%		0.6%
Total loan/Pass through rate		9.0%		6.0%
Annual interest		$18,000		$12,000
Bank cost of funding	5.4%	$10,800	5.4%	$10,800
Net interest margin	3.6%	$7,200	0.6%	$1,200
Risk weighting on bank balance sheet		100%		20%
Bank capital requirement		11%		11%
Bank capital $		$22,000		$4,400
Bank return on equity		33%		27%
		Unsecured loan		Government Guaranteed

Finally, MBA estimates that:

1. the cost of hedging interest rate risk, adjusted for the probability of reperformance, is 25 basis points per year;

2. any EBO securitization trades at a 50-basis-point-per-year discount to an equivalent-coupon Ginnie II MBS; and

3. the combined cost of any tax, insurance, and/or foreclosure-related payments made by the issuer equals 200 basis points per year.

As demonstrated above for this example, pursuing an EBO securitization represents by far the greatest liquidity relief for the issuer (i.e., a total reduction in cash position prior to resolution of only $11,000 versus $36,779 when continuing to advance and $208,000 when buying out and holding on balance sheet). However, it provides a somewhat less advantageous outcome from a net value standpoint. Accordingly, this option may make the most sense for issuers that have less access to alternative sources of liquidity, experience a sudden spike in government servicing delinquency, have greater servicing exposure to regions that are susceptible to natural disasters, and/or are motivated by other reasons to improve their free cash position or otherwise prioritize liquidity over net value.

From the perspective of a bank investor, while making a simple loan to an issuer produces a slightly higher return on equity under MBA's assumptions (i.e., 33 percent versus 27 percent), the purchase of an EBO security is fully guaranteed by the federal government and only requires one-fifth of the capital due to its vastly improved risk weighting (i.e., $4,400 versus $22,000). This means that the bank could provide five times the level of liquidity support to its warehouse banking clients for the same amount of capital, clearly boosting the availability of systemic liquidity and potentially creating a new avenue through which warehouse lenders can offer value for their clients.

The above presents an example of an issuer analyzing whether to securitize an EBO within its own book. As noted earlier, EBO securitization can also be performed on a third-party basis where the original issuer buys out the loan and sells it to an aggregating issuer/master servicer who subsequently pools it. In such instance, the sale between issuers would be completed at a moderate discount that factors in the cost of default servicing and negative carry on interest advances for the expected duration of the loan, any market interest rate adjustment, interest rate risk in the event of reperformance, the cost of securitization, and a reasonable operating margin. Importantly, this third-party EBO securitization option provides durable new infrastructure that facilitates bulk sales and potentially improves the marketability of non-performing government servicing assets.

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Opportunities to Improve the Proposal

While this EBO securitization proposal can be fully implemented by Ginnie Mae without legislative action, the following targeted reforms could further strengthen the program and expand its benefit for market liquidity.

CLARIFY REMIC ELIGIBILITY STATUS

It has not yet been established whether a Ginnie Mae EBO security would qualify for eligibility as a Real Estate Mortgage Investment Conduit (REMIC) and thus benefit from the pass-through entity tax treatment that applies to other classes of Ginnie Mae securities.[4] Therefore, the proposal could be improved through collaboration between Ginnie Mae and the Internal Revenue Service (IRS) to review REMIC standards and confirm eligibility for EBO pools. Notably, the IRS has an extensive precedent for issuing Revenue Procedures (i.e., a "Rev. Proc.") to create carve-outs for REMIC eligibility. For example, in 2009 it exempted from REMIC rules any mortgages modified under the Home Affordable Modification Program (HAMP) as well as commercial mortgage loans at risk of default. More recently, the IRS exempted certain forborne loans and related modifications under programs related to the COVID-19 emergency. Importantly, a new Revenue Procedure that confirms EBO pool eligibility for REMIC status would not result in any loss of federal revenues. Finally, the U.S. Department of the Treasury, the parent entity of the IRS, chairs the FSOC and has publicly indicated an interest in working with Ginnie Mae to address the topic of issuer liquidity. Treasury also has a recent history of collaboration with Ginnie Mae on this topic, such as establishing the borrowing authority for PTAP during the COVID-19 emergency.

4. https://www.law.cornell.edu/cfr/text/26/1.860D-1

MODIFYING DEBENTURE RATE

As discussed above, in many circumstances the issuer of a non-performing FHA loan is ultimately reimbursed at a debenture rate that is lower than the rate of the MBS coupon into which it is required to advance. In fact, this negative carry problem exists regardless of whether the issuer elects to buy the loan out or continue advancing. Legislative reform to align the FHA debenture rate with the issuer's advancing rate would remedy this issue, materially improving liquidity issues and increasing the value of Ginnie Mae MSRs. While such reform would come at a cost to the FHA's Mutual Mortgage Insurance Fund (MMIF), at the time of this writing, FHA's MMIF capital ratio stands at a near-record 11.47 percent, nearly six-times the statutory requirement during a period of severely strained housing affordability.[5] More broadly, at the time the current debenture rate policy was established, foreclosure timelines were much shorter, long-term voluntary forbearance was not used as a policy tool, and the Ginnie Mae issuer base predominantly consisted of traditional depository institutions. Simply stated, the debenture interest policy has not adapted to the evolution of servicing or government policies regarding loss mitigation and is therefore long overdue for an update.[6]

5. https://www.hud.gov/sites/dfiles/Housing/documents/2024FHAAnnualReportMMIFund.pdf

6. MBA also notes the Consumer Financial Protection Bureau has recently proposed significant reforms to the loss mitigation rules under Regulation X, which represents a paradigm shift in the loss mitigation procedures available to borrowers. If finalized, Regulation X's new loss mitigation review cycle could hold open loss mitigation evaluations and extend borrower delinquencies. For these reasons, modifying the debenture rate aligns the risks servicers are taking under new program rules.

FHLB INVESTMENT

The Federal Home Loan Bank System was established by Congress to provide liquidity support for the housing finance market. Accordingly, the FHLBs make sense as potential investors in Ginnie Mae-wrapped EBO securitizations. Congress could pass legislation to encourage, or even require, the purchase of such bonds by each FHLB, thereby ensuring demand in the program and further improving the economics for each stakeholder in the transaction. Because these bonds are federally guaranteed, such a policy would not expose the FHLB System to any additional credit risk.

REPERFORMANCE INCENTIVES

MBA's proposal currently requires an issuer to purchase a reperforming EBO out of the EBO securitization, after which it can either hold the loan on its books or re-issue it into a traditional Ginnie Mae MBS after the applicable seasoning period has passed. Based on current Ginnie Mae pooling requirements, as well as a desire to align the interests of the consumer, servicer, and investor, we do not believe an alternative approach, such as leaving the reperforming loan in the EBO pool, is practicable. However, if future legislation enabled the issuer of an EBO securitization to share in the economic upside in the event of reperformance, perhaps through a direct subsidy or a programmatic exception enabling the issuer to negotiate modified terms with the investor, we expect it would further boost program participation and benefit.

Alternative Solutions Proposed To Date

The following is a list of other proposed approaches to mitigate liquidity risk within the Ginnie Mae program.

The list does not include the multiple increases in issuer capital and liquidity requirements in recent years which have increased barriers to participation in the program without meaningfully addressing the structural issue of the program. It also excludes recent recommendations by FSOC to establish an issuer-financed emergency fund and/or provide the Federal Housing Finance Agency (FHFA) with direct supervisory power over IMBs,[7] both of which would increase costs ultimately passed through to consumers without a commensurate benefit.

BIFURCATION OF MSR ASSET

Both Fannie Mae and Freddie Mac facilitate the financing of servicing advances by permitting the bifurcation of GSE-related MSRs and the related servicing advances as collateral for a secured loan to a seller-servicer. In other words, there can be one secured lender for the MSRs themselves and another for the advances, with separate tri-party agreements among the GSE, the seller-servicer, and the lender providing each credit facility.

Bifurcation can be an effective source of liquidity. However, unlike Fannie Mae and Freddie Mac, Ginnie Mae does not permit an issuer to have more than one credit facility using Ginnie Mae MSRs as collateral. The credit facility must be approved by Ginnie Mae and requires execution of a tri-party Acknowledgment Agreement between Ginnie Mae, the lender providing the credit facility, and the issuer. Under the Acknowledgment Agreement, the lender's security interest in the MSRs and advances is automatically extinguished upon a default of the issuer and Ginnie Mae's termination of the issuer's approved status, unless the secured lender is willing and able to immediately take ownership of the MSRs. Unlike with the GSEs, neither the issuer nor the lender retains any right, title, or interest in and to the MSRs, the advances, and related proceeds thereon.[8]

7. As stated above, IMBs are directly supervised and licensed in every state in which they operate by state regulators. They are also subject to strict counterparty standards and oversight.

8. There is one exception where the secured creditor has the right to cure an issuer's monetary default within a very short time after Ginnie Mae's termination of the issuer, but such a cure can be highly risky from a monetary perspective and rarely, if ever, is utilized.

Ginnie Mae has historically resisted requests from the industry to permit issuers to enter into more than one Acknowledgment Agreement, honor the secured creditor's security interest following an issuer's termination, or bifurcate credit facilities to permit separate financing for MSRs and advances involving different lenders. This position has made it difficult for issuers to obtain financing for their Ginnie Mae MSRs and advances.

Unless and until private financers of Ginnie Mae EBOs obtain a meaningful and non-extinguishable security interest in the servicing asset, interest in lending in the Ginnie Mae space will remain low, and financing can only be provided to issuers at costly unsecured rates. Through bifurcation of the MSR asset, private financers would be able to offer lower, secured interest rates to facilitate EBOs, which in turn substantially reduces the risk of an issuer failure.

POOL SPLITTING

Currently, Ginnie Mae MSRs can only be transferred as whole pools. As a result, an issuer cannot transfer delinquent loans in a pool to another servicer — such as one that specializes in servicing such loans — without transferring the entire pool, thus materially limiting the transferability of any Ginnie Mae MSR.

The ability to sell Ginnie Mae MSRs on subsets of pools — or loan level — rather than entire pools would significantly improve the liquidity of these MSRs in the marketplace. The additional flexibility would improve overall MSR pricing while attracting new buyers. Pool splitting also improves Ginnie Mae counterparty risk management by enabling a more targeted and proactive approach to addressing servicer performance and liquidity concerns. For example, the ability to direct problematic loans to a backup specialty servicer would reduce risk and align with Fannie Mae and Freddie Mac loan level servicing transfers.

Pool splitting also benefits both transferor and transferee issuers by allowing exclusion of special loan types (i.e., FHA 203(k), Hawaiian Home Lands, Texas VA Home Loans) where the transferee lacks either capacity or the appropriate expertise. It could also allow for strategic segmentation of pools based on loan level characteristics such as judicial vs. non-judicial foreclosure states, seasoning, and FHA/VA splits, including complex loss mitigation programs like FHA's Payment Supplement Partial Claim.

Encouragingly, Ginnie Mae has been engaged in a multi-year effort to facilitate pool splitting within its program by moving to loan level tracking and accounting. While some of the technical obstacles have been resolved, until recently Ginnie Mae lacked sufficient resources to complete this project. With Fiscal Year 2025 funding secured and additional staff in place, MBA is hopeful Ginnie Mae can focus more attention on this issue.

EXPANDED PTAP

In the event of a presidentially declared emergency, Ginnie Mae has previously established a temporary PTAP, a special facility available to issuers facing a temporary liquidity shortfall that is directly attributable to a major disaster. This facility can be used to fund advances of principal and interest without the consequence of termination and extinguishment. However, such a request for assistance is a basis for a technical default under Ginnie Mae program requirements. Ginnie Mae first used the PTAP after Hurricane Katrina to assist smaller issuers with large exposures in the impacted area and redeployed it in response to the spike in COVID-related mortgage forbearance beginning in March 2020. During COVID, Ginnie Mae temporarily waived the technical default provision to ensure it could provide scalable relief to the marketplace without jeopardizing issuers' access to their warehouse lines because of a default. Fortunately, due in large part to the contemporaneous surge of refinance volume and corresponding wave of custodial funds available to lenders to cover advances during that period, the PTAP facility was barely utilized by IMBs.

PTAP provides a partial template for a potential market backstop within the Ginnie Mae program, though with noteworthy limitations. First, the facility cannot be used to finance advances of property tax, insurance payments, or costs related to foreclosure. Second, absent a presidentially declared emergency, PTAP cannot be established, and absent a specific waiver by Ginnie Mae, issuers who avail themselves of the facility are considered to be in technical default of their obligations under the Ginnie Mae Guaranty Agreement. This, in turn, can trigger violations of various covenants and contractual agreements, so-called "cross-defaults," with other counterparties like their warehouse lenders and regulators. Finally, Ginnie Mae must rely on collaboration with the U.S. Treasury to fund the facility. All the above suggests that the current PTAP template is a suboptimal backup liquidity option, particularly absent a market-wide crisis. To be a viable source of advance funding, the program would need a permanent borrowing agreement with the Treasury and authority to provide financing for tax and insurance payments, which would likely require legislation. It would also require rulemaking to establish that such provision of funds is not considered a triggering event for technical default.

Notably, the May 2024 report by FSOC recommends that Congress consider legislation to expand the PTAP facility to facilitate financing of tax and insurance advances as well as foreclosure costs and maintenance advances, while also providing additional autonomy to Ginnie Mae and flexibility around the technical default issue. MBA strongly agrees and believes the availability of an expanded PTAP as a permanent backstop would increase market confidence while ensuring that issuers are able to secure at least some form of financing for advances on short notice.

EXPANDING BANK PARTICIPATION

Bringing traditional depository institutions back into the mortgage market could improve liquidity and reduce market concentration risk while also increasing demand for — and therefore, the value of — Ginnie Mae servicing rights. MBA has long argued that reducing the punitive risk weighting of MSRs established under the Basel III capital framework, along with reducing the perceived regulatory risk within the FHA program, would reverse the trend of banks exiting mortgage servicing, particularly government servicing. At the time of this writing, the most recent Basel III Endgame proposal recommends increasing the risk weighting for mortgage loans held on balance sheet, provides no relief on MSR risk weighting, and increases the capital charge for unused portions of warehouse lines. These recommendations will only further push banks out of the mortgage space, increase concentration among IMBs, and reduce the total number of participants in the servicing marketplace.

INCREASED G-FEE FOR LIQUIDITY RISK

Some stakeholders have suggested a legislative proposal to establish a modest Ginnie Mae guarantee fee increase, the proceeds of which would be used to finance a standing Ginnie Mae liquidity fund to cover servicing advances beyond a certain duration of issuer advances. MBA believes this proposal has merit and expects that the resulting reduction of issuer liquidity risk would be sufficiently accretive to the value of Ginnie Mae MSRs to offset the additional cost of the g-fee increase, meaning minimal impact to borrower costs at the point of origination. This would, however, be a significant reform to Ginnie Mae's charter and a program that could take years for Congress to enact.

IMPROVED REIMBURSEMENT SPEEDS

MBA has encouraged FHA to consider accelerating reimbursement of servicers for their tax and insurance escrow advances rather than delaying reimbursement until a borrower completes a loss mitigation option or the loan goes to foreclosure and a claim. Under this approach, FHA could align with the GSEs and allow servicers to file an escrow-only claim every few months until the borrower either reperforms or proceeds to liquidation. Such a policy change from FHA would provide a significant benefit for Ginnie Mae issuers — particularly given the rapid rise in escrow advancing costs — and offer needed liquidity relief that would complement other proposals for enhancing liquidity.

EXPANDED FHLB MEMBERSHIP

While not within the direct purview of Ginnie Mae, any action by FHFA and/or Congress to open membership in the Federal Home Loan Bank System to IMBs would present another opportunity to improve servicing liquidity by lowering the financing cost of servicing advances. IMBs clearly serve the shared goal of financing homeownership. Depending on the terms of such membership expansion, it could also reduce the cost of home loan financing for first-time, veteran, and traditionally underserved homebuyers while minimizing issuer liquidity risk.

Conclusion

A fundamental timing mismatch within the Ginnie Mae program has long been a source of anxiety for issuers, Ginnie Mae, and financial regulators. Opportunities abound to mitigate the issue, many of which can be implemented today under existing federal regulatory authority. MBA has highlighted multiple paths Ginnie Mae should pursue, which can provide liquidity benefits to issuers and complement each other. EBO securitization presents an opportunity to add yet another tool to the toolbelt — one that leverages the Ginnie Mae guarantee, expands liquidity for government servicing, and creates a new, durable, market-based infrastructure that is available through all market cycles, including and especially at times when issuers need it most. The time has never been better for Ginnie Mae to act. MBA appreciates its strong and longstanding working relationship with the Ginnie Mae team and offers itself as a resource to work in common pursuit of this shared goal.

Frequently Asked Questions

1. Does this proposal increase costs for consumers?

No. In fact, it is likely to save money for future consumers. By improving systemic liquidity and reducing the probability of an issuer failure, we expect Ginnie Mae MSR values to improve, increasing value that ultimately passes through to consumers in the form of better loan pricing.

2. Does this proposal increase risk for Ginnie Mae?

No. While Ginnie Mae would provide a guarantee of these EBO pools, this risk exposure pertains to the same underlying loans that were already guaranteed within traditional Ginnie Mae MBS. Further, this risk is more than offset by the reduced probability of an issuer failure and thus reduced exposure to counterparty risk, which is the primary focus of Ginnie Mae's oversight.

3. Won't this program be adversely selected with bad loans and long timelines?

Yes, and in this case that is a good thing. In effect, this proposal indirectly facilitates the splitting of Ginnie Mae pools, aligning monthly advancing requirements with performing loans and investors that expect a monthly remittance, while aligning non-performing loans with investors interested in accrual bonds with less prepayment volatility.

4. What does an EBO investor receive?

An EBO investor receives a lump sum of accrued principal and coupon-rate interest at such time when an underlying loan in the pool resolves either through reperformance or liquidation. Ginnie Mae receives payment of the accrued value of its guarantee fee at the same time. The issuer ultimately receives and advances these funds through either claim proceeds alone or through a combination of claim proceeds and property liquidation.

5. What is the maturity date of an EBO security?

While in practice these bonds will prepay as soon as all underlying loans resolve through reperformance or liquidation, Ginnie Mae would likely establish a finite but distant end date for the bond when it promulgates program requirements. For the purposes of registration and transfer of Ginnie Mae EBO securities through the book-entry system of the Federal Reserve Bank, the security would be assigned a final distribution date of 50 years after the issue date of the EBO security.

6. Can Ginnie Mae guarantee an EBO pool consisting of a single loan?

Yes. Ginnie Mae already has precedent for guaranteeing MBS pools consisting of a single loan. For example, Ginnie Mae's bond financing program (BFP) allows for a minimum pool size of $25,000, with pools consisting of fewer than three loans or even a single loan.

7. Can an EBO Issuer transfer servicing to a sub-servicer?

Yes. MBA expects that multiple large national sub-servicers could quickly develop specialization in servicing EBO pools and compete for this business. This may also raise the comfort level of smaller issuers who are new to the EBO securitization program and/or lack the appropriate expertise to service these loans in-house.

8. Won't below-market interest rate loans trade at a discount?

Yes. This proposal is not solving for the problem of below-market bond yields in a higher-interest rate environment, nor are we arguing that this proposal will always be the best execution. Rather, we are proposing an option for future market cycles where broad swathes of outstanding Ginnie MBS would not require a steep discount to re-pool.

9. What happens if an EBO issuer fails?

Ginnie Mae would proceed similarly to any other issuer failure, seizing the EBO book of the issuer and assigning it to a backup issuer that specializes in servicing EBO pools.

10. Would this proposal impact prepayment speeds?

MBA expects this proposal would cause a marginal increase in early buyouts, with a greater impact in recently originated pools with many loans located in slower loss mitigation jurisdictions and/or judicial foreclosure states.

11. Will this program create an incentive to prolong delinquency once pooled?

Whoever services a loan within an EBO pool, whether it is the issuer itself or its designated sub-servicer, remains obligated to comply with strict loss mitigation guidelines from FHA, VA, and USDA, and faces steep penalties including curtailment of potential claim proceeds if they are not followed. This remains a compelling incentive to work with borrowers in good faith toward any resolution that is most in the borrower's interest.

12. Will this program have sufficient demand from investors?

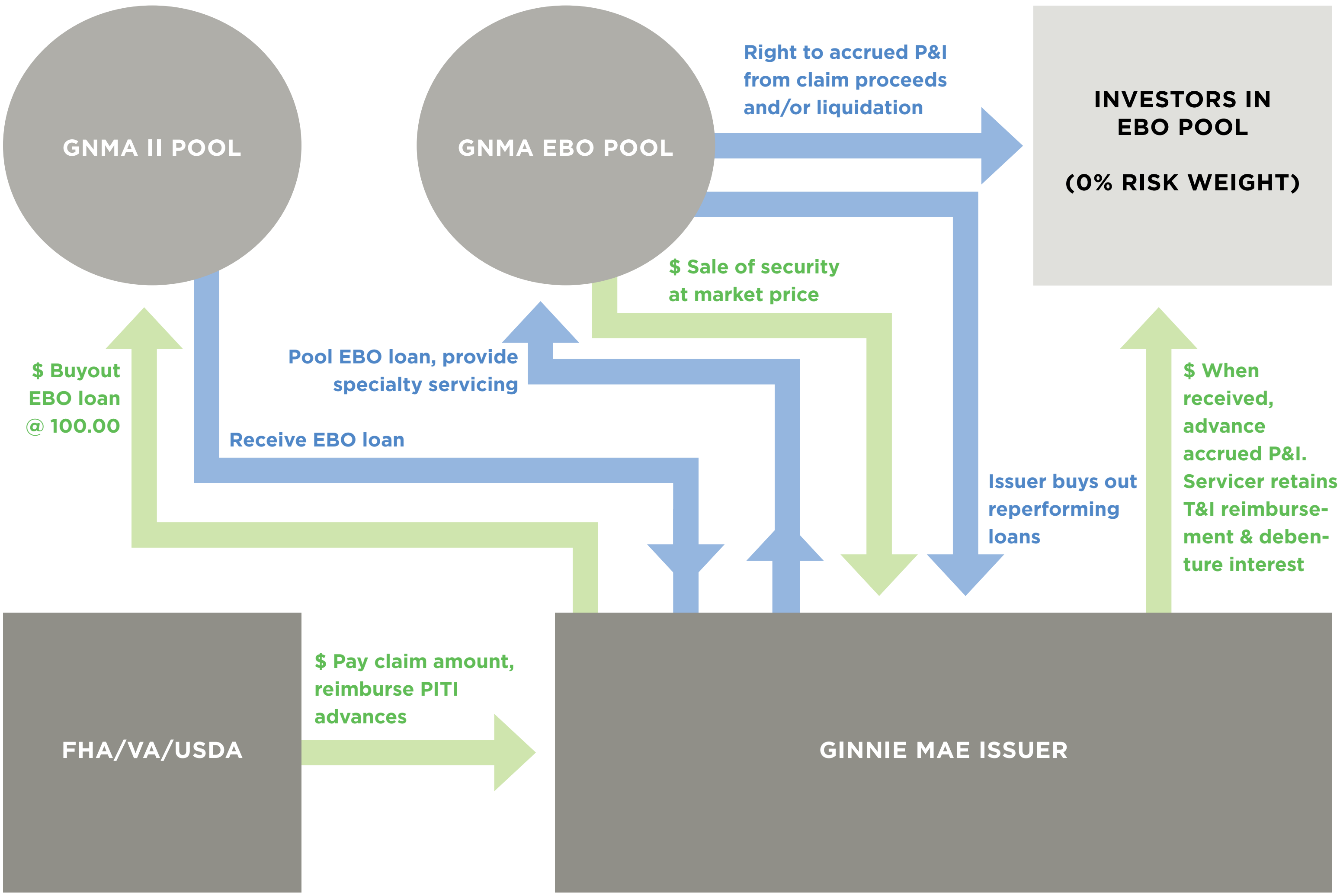
We expect this program would have a small but not insignificant trading volume, with investor profiles similar to investors in the HMBS program and with sufficient demand from the warehouse lending community alone to ensure the market remains liquid and viable when it is needed most by the issuer.

13. What happens to the original MSR asset when a loan is bought out?

At the point the loan is bought out of the original Ginnie Mae security, the MSR is written off. Prior to buying out the loan, a severely delinquent Ginnie Mae MSR typically carries a negative asset value that offsets positive MSR values on financial statements. The removal of the negative MSR therefore increases the overall value of the issuer's MSR book and potentially means the issuer must hold more capital. Stated differently, the greater the number of negative MSRs removed from a balance sheet, the more an issuer's capital position will need to increase to meet relevant regulatory capital requirements.

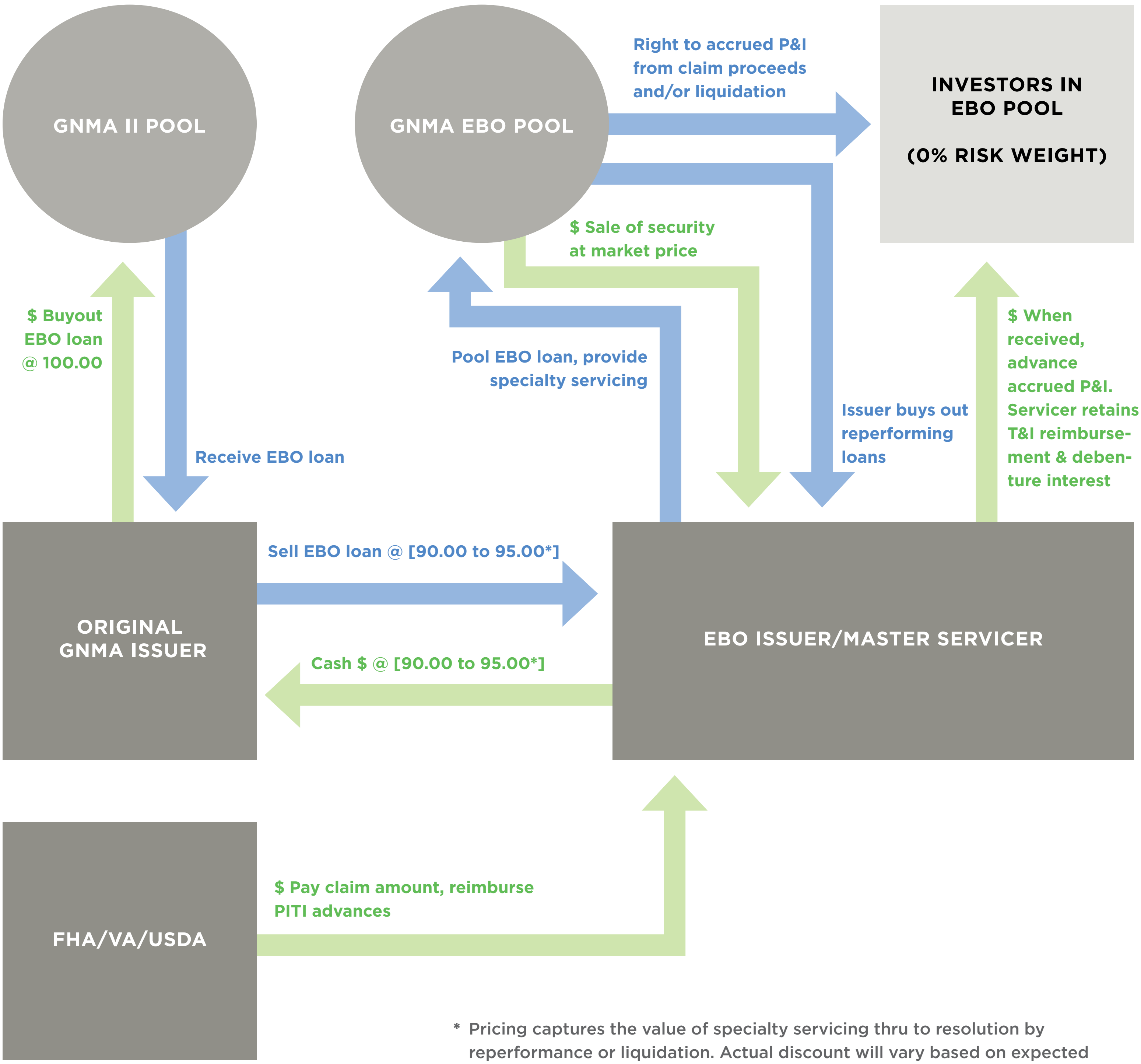
Appendix

SAME ISSUER/SAME BOOK



Appendix

DIFFERENT ISSUER/THIRD PARTY SALE



* Pricing captures the value of specialty servicing thru to resolution by reperformance or liquidation. Actual discount will vary based on expected duration of loss mitigation, interest rate differential between EBO loan and market rate, and interest rate risk on reperforming loans.

Acknowledgments

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