# Thoughts on Strategic Defaults and State-specific Foreclosures; Mortgage Spreads

By: Rob Chrisman | Wed, Oct 24 2012, 10:54 AM

Occasionally I am asked about the **flow of taxes into and out of various states**. (Okay, I just made that up, but when you're in Kansas one has to make things up once in a while. No one ever asks me about that, thankfully.) But for those who like informative pictures, here is a good one about which states make more money from other states and which ones contribute more.

Even though we don't change our clocks until Sunday, November 4th (in most parts of the nation), mortgage conferences can wreak havoc on one's internal clock. But not enough for participants not to see the **huge trends in the industry toward compliance, management promoting compliance from the top down, and the role that it will take going forward**.

American Mortgage Service Co. is looking for an underwriting manager at its Cincinnati, Ohio corporate office. American Mortgage is a 38 year old mortgage banker (americanmortgage .com) doing business in KY, OH, IN, TN, AK, and WY with a high percentage of purchase and government loans - 2012 volumes will be greater than $500 million. The candidate must possess a CHUMS ID and VA SAR as well as excellent leadership and communication skills. This position will work closely with processing, closing, post-closing and production. Relocation possibilities will be entertained. Interested candidates may send their resumes in confidence to stephanie.windle@americanmortgage .com.

The MBA has made its thoughts known: it has sent a letter to the Fed, Office of the Comptroller of the Currency, and the FDIC stating its disapproval of Basel III and the Standardized Approach and Advanced Approach rules, citing the negative implications the regulation would have for mortgage markets. One of the key issues that the letter highlights is the **differences between the American Basel III and the European Commission's proposals**, which would result in American banks being subject to "artificially tight credit conditions" and higher costs. These conditions, the MBA says, would put American banks at a distinct disadvantage when competing with banks abroad, adversely affect consumers, and "stifle real estate finance." The letter points out that community banks in particular would be impacted by the costs associated with the infrastructure necessary to comply with the regulations. **[READ: MBA Letter Addresses Basel III and it's Effects on Mortgage Markets]**

The MBA also released its **weekly application survey**, which was weak and showed the largest percentage drop in a year down 12%. Purchases were down over 8%, and refi's were down almost 13%. Refi's still make up 81% of total apps - of course that is heavily weighted by the large banks/aggregator numbers.

I received this note on **strategic defaults**: "I saw this article today and it made me think. 'Survey: 1/3 of Americans Say Strategic Default Acceptable' by Mike Sorohan. Nearly one-third of more than 1,000 adults surveyed by ID Analytics, San Diego, said homeowners should be able to strategically default on their mortgages, without any consequences. The survey of 1,026 U.S. adults, conducted online by JZ Analytics last month for ID Analytics, also reported 13 percent would likely strategically default on a mortgage and 17 percent know someone who has strategically defaulted on a mortgage.' **What jumped out is how many Americans feel it is acceptable for homeowners to walk away from a mortgage and go into foreclosure**,' said John Zogby, senior analyst with JZ Analytics. 'If Americans carry on with that mindset, it will continue to cause problems as the economy undergoes a slow recovery.' A strategic default is when a homeowner, who has the financial ability to make the payment on a house that is worth less than is owed on the mortgage, decides to walk away and let the house go to foreclosure. A 2011 study by Research Institute for Housing America, the research arm of the Mortgage Bankers Association, reported that current economic conditions and social networks have influenced homeowners' decision to strategically default on their mortgages, with 'deleterious consequences' in some markets."

The writer went on, "I think that the mortgage industry should offer two alternatives to borrowers. 1) A full recourse option where default means bad credit and lenders retain the right to sue for deficiency and 2) A non-recourse option, where, if the borrower defaults, they can walk with no negative impact to their credit and the lender has no recourse to collect on the debt. The two programs likely would look like this: Full Recourse 4%, 95% Max LTV, 620 minimum FICO; Non-Recourse: 6%, 70% Max LTV, 720 minimum FICO. Let's give borrowers the choice up front. Let's make the pros and cons of both choices be known before problems occur. Want to guess which choice borrowers will take?"

Attorney Brian Levy with Katten Temple also had some observations on recent news. "The note describing home value recovery highlights a critical lesson from this market that bears emphasis. If you look at the places that began to recover the soonest (and the strongest), there is **a direct correlation between home value increases and the time needed to foreclose in those states**. Homeowners in states like Arizona and California that have a relatively quick and uncomplicated non-judicial foreclosure process taking only a few months to complete, have seen their home values on rise again for some time. Homeowners in states like Florida, Illinois, New Jersey and the District of Columbia, where it takes over 2 years on average for a foreclosure case to be completed (due to court backlogs, mandated mediation and other requirements on foreclosing lenders), are still faced with stagnant values."

Mr. Levy went on. "Based on this evidence, it seems clear that the regulators and consumer activists who seek to delay the foreclosure process by requiring lenders to move through more and more hoops prior to foreclosure, are doing a disservice to the vast majority of homeowners who are people who pay their loans faithfully or own homes free and clear. While it is typically in the best interest of a lender to avoid foreclosure and efforts should be made to see if a borrower can be nursed through a tough time, on a macroeconomic scale, delays in foreclosure result in higher costs for other borrowers (see FHFA plan to set different GSE pricing by state) and, more importantly, prevent recovery in values from proceeding depressing home prices for everyone else in the market. Homeowner/voters should let their state and federal legislators and other elected officials know what they think of these kinds of efforts that prevent efficient markets from operating thereby depressing the value of their homes." (If you'd like to reach Brian, he can be found at blevy@kattentemple .com.)

**What's life without a few somewhat recent investor guideline changes, training news, and agency updates?**

First, let me clarify a note from yesterday on **United Mortgage** claiming Freddie Mac doing something that it did not, and that is the claim that "LP/Freddie is now allowing debt ratios over 50 on the Harp loans." United Mortgage might be, but Freddie is not.

Freddie Mac has updated the Relief Refinance II guidelines, which previously required at least one borrower to have a source of income, to allow borrowers with reserves equal to 12 months' PITI to qualify for new refinances. These reserves should be documented using the most recent monthly or quarterly statement from checking, savings, or money market accounts; stocks and bonds traded on an exchange or market "generally available to the public"; and/or IRS-qualified retirement plans at 70% of the vested amount minus outstanding loans. If mature, savings bonds may be counted at 100% of face value, while bonds that aren't mature are counted towards reserves at the redeemable value at the time of underwriting. Additional Relief Refinance II updates allow borrowers to be omitted from the Note of the new mortgage and remain on the title provided that the loan file confirms that remaining borrowers have made the mortgage payments for the most recent 12-month period or that they have a minimum FICO score of 620, DTI of 45% or less, and can verify their income and employment, thereby qualifying them for the new mortgage.

Tomorrow at 11AM PST the **California Mortgage Bankers Association is offering up a call titled, "Unfair and Deceptive Business Conduct, Part II"** with speaker Michael Pfeifer, CMBA General Counsel, Pfeifer & DeLaMora, LLP. "Follow up on last month's presentation, which outlined social media rules, how to avoid unfair, deceptive and abusive acts through false and misleading ads, and the challenge that originators face in marketing legally in the digital age." To Join the Teleconference Portion, dial 1-800-351-6802, and when prompted by the operator, provide the passcode: 4378. When dialing in, you will reach a live operator and you'll need to provide this passcode verbally. Please be aware that each of your lines is in a Listen Only Mode.

Turning to the markets and mortgage rates, **the disparity between current mortgage rates and those of existing loans is at a ten-year high and appears to be increasing.** That spread has now exceeded 1%, which suggests that it's a great time to refinance (compare this to mid-2006 to 2008, when that percentage was a negative and it was more strategic to hold onto existing rates). Despite this, however, there isn't much refinancing going on, even amongst borrowers who could both benefit from and qualify for a refinance. That's due in part to the fact that there are over a million borrowers who are in negative equity positions with median LTVs of 100% and don't realize that they're eligible. For this particular subset of borrowers, refinancing would be well worth the trouble, as they're paying an average interest rate of 5.96%. What with the 3.37% rates we're seeing for 30-year fixed-rate loans that seems almost incredibly high, and if those borrowers were to refinance, they would be looking at savings of $350 a month.

Of course, taking a longer-term view, a rate of 5.96% only seems absurd because of the current climate, and it really comes down to the fact that no one can force borrowers to refinance. The logic behind HARP 2.0 and QE3 is sound, but obviously there's a yawning chasm between theory and practice. **As the Old English proverb says, you can lead a borrower to a government-sponsored refinancing assistance program**, but you can't make him drink (adapted slightly).

But hey, rates are doing just fine. Tuesday residential MBS volumes were below normal with Tradeweb reporting at just 73% of the 30-day moving average in two-way flows. By the end of the day MBS prices were marked higher (better) by about .125, and the 10-yr closed at 1.76%. For thrills and chills today, with one week to go until Halloween, we have this afternoon's FOMC statement, it is generally anticipated to be uneventful following the September QE3 surprise. And overnight rates are going to be 0% for many moons. Prior to that we'll have New Home Sales (Sep), the FHFA's Housing Price Index (Aug), and a $35 billion 5-year T-note auction at 1PM. **In the early going rates are unchanged from Tuesday's close.**

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