Chris Smith
Area Manager/Loan Officer, Chris Smith Group/Nations Lending
470511
9614 Lima Rd, Suite 104 Fort Wayne, IN 46818

Office: 260-204-1385
Mobile: 260-710-2862
chris@chrissmithgroup.com
View My Website

Who Broke The Mortgage Market And When Will It Be Fixed?

I will do my best to speak to both consumer and mortgage industry people on this topic. It affects **everyone**. With that in mind, the following is a list of questions that loan originators have been asking. Consumers might not be familiar with all the terms, but the rest of this article will speak to everyone.

- Why are so many non-QM lenders raising rates or disallowing new apps?
- Why can't I do cash-out non-QM or Jumbo right now? Or Non-Owner, high LTV, low FICO?
- Why are my FHA/VA rates suddenly terrible?
- Why am I suddenly seeing MASSIVE hits for certain FICO/LTV combinations?
- Why am I suddenly hearing more than I've heard since 2008 about lenders potentially being in trouble?
- Why are lenders changing rates MASSIVELY from day to day?
- Why are different lenders so far apart from one another in terms of what they're quoting?

The mortgage industry, like many others, is dealing with more than one problem right now. And like many other industries, the problems arose **not** from some inherent wrongdoing or mismanagement, but from the **most abrupt and unexpected** economic adjustment the world has ever seen. So if you hear someone comparing 2020 to 2008 and implying the mortgage market is bad or evil in some way, they're misguided. People love to freak out about serious stuff. And stuff is indeed serious.

This is a multifaceted issue with two main components:

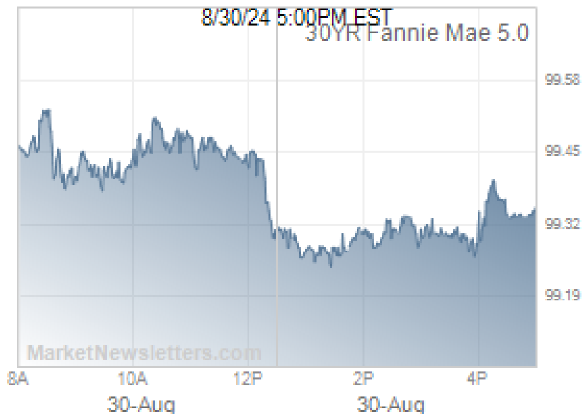
1. The general market disruptions brought about by coronavirus and
2. The impending mortgage market consequences from the soon-to-be-passed disaster relief bill (which is unfortunately also referred to as "the stimulus bill").

Part 1. General Market Disruptions Brought About By Coronavirus

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 5.0	99.35	-0.16
MBS GNMA 5.0	99.91	-0.04
10 YR Treasury	3.9039	+0.0424
30 YR Treasury	4.1932	+0.0468

Pricing as of: 8/30 5:59PM EST



Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	6.43%	+0.02	0.00
15 Yr. Fixed	5.95%	0.00	0.00
30 Yr. FHA	5.82%	+0.02	0.00
30 Yr. Jumbo	6.62%	0.00	0.00
5/1 ARM	6.28%	-0.01	0.00
Freddie Mac			
30 Yr. Fixed	6.35%	-0.51	0.00
15 Yr. Fixed	5.51%	-0.65	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	6.44%	-0.06	0.54
15 Yr. Fixed	5.88%	-0.16	0.68
30 Yr. FHA	6.36%	-0.06	0.85
30 Yr. Jumbo	6.75%	+0.07	0.39
5/1 ARM	5.98%	-0.27	0.65

Rates as of: 8/30

If you really want to do some reading, my newsletters lay a good foundation for this. Here's the most recent one. You've already heard about the massive stock losses in Feb and March. This coincided with massive bond market gains. Mortgages are part of the bond market and **gains** typically mean **lower** rates.

In fact, the bond market improved so much so quickly that it was **too much of a good thing** for the mortgage side of the bond market. "How could rates be too low?!" you may be wondering.

Investors who buy mortgages are planning to make money on interest paid over time. They pay extra upfront for the right to collect that interest. If the loan is paid off earlier than they expect (due to rapidly falling rates and refinances), they either lose money or simply make much less than they expected. As long as the risk of rampant refi demand remains high, investors remain hesitant to pay what they normally would for mortgages. **This makes rates go higher** or stay flat even as other long-term rate indicators, like 10yr Treasury yields, plummet to all-time lows.

In fairness, mortgage rates made it to all-time lows too, but not **nearly** as convincingly as Treasuries. Moreover, those low rates resulted in the **biggest-ever** weekly jump in refinance demand, and remember, that's **not** good for mortgage valuations (and thus not good for rates). In addition to mortgage investors pulling back due to refi fears, the entire financial market was frantically trying to sell everything it could in order to raise cash. (More details here...)

This **isn't** "raising cash" in the sense of drumming up funding for some new venture. This is a repositioning of assets in response to a crisis. Stocks, bonds, whatever... **All of it** carries some degree of risk and none of it can be used as day-to-day capital the same way as cash. Massive global economic and financial market emergency? Investors start acting like this guy from The Fifth Element.

The cash grab and the refi fear meant mortgage investors had **2 big reasons** to sell, and again, when they're selling, rates are **rising**. This is why mortgage rates jumped higher at the **fastest pace in history** 2 weeks ago, even as 10yr Treasury yields remained at levels that convinced many savvy borrowers that mortgages should be doing much better.

A market phenomenon known as a "margin call" added to the volatility in the mortgage market especially. This refers to lenders and their trading partners constantly trying to settle up their ledger with one another in order to maximize cash in hand. When bond prices are falling quickly, it's the lenders that are demanding cash from dealers. The bigger the move in bonds, the bigger the demands on the cash of the entities responsible for providing mortgage financing.

All of the above added up to a **major threat** to the bond market's ability to provide credit. That's a complicated way of saying people and businesses and banks were at risk of not having the cash they would otherwise be accustomed to.

To use a **simple example**, let's say you remodeled your home with a credit card and then were expecting to quickly get a refinance to pay off the debt, but due to the cash crunch in the bond market, your loan was heavily delayed or not possible at all. You'd now be looking at a few high interest payments at the very least. Maybe that's no big deal to you, but multiply it by the size of the entire financial system and it adds up (massively and quickly).

This is precisely why the Fed stepped in with hundreds of billions of dollars of bond buying guarantees and trillions of dollars in short term loans to the biggest banks (the rate cut didn't matter for mortgage rates). **Don't** think of these loans like "printing money." They merely provide a quick and easy way for big banks with a ton of assets to turn those assets into cash without trying to get that cash from other banks who are also trying to get cash. This gives banks time to do what's necessary in order to **repay the cash** to the Fed and reclaim the assets they initially put up for collateral (jargon term for all this = repurchase agreement or "repo" for short).

The unfortunate consequence of the Fed buying massive amounts of mortgage bonds was that the margin call issue started to go the other way. Now, instead of mortgage lenders seeking cash from the bigger players, the bigger players were owed cash from mortgage lenders. This exacerbated the problem discussed in part 2.

Part 2: The Disaster Relief Bill is a Disaster For The Mortgage Market

To be fair, it's not just the bill, but rather an underlying problem it fails to address. **3.3 million people filed for unemployment** this week. More are on the way. Many of them will not be able to make ends meet. Some of them will sell their homes, refi for a lower payment (if they can qualify without their previous level of income), or in the worst cases, default on their payments. Mortgage investors are protected from the loss of interest and principal in the event of default in most cases, but defaults nonetheless cause the same valuation issues as a refinance. And remember, rapid refi demand makes investors less interested in buying mortgage debt.

Now consider the disaster relief bill. It **encourages** millions of Americans affected by coronavirus-related income disruptions to seek a **forbearance** on their mortgages. This means no payments for 6 months at minimum. That, in and of itself, is a **great** thing for homeowners. It provides relief when it's needed most. There are some serious, **unintended consequences**, however.

The investors who buy mortgages have a guarantee to receive timely payments. If the homeowner can't pay it, the loan servicer is supposed to. If the servicer can't pay it, the housing agencies (Fannie, Freddie, Ginnie) foot the bill. And finally, if the agencies can't pay, taxpayers foot the bill because Treasury will have to provide a "draw" for the agencies.

As the bill was written by the House, it stated that The Fed and Treasury would extend credit to mortgage servicers that needed it due to COVID-19-related delinquencies, defaults, or forbearances. The bill passed by the Senate (and sent back to the House) **has no such clause**, nor any protections for servicers or GSEs. While there is reason to believe that a section of the bill could/should still cover servicers in need, the **absence** of a concrete promise has many of them understandably cautious.

Beyond that, even if servicers are ultimately covered by a Fed credit facility inside or outside of the disaster relief bill, the fact remains that forbearances make loans less profitable for a variety of reasons. **Before you pound your fist** and curse the evil banks for only caring about profit, that's **not** at all what I'm saying. Lenders **WILL** continue to offer financing to people who need it. But at the moment, it's **very hard** for them to know how to assign cost/value to the riskier edges of the mortgage market credit spectrum.

In other words, if you need a big loan without much equity, a low credit score, and non-standard income documentation, you might find such programs completely unavailable or simply **priced too poorly** to make sense. Investors are not interested in owning such debt until they get more clarity, both on the containment of coronavirus and the ability of servicers to keep payments flowing in a timely way.

Even more normal parts of the mortgage market are **suffering** because of how they're expected to fare during the COVID crisis response. **FHA/VA** loans are examples. This has to do with rules on how servicers pay investors. In general, the average FHA/VA loan is on the hook for a larger percentage of the monthly payment than the average conventional loan.

Investors could also be feeling more cautious about FHA borrower demographics, where first time homebuyers with lower cash reserves may be less able to weather a financial storm. If that makes those borrowers more likely to seek forbearance, it raises questions for investors that don't have concrete answers in the stimulus bill.

The Bottom Line

Any loan that's not right down the middle of the conventional spectrum raises questions about how it will impact lenders as they navigate what is easily the **largest and fastest surge of forbearances the mortgage market has ever seen**. Every loan raises questions. Due to their servicing rules or risk profiles, some loans raise more questions than others. Those loans have been absolutely demolished by an absence of investor demand. To reiterate, lower demand among investors = higher rates.

In essence, despite extraordinarily high prices on the bonds that underlie the top tier mortgage debt, much of the mortgage market is **broken** by the volatility and uncertainty surrounding COVID-19. Some parts will heal quickly as bondholders better understand their forbearance protections. Other parts will face a tougher road due to the impending recession (high LTVs especially). In all cases, TIME and STABILITY (in markets, the economy, and epidemiology) will be required before rates and product offerings return to where they were.

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