A Look Back and a Look Ahead – Mortgage Financing 2015

A note of thanks for allowing us to continue partnering with the FPA of Minnesota as a Platinum sponsor. We enjoyed our opportunity to present at the December meeting and include the material below as an expansion on those comments. Please reach out to us with any questions on how these or other mortgage topics may impact your clients.

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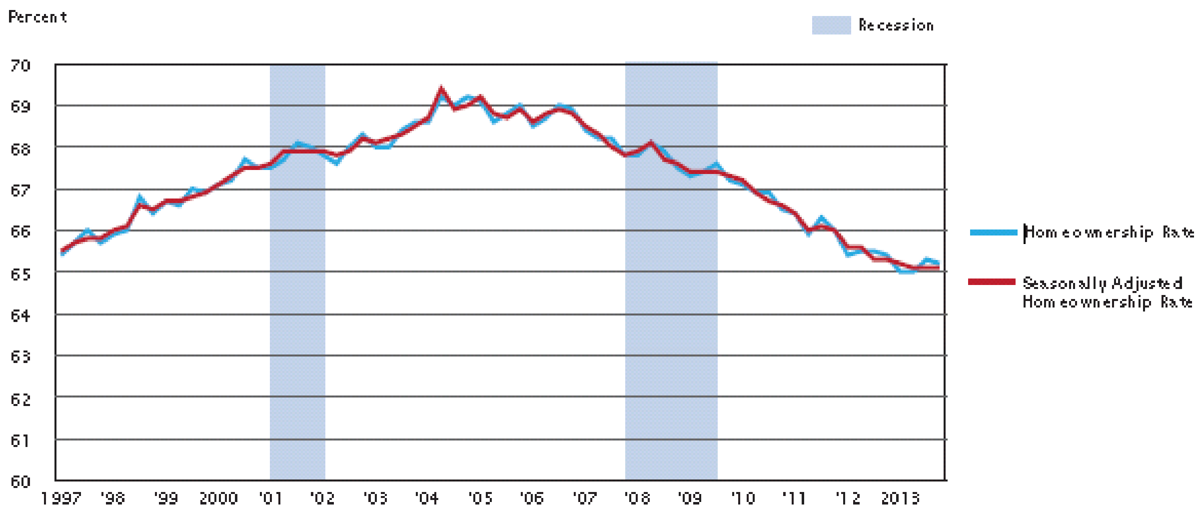
We enter 2015 with a sense of optimism toward home financing and real estate that almost leaves one giddy. Is that based on today's market opportunity or the simple absence of the preceding year's challenges? After you've been hit on the head with a hammer a few times, the lack of it can feel pretty good! So, if we want to appreciate what the future holds, a look back might be useful.

<u>The Dark Days</u>

It was only 7 or 8 years ago but for some the memories are already faded, which can be a bad thing as history can be a good teacher. In the late 90s and heading into the new millennium investors had the tech bubble and emerging markets like Southeast Asia to place capital, but with the collapse of those markets many participated in a "flight to quality" and turned to Real Estate in the United States as a secure alternative offering high returns. We saw historically stable homeownership rates in the 60 – 65% range spike up near 70% as aggressive home financing tools encouraged homeownership with little or no money down and lax review of documentation.

Figure 6.
Quarterly Homeownership Rates and Seasonally Adjusted Homeownership Rates for the United States: 1997-2013



Source for Recession Data: National Bureau of Economic Research, Inc., Cambridge, MA 02138 <www.nber.org>.
Source: U.S. Census Bureau, Current Population Survey/Housing Vacancy Survey Series H-111.

It was all good news for homeownership rates, until it became clear we were often turning great renters into bad homeowners. Many parties share blame for the Great Recession: overly aggressive investors , bad policy from Washington, poor securitization and risk- rating practices, mortgage lenders outdoing each other in advocating products to homeowners that neither they nor their clients fully understood, and others. These factors all contributed to homeowners burdened with debt and underwater on mortgages, and historic highs in delinquency rates & foreclosures.

Source: Board of Governors of the Federal Reserve System (US)

Delinquency Rate On Single-Family Residential Mortgages, Booked In Domestic Offices, All Commercial Banks

Response To The Dark Days

We know what happened next. "Too Big To Fail" and "Quantitative Easing" became punchlines on Saturday Night Live, Dodd-Frank, Basel III, CFPB, and other regulatory reform brought an overwhelming uncertainty about what financing could be offered, on what terms, and with what associated risk. The once busy ice cream store with 31 flavors became a guy with a streetcart hustling 'vanilla" but always in short supply and byzantine rules about who could buy it on what terms - which we came to know as bank overlays. The regulatory agencies and Congress struggled to add definition to Dodd-Frank reform and along the way created "safe harbor" for "qualified mortgages" (QM) where lenders could safely lend with reduced liability. However, the guidelines for loans meeting safe harbor provisions left many good borrowers underserved and lenders unwilling to leave the safe harbor.

2014 The Year Of Stability

While 2014 was anything but boring, relative to previous years it was clearly a year of stability with housing and mortgage markets cementing advances begun in 2013 and finding traction with a housing rebound and low interest rates. Delinquency and foreclosure rates declined dramatically from previous highs to near "normal" rates and short sales and REO sales dropped dramatically. For loans originated in the most 2-3 years we are now seeing historically low delinquency rates. The capital markets have taken note of those improvements and, always on the prowl for higher returns, the housing market once again looks like a reasonable bet to many. As Fannie Mae and Freddie Mac have increased fees and narrowed their lending programs, private capital has become more aggressive entering the mortgage financial markets by offering "non-QM" options outside of the definition of safe harbor. We have even seen Fannie Mae and Freddie Mac recently announce new lending programs with downpayments as low as 3%, opening the door (or Pandora's box depending on your perspective) to homeowners that couldn't meet the 5% downpayments required previously.

2015 Don't Let History Repeat Itself

""Concerns about broader global issues have caused a flight to quality, with investors seeking safety in U.S. Treasury Securities,"

Michael Fratantoni – Mortgage Banking Association, Chief Economist – **2014**

We heard comments along this line before the Great Recession – have we learned our lessons well ?

Many positive factors come together to make us comfortable that we have a great year in front of us:

- Broad housing gains continue, but at a more sustainable pace than earlier gains in the 2014.
- Delinquencies, foreclosures and short sales continue to abate.

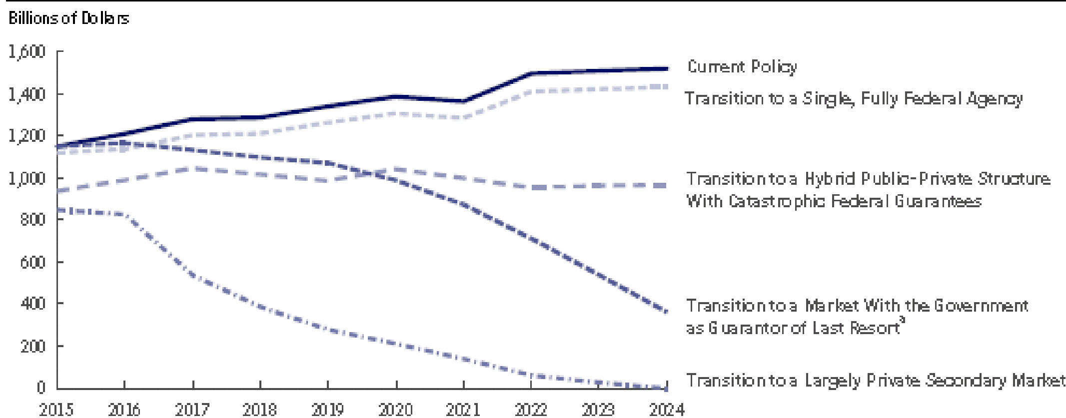
- Most economists have formed consensus that interest rates will remain flat to slowly rising from today's 4.00 – 4.25% range for Fix30 financing up to the 4.75 – 5.00% range in the next 1-2 years.
- The long anticipated end of Quantitative Easing (QE) by the Federal Reserve holds little fear as the secondary markets have stabilized from several years ago.

That is not to say we don't have areas to be concerned about in serving our clients:

- Continuing reform – Dodd-Frank and CFPB have much left undone and will continue to impact us with regulatory reform and risks to those whose compliance is found lacking
- Interest Rate Resets – Many of the measures implemented in the Great Recession were temporary interest rate reductions and some observers fear that these actions simply deferred our problems rather that solving them.
- Home equity loans & Interest Only payments– these were popular financing tools between 2004 – 2006 and typically had 10 year terms and interest only payments. We will see these coming due or being adjusted in the next few years which is cause for concern.
- Growth of private capital and retreat of GSE's Fannie Mae and Freddie Mac - A just-released study by the Congressional Budget Office (see link below) opines that fee increases and policy changes by the GSEs are expected to significantly cut their new-loan business over the next decade. Their share of the mortgage market is expected to fall to about 40% by 2024, compared to 60% in 2013, to be replaced by private capital.

Figure 3-1.

Volume of New Loan Guarantees by Fannie Mae and Freddie Mac Under Illustrative Transition Paths to Different Market Structures



Source: Congressional Budget Office.

Notes: Under current policy, the increase in guarantee fees of 10 basis points (0.1 percentage point) that was authorized by the Temporary Payroll Tax Cut Continuation Act of 2011 is due to expire on October 1, 2021, which causes CBO's baseline projection of new guarantees to jump in 2022.

For a description of the policy changes included in the illustrative transition paths, see Table 3-1.

b. The transition to this market structure would not begin until 2016 to allow time for any implementation issues with auctions of Fannie Mae's and Freddie Mac's guarantees to be resolved.

http://www.cbo.gov/sites/default/files/cbofiles/attachments/49765-Housing_Finance.pdf

Summary:

As the year unfolds we will certainly see many changes in the mortgage industry that impact your clients, and invite you to call on Marketplace Home Mortgages as a resource to help answer questions about your client's home financing needs. As the leading correspondent lender in the Midwest we offer your clients full access to a range of products and lending programs to serve their needs, from conventional to jumbo options including Asset Assisted lending, as well as FHA, VA, Reverse, Renovation, USDA and Bond programs.