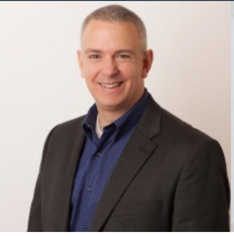
Mortgage Market Commentary

April 27, 2020



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A Message from Jeffrey Chalmers:

"The More You Know..."

The Day Ahead: No Grand Mortgage Market Backstop = No Surprise

Given the size and scope of the unemployment/forbearance issue, mortgage investors have been rightfully concerned about the timeliness of payments, and perhaps even the solvency of existing mortgage market backstops (servicer balance sheets and Fannie/Freddie/Ginnie). Even if they could count on servicers and agencies keeping payments flowing, there would still be questions about the value and saleability of forbearance loans.

The nature of the issue was/is **so obvious** that even a US Congressperson could understand it! That's why the first draft of the CARES Act included a servicer backstop provision via the Fed's 13(3) emergency lending powers. This was cut in the Senate/final version of the bill and thus began the outcry from the mortgage industry.

I've expressed plenty of my own concern and indignation about the incongruence of the CARES Act's forbearance policies. Specifically, it gives homeowners the impression that there are no credit consequence and it prevents mortgage companies from verifying bonafide financial hardship, thus effectively publicizing forbearance. There's nothing wrong with that, necessarily. Missed payments are **going to be happening** with or without legislation, but if we're going to standardize the practice and run the risk of encouraging it among those who may not actually need it, we should have something in place to offset anticipated servicer losses. This was/is the case to be made for a backstop.

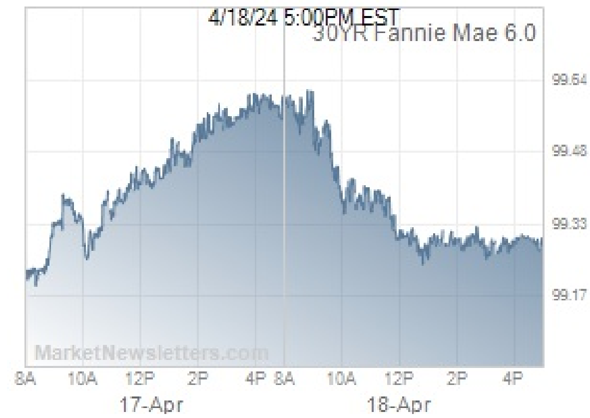
A backstop **could** come from the Fed, as mentioned, but such backstops have had **steep costs** in the past. The Fed and Treasury would have needed to conspire to drop helicopter money for mortgage servicers in order to ease cash flow concerns. The Fed doesn't do helicopter money (not yet, anyway), and the Treasury wouldn't technically do it either (as true helicopter money wouldn't be financed by taxpayers).

To be very sure and very clear, if any person or company or sector were to get helicopter money from the Fed, it **wouldn't** be mortgage servicers who **already** have billions of dollars to go before running out of cash and it wouldn't be the GSEs who effectively have hundreds of billions of dollars via

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 6.0	99.30	-0.29
MBS GNMA 6.0	100.06	-0.09
10 YR Treasury	4.5776	-0.0489
30 YR Treasury	4.6853	-0.0465

Pricing as of: 4/18 9:18PM EST



Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.43%	+0.02	0.00
15 Yr. Fixed	6.84%	+0.01	0.00
30 Yr. FHA	6.90%	+0.03	0.00
30 Yr. Jumbo	7.62%	+0.02	0.00
5/1 ARM	7.40%	+0.03	0.00
Freddie Mac			
30 Yr. Fixed	7.10%	-0.34	0.00
15 Yr. Fixed	6.39%	-0.37	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	7.13%	+0.12	0.00
15 Yr. Fixed	6.64%	+0.18	0.64
30 Yr. FHA	6.90%	+0.10	0.99
30 Yr. Jumbo	7.40%	+0.27	0.46
5/1 ARM	6.52%	+0.11	0.60

Rates as of: 4/18

Treasury funding commitments. This means that even if the entire mortgage market defaulted at the same time, there is already capital in the system to cover a few months of payments.

But the very **valid contention** of the industry is that strain has needlessly been created and that strain has a cost that could jeopardize the stability of the mortgage market. While I'm not sure "jeopardized stability" is the right term, we can plainly see rampant tightening of guidelines and raising of costs in many corners of the mortgage market. This has all happened as investors seek to minimize the strain that would be caused by missed payments.

The official response? Tough shit. This move by the FHFA was passed off as improving liquidity in the secondary mortgage market. **Let me translate that** for you. The FHFA is allowing the GSEs to be lenders of last resort for servicers who would otherwise be insolvent. Those servicers would lose a lot of money paying the 5-7% fees set forth in the FHFA plan. Granted, they would have paid even more in haircuts if the Fed provided a liquidity facility, so this is not highway robbery. This simply is what it is.

Bottom line: the type of servicer backstop that truly would benefit the mortgage market hasn't ever been likely UNLESS the mortgage market (servicers + GSEs) runs out of money. We're not there yet, so the truly beneficial backstop isn't here yet either. The FHFA's move made it even less likely for 2 reasons. First, it implied a transfer of servicing from struggling servicers to those with capacity (i.e. mortgage industry using its own money before asking for official help, even if GSEs help facilitate the servicing transfers as an intermediary). Second, the FHFA director sits on the FSOC with Powell and Mnuchin. Powell just removed mortgage servicers from TALF eligibility 2 weeks ago and now that FHFA has announced 2 separate official liquidity measures, it's clear that this is the FSOC's "final answer" for now.

In other words, **we can be sure** that there has been ample discussion about what the official response would be from policymakers to the servicing concerns. We would only expect to see one of the three entities (FHFA, Fed, or Treasury) spearhead the response. When the Fed pulled the residential mortgage reference out of TALF, this was only more of a certainty. Here's what I said at the time:

> So that's it? We're doomed?
>
> Not exactly... While it does seem fairly clear that the Fed intentionally closed a door that had previously been open for mortgage servicers, we have to ask ourselves why. There are two great reasons I can think of. The first is that mortgage servicers are very far down the list of those in most immediate financial need due to coronavirus fallout. Money markets and main street needed money almost immediately whereas mortgage servicers won't even be able to count their boat loads of delinquent payments for almost a month. From an outside perspective, that makes the mortgage industry a low priority for now, even if officials understand that it will be a big priority soon.
>
> The other side of the coin is that the access for residential MBS was removed because the Fed is aware of another solution in the works. We certainly know both they and the Treasury have been talking about it and hearing about it.

Indeed, the Fed was likely aware of another solution. **Unfortunately**, this is more of a last resort stop-gap than a magic fix. If there was any doubt about my conclusion (i.e. that Powell and Mnuchin said "1, 2, 3, not it!" before Calabria), Mnuchin made it clear last night. And I emphatically predicted this 24 hours earlier in the MBS Live Huddle video (starting around minute 3:00)

Long story short, the mortgage market is **on its own** to sort this out, at least until things get much MUCH worse.

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