Unintended Consequences - Can Home Loan Rates Go to 0%? (Hint: Nope)

By: Rob Chrisman | Tue, Oct 2 2012, 10:54 AM

Funders and government workers (not the same!) know that **next Monday is a holiday** for many. October - it has Halloween! Wasn't it just the 4th of July? Halloween dates back to Celtic rituals thousands of years ago, but in 29 days we'll have roughly 41 million children hitting the streets trick-or-treating. That's how many children age 5 to 14 there are in the U.S., per the Census Bureau. (Apparently when they reach the age of 15, kids are handed a carton of eggs or several rolls of toilet paper.) And these kids will be knocking on the doors of **132 million occupied housing units** across the nation. (For some more Census housing data, suitable for Realtor presentations, visit here.)

San Diego-based AimLoan.com is hiring a Vice President of Compliance and Quality Assurance. "Over the past 14 years, AimLoan has grown to be the third largest online mortgage banker in the country, closing $3 billion in prime mortgages annually. Starting salary in the $75,000 to $90,000 range, plus a quarterly incentive plan and annual bonus that is expected to add another 50% or so to the base salary. Full benefits package, including health, dental, 401(k) with matching and profit sharing and three weeks paid time off." Learn more by visiting www.aimloan .com. Interested candidates should email their resume to Vince Kasperick at vince@aimloan .com.

"Rob, are 30-yr home loan rates going to go to 0%? I heard that from one of my potential clients over the weekend." No, they won't. But since the QE3 announcement nearly three weeks ago, rates have indeed fallen. The average rate for a conforming loan last week was 3.4% while a jumbo loan went for 4.1%. Sure, given the European issues our economic malaise rates will potentially keep falling - but not all rates. As a quick side note, as you'd expect, the spread between conforming and jumbo loans has again widened - the Fed is buying securities backed by conforming loans, not jumbo loans. (That doesn't help the argument for doing away with Freddie and Fannie entirely, does it?) At its low the spread was about 50 basis points in yield, and now we're back to about .625, and in some cases .750.

Remember two things when thinking about rates on home loans. The first is that "QE Unlimited" involves the purchase of agency securities, not jumbo, Alt-A, portfolio, whatever. The second is that at some level **a bank, or other investor, will not want to own a 30-year security yielding next-to-nothing**. Everyone should remember when S&L's were earning low rates on their investments but having to pay out higher rates to depositors. That is a no-win situation. The answer to that is usually to move into an ARM market. Normally this happens in a high rate environment, but we could see the same thing in this low rate environment. Just thinking out loud...

And in some areas of the country, high balance conforming loans are plentiful. Every investor/aggregator has a different policy about these loans, but generally since they can only make up a small percentage of any pool, the pricing is meant to limit production. And the Fed is, as best I can tell, not buying specified pools made up of high balance conforming loans. Some investors change their price or rate adjustments, and lenders should expect to see them continuing to widen out.

But certainly QE3 has helped the overall mortgage rate market to varying degrees. When the Fed "eases" in the last three rounds, it buys securities in the open market, reducing supply, thus increasing prices, and thus decreasing yields. Since the Fed doesn't want to take much risk, they usually buy the safest of securities, such as Treasuries or agency mortgages. QE1 amounted to $1.75 trillion, and started in 2008. QE2 was rolled out in 2010 due to the high unemployment rate and lack of economic activity. (Sound familiar?) But after this second round, our 10-yr hit a low yield of 1.38%, so it definitely had the effect of lowering Treasury rates. Under these programs, for this year alone in fact, the Fed has purchased roughly $360 billion in longer-dated maturities and now controls about 65% of the total gross issuance of all Treasuries available for these maturities. **Yes, that's right - one part of the government issues them, and another part buys them.** It is not hard to see why critics say this is ludicrous.

And now we have QE3, with the Fed buying $40 billion of agency loans per month. Depending on whom you ask, this is about all of, or twice, the amount being originated by mortgage companies per month. But if you're a pension fund, or a community bank, where a sizeable percentage of your security portfolio is made up of MBS, this sharply reduces investment options. You're in it for the spread. If you're paying .25% on your deposits, and earning 3.25%, that is okay. But if rates slide higher, and suddenly you have to pay 1, or 2, or 3% to your depositors, owning a large amount of MBS paying 3.25% won't work. Yes, some of this spread risk can be hedged (protected), but that can be costly. **So will banks become more interested in riskier assets to help generate revenue? Haven't we seen this before?** Mortgage banks and community bankers are under severe pressure, given the significant cost of additional regulation, extreme competition and the impact of changes on the industry (not to mention a weak lending environment). Now, according to Pacific Coast Bankers, "many have begun moving away from government backed securities toward structure, credit or interest rate risk (to generate a return). Unfortunately, there is no free lunch when yields are stuck at such low levels in the market. When this happens, every 10bp more you try to capture can be an exponentially impactful move in risk, so extreme caution is warranted." Ah, **unintended consequences**...

Let's switch gears and **see what investors have been up to recently**. These will give you a flavor for what is going on out there, but as always it is best to read the actual bulletin.

Citibank has updated both the PDF and Excel versions of its rate sheets, which will require all clients to update any pricing models that are directly linked electronically.

Flagstar clients who opt to submit refinances using the Check and Close underwriting channel are now required to include the appraisal with the underwriting submission. If the loan has a PIW offering on the AUS findings, it's not necessary to include the appraisal; however, all other refinances loans submitted through Check and Close without an appraisal will be held in Submission Review until the appraisal has been received.

US Bank is making changes to its appraisal fees, switching from the current tiered pricing structure to a Set Fee for property values less than $1,000,000 and a Quote Fee for those valued at more than $1,000,000. The new fees will apply to all appraisals ordered after October 7th, and the online Appraisal Ordering System will be reconfigured accordingly.

Due to the FHFA's decision to increase g-fees, US Bank is levying extension fees on all fixed and adjustable rate Freddie Mac and Fannie Mae products. All 20- 30-, and 35-year loans requiring extensions that were locked before September 12th and that do not close and fund before October 12th will be subject to the current extension fee plus 50bps, while all such 10- and 15-year loans will be subject to the current fee plus 20 bps. Loans that fail to close and fund by the deadline will incur deficiency fees as well if the seller doesn't clear any funding deficiencies within seven calendar days of being notified.

Fifth Third reminds clients that the LTV/CLTV for FHA Streamline refinances without appraisals is not based on the original appraisal value but the original property value as determined by the refinance authorization when the case number assignment was obtained.

As per the FHFA's g-free increase announcement, all 20- and 30-year loans locked with **Affiliated Mortgage** prior to September 4th, extended on or after September 12th, and granted a new lock expiration date on or after October 5, 2012 will be charged 50 bps in addition to the current extension fees. Corresponding 10- and 15-year loans will be charged an extra 30 bps. Loans that were locked before September 4th and put on "hold funding" status on or after October 10, 2012 will also be subject to the additional charges of 50 bps (20- and 30-year products) and 30 bps (10- and 15-year products). The normal AMC lock extension schedule applies to all new locks dated September 4th and thereafter.

United Guaranty no longer requires a borrower-signed Third-Party Authorization form (Form 1003) from new servicers making HARP loan requests to determine whether reps and warrants are waived on original loans. Third-Party Authorization forms should instead be included for specific loans after a waiver decision has been made. UG has also standardized its Annual Renewal Premium calculations for HARP modifications, which goes into effect for all HARP-modified loans on the new closing date.

In light of the g-fee increases, **SunTrust** is encouraging brokers to gather all the conditions necessary to close their loans as quickly as possible so that they're able to fund before November 1st and avoid the 50 bps increase that will apply after that date. That additional 50 bps will apply to all loans.

Sure, rates aren't doing much, but that doesn't mean that the problems in Europe have gone away. As a quick, basic refresher, remember that Europe's problems actually help to keep our rates low, but their problems also don't help the world economy to recover. And the U.S. financial markets continue to be infected by elevated systemic risks from Europe. As the FOMC has noted for over a year now - "strains in global financial markets continue to pose significant downside risks to the economic outlook". Of course, we have our own problems in the US, primarily emanating from elevated funding rates on $10 trillion in existing mortgage debt - but the Europeans are making it nearly impossible to counteract our problems with aggressive and appropriate monetary policy easing. Currently we have Spain, Greece and Portugal where the politicians are tackling their 2013 budgets (let's see mortgage companies doing the same thing!). But given the "tax revenue versus pension obligation" problem, there will be no easy solutions and in turn causes nervousness - which serves to help money flow into the U.S., and helps keep our rates low.

And here the news is also helping keep rates low, but is not helping our economy. Construction spending unexpectedly fell 0.6% in August down for a second month as declines in commercial and government projects overshadowed the strongest pace of home building in three years. The drop was the biggest in more than a year, was unexpected, as forecasts were calling for a 0.4% increase. Agency (Fannie, Freddie, Ginnie) prices did well, improving by about .125, and the 10-yr. closed at 1.62%. For today, however, there is no scheduled news, and the market hasn't done much since Monday's close - **the 10-yr is at 1.64% and MBS prices are up.**

When they have little better to do, some folks ask, "Can Texas secede from the union?" In the meantime:

If someone in a Lowe's store offers you assistance and they don't work there, you may live in Texas.
If you've worn shorts and a parka at the same time, you may live in Texas.
If you've had a lengthy telephone conversation with someone who dialed a wrong number, you may live in Texas.
If 'Vacation' means going anywhere south of Dallas for the weekend, you may live in Texas.
If you measure distance in hours, you may live in Texas.
If you know several people who have hit a deer more than once, you may live in Texas.
If you install security lights on your house and garage, but leave both unlocked, you may live in Texas.
If you carry jumper cables in your car and your wife knows how to use them, you may live in Texas.
If the speed limit on the highway is 55 mph -- you're going 80, and everybody's passing you, you may live in Houston, Texas.
If you find 60 degrees 'a little chilly,' you may live in Texas.
If you actually understand these jokes, and share them with all your Texas friends, you definitely have lived in Texas.

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