

May 1, 2023 – Wealth Planning Commentary

Change in mortgage rate fees

Unless you are a loan officer, it's unlikely that you keep track of the many variables that determine a mortgage rate. Rates depend on market factors, inflation, and personal factors such as credit score, down payment amount and the loan to value ratio. Fannie Mae and Freddie Mac mortgages comprise around 60% of the market and they charge a fee called the loan-level price adjustment (LLPA). This fee is charged at the time of loan origination. On May 1st, the LLPA rules were changed and may negatively impact borrowers with high credit scores and benefit those with low credit scores.

LLPA is a risk-based pricing tool driven by credit score, loan-to-value ratio, and the type of product used. The Federal Housing Finance Agency (FHFA) sets the rules for the LLPA calculation. The goal of the recently implemented changes is to improve the affordability of housing. Loans that are a higher risk to lenders, such as ones purchased with a low credit score or with less than 20% down payment, will receive greater discounts from FHFA than before. Loans that are lower risk to lenders may not be discounted as much as in the past. One may deduce that these changes also help maintain adequate compensation for the overall risk in the lender's mortgage portfolio.

The changes do not mean that borrowers with low credit scores will pay less than those with higher scores. Individuals with higher credit scores will continue to pay less overall. A buyer who makes a 20% down payment with a credit score of 640 would see their fee drop 0.75%, from 3% to 2.25%. Another buyer, with a 20% down payment and a credit score of 740, would see their fee climb by 0.375%, from 0.5% to 0.875%. Essentially, a borrower with a higher credit score will see less of a discount. The FHFA believes that high credit borrowers do not require as much government support. The LLPA increase also applies to loans for investment properties, secondary homes, million-dollar listings and cash-out refinances.

Properties that are purchased with less than a 20% down payment will likely have a lower LLPA fee than before the changes. Lenders require primary mortgage insurance (PMI) in such scenarios and the FHFA is seeking to support these borrowers.

Potential buyers and borrowers may wonder how to find the most competitive mortgage rate. The new update does not change the game and high credit scores will attract competitive rates. Borrowers may test different mortgage scenarios like making more than a 20% down payment or less than 20% down and purchasing discount points. We recommend collaborating with your mortgage professional and wealth manager to review your situation and help identify a mortgage that meets your objectives.

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