CLIENT ALERTS & INSIGHTS

Low Rates, High Risk: Mortgage Buydowns and a Coming Wave of AG Enforcement

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Key Takeaways

- Large home builders are increasingly offering mortgage buydowns-promotional low interest rates for new homebuyers-to boost sales, but these incentives often mask higher home prices and can expose buyers to financial risk if housing values decline or payments rise after introductory periods.
- This trend is drawing heightened attention from federal and state regulators, who are concerned about potential consumer harm and market instability reminiscent of the 2008 financial crisis. Builders and lenders face significant legal and enforcement risks if they engage in misleading practices or fail to provide clear disclosures.
- Builders, lenders and affiliated partners should immediately review their mortgage buydown programs for compliance with state and federal laws, strengthen underwriting standards, and ensure transparent disclosures to avoid regulatory scrutiny and potential enforcement actions.

Housing affordability has become a top priority for both federal and state governments. On January 14, 2026, the White House published an article outlining the President's efforts to address housing affordability. These efforts include directing Fannie Mae and Freddie Mac to purchase $200 billion in mortgage-backed securities to reduce borrowing costs, as well as taking action to restrict large institutional investors from acquiring single-family homes.

At the state level, Connecticut Attorney General William Tong, the new president of the National Association of Attorneys General ("NAAG"), announced his 2026 NAAG Presidential Initiative, titled "Driving Down Costs for American Families." General Tong stated that the initiative will focus on how attorneys general can use their law enforcement authority to reduce costs for consumers, including housing costs.

Consistent with these federal and state initiatives, the market has seen a notable decline in mortgage interest rates since May 2025. The average 30-year fixed mortgage rate fell from 6.89% on May 29, 2025, to 6.11% as of February 5, 2026. One contributor to these lower rates has been large home builders, many of whom began offering reduced mortgage rates for newly constructed homes in late 2025 and early 2026. For example, as a promotion in November 2025, one large home builder

offered a starting mortgage interest rate as low as 0.99%. While these promotional rates may be appealing, homebuyers who fail to understand what these offers entail and the potential risks involved may turn into complaining witnesses for government enforcement actions.

Mortgage Rate Buydowns by Large Home Builders

Large home builders can offer reduced mortgage interest rates through "bulk forward commitments," under which a builder pays an upfront fee to secure a large pool of mortgage funds at below-market rates. Using these commitments, builders can offer permanent mortgage buydowns that lower interest rates for buyers. This practice can be problematic for several reasons.

One key risk is that the apparent "discount" provided through a mortgage buydown is often built into the home's purchase price. Rather than lowering home prices to stimulate demand, builders may keep prices elevated while offering lower interest rates. A September 2025 report by the National Association of Home Builders found that while 39% of builders reduced prices by an average of 5%, 65% of September sales relied on incentives. Inflated home prices increase risk for buyers. In the event of a market correction-or worse, a housing downturn-buyers who purchased homes using buydown incentives may experience a decline in home value and end up with negative equity, meaning they owe more on their mortgage than the home is worth. As both federal and state governments continue pushing for lower housing prices, this risk is particularly acute for buyers who have already locked in these arrangements.

Temporary mortgage buydowns may present even greater concerns. Under these arrangements, builders subsidize the loan to offer a significantly reduced introductory interest rate for the first few years. A common structure is the "2-1 buydown," where the interest rate is reduced by 2% in the first year and 1% in the second year, before reverting to the full market rate in the third year. Buyers may experience mortgage payment increases of hundreds of dollars per month as these subsidies expire.

A report from Reverse Engineering Finance found that the top FHA purchase lenders with the highest number of FHA mortgages originated between 2022 and 2024 were builder-affiliated lending arms. Although these lenders offered lower average interest rates than other mortgage lenders, they also reported the highest percentages of underwater FHA mortgages, ranging from 25% to 27%.

A Familiar Pattern Resembling Pre-2008 Risks

These risks share similarities with the conditions that contributed to the 2008 financial crisis. Temporary mortgage buydowns resemble adjustable-rate mortgages ("ARMs"), which initially offer lower interest rates that later adjust to market levels. ARMs were a major factor in the 2008 housing collapse, as many buyers were drawn in by low introductory rates but later defaulted when their payments increased.

While many buydown mortgages eventually convert to fixed rates that are set in advance, some builders have offered ARMs paired with buydowns. In these cases, borrowers may face a steep increase in interest rates once both the buydown period ends and the adjustable rate begins.

Buydowns may also raise concerns if builders or their affiliated lenders loosen underwriting standards or fail to conduct adequate due diligence, enabling borrowers to qualify for loans they cannot afford once introductory rates expire. The 2008 crisis was fueled by lenders extending

mortgages without sufficient underwriting and failing to clearly disclose payment structures, which ultimately led to widespread defaults and foreclosures.

Although current conditions may not mirror 2008 in severity, anticipated declines in housing prices-driven in part by government affordability initiatives-could make it difficult for buyers to refinance or recoup their investments through resale.

Regulatory and Enforcement Risks

In the aftermath of the 2008 housing crisis, Congress expanded regulatory oversight, and federal agencies, including the FBI, increased enforcement efforts targeting mortgage-related fraud. Homebuyer incentives became a focal point for both state and federal authorities seeking accountability for market instability. Investigations by the Department of Justice and state attorneys general ultimately resulted in a historic $25 billion settlement with the nation's largest mortgage servicers.

Given the renewed focus on affordability, federal regulators and state attorneys general may scrutinize builder mortgage buydowns that contribute to market disruption, particularly where disclosure or underwriting deficiencies are present. Builders and their lending affiliates risk liability under federal and state Unfair, Deceptive, and Abusive Acts or Practices ("UDAP/UDAAP") laws. For example, California's Unfair Competition Law ("UCL") prohibits unlawful, unfair or fraudulent business practices and misleading advertising, and may be used to challenge inadequate disclosures or inflated home pricing.

Similarly, the Truth in Lending Act ("TILA") requires lenders to provide clear written disclosures of key loan terms, including payment schedules, annual percentage rates ("APR") and the true cost of credit.

Conclusion

As federal and state governments intensify their focus on housing affordability, increased regulatory scrutiny of the housing market is likely to follow. Builders and mortgage lenders would be well advised to review their lending practices for compliance with applicable state and federal laws. Emphasizing transparent disclosures and rigorous due diligence can help mitigate regulatory risk and reduce the likelihood of enforcement actions.