The Transition from LIBOR to SOFR
Unintended Issues for New Mexico's Housing Market

Adjustable-rate mortgages rely on independent and secure reference rates to determine how a consumer's payment will change over time. For many years, the reference rate used for most adjustable-rate financial transactions throughout the world has been LIBOR. For a variety of reasons, however, LIBOR cannot be relied upon to serve this function moving forward. At the behest of regulators in the United States and the United Kingdom, and to avoid widespread market disruption, financial institutions across all markets began transitioning away from LIBOR in recent years and moving towards its recommended replacement, the Secured Overnight Financing Rate (SOFR). This change in reference rates was the result of years of analysis, outreach, and consideration by government agencies and market participants alike.

This transition includes the federal government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, who announced last year that at the end of 2020 they would no longer acquire mortgages indexed to LIBOR.[1] The GSEs, in coordination with their regulator (the Federal Housing Finance Agency) determined that they will replace LIBOR-indexed mortgages with SOFR-indexed mortgages. A key difference in the GSEs' parameters for these loans is that, while LIBOR-indexed loans featured interest rate resets once per year, SOFR-indexed loans feature interest rate resets twice per year. To avoid the potential for payment shock to borrowers, the GSEs also cut in half the maximum amount by which a borrower's interest rate could increase with each reset. The end result is that the borrower maintains the same protection against rising interest rates.

Unfortunately, a provision of a New Mexico statute is having an unintended effect that will limit the availability of adjustable-rate mortgages in the state. Existing state law prohibits a state-chartered mortgage lender, whether a bank or a non-bank, from originating a mortgage loan with an adjustable rate that resets more than once every twelve months. Specifically:

> *No creditor shall make or originate a home loan that includes or uses one or more of the following lending practices: … making or originating an adjustable rate home loan, except a home equity line of credit, where the interest rate and payment may change more frequently than annually during the term of the loan;…*[2]

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[1] Fannie Mae Lender Letter LL-2020-01, February 5, 2020. Available at: https://singlefamily.fanniemae.com/media/21831/display. Freddie Mac Bulletin 2020-9, April 1, 2020. Available at: https://sf.freddiemac.com/content/_assets/resources/pdf/guide-bulletin/april-to-june-2020-bulletins.pdf.

[2] New Mexico Home Loan Protection Act, Section 58-21A-4, Paragraph (N)(2). Available at: http://www.rld.state.nm.us/uploads/FileLinks/23708bf3a25f4c8eb06a80812273e1a9/Home_Loan_Protection_Act_2009.pdf.

Thus, the conflict is that any GSE-approved adjustable-rate mortgage originated by a state-chartered lender now violates the terms of the New Mexico statute. To our knowledge, this is a unique situation in which state law does not permit origination of loans in accordance with the GSEs' parameters.

Lawmakers in New Mexico must act during the current legislative session to amend state law to return the affordable housing options offered by the GSEs to the families that rely on them to purchase or refinance their homes. One suggestion would be to amend the New Mexico Home Loan Protection Act such that the limitation on interest rate resets applies to all loans except those that meet the standards of the GSEs or federal housing programs, which are subject to robust federal consumer protection mandates. These loans would include those eligible for purchase, guarantee, or insurance by the Federal Housing Administration, the Department of Veterans Affairs, and the Rural Housing Service of the Department of Agriculture, as well as Fannie Mae and Freddie Mac.

With the Legislature only meeting through mid-March, action is necessary today!