Servicers need liquidity to make advances during forbearance

By Brad Finkelstein

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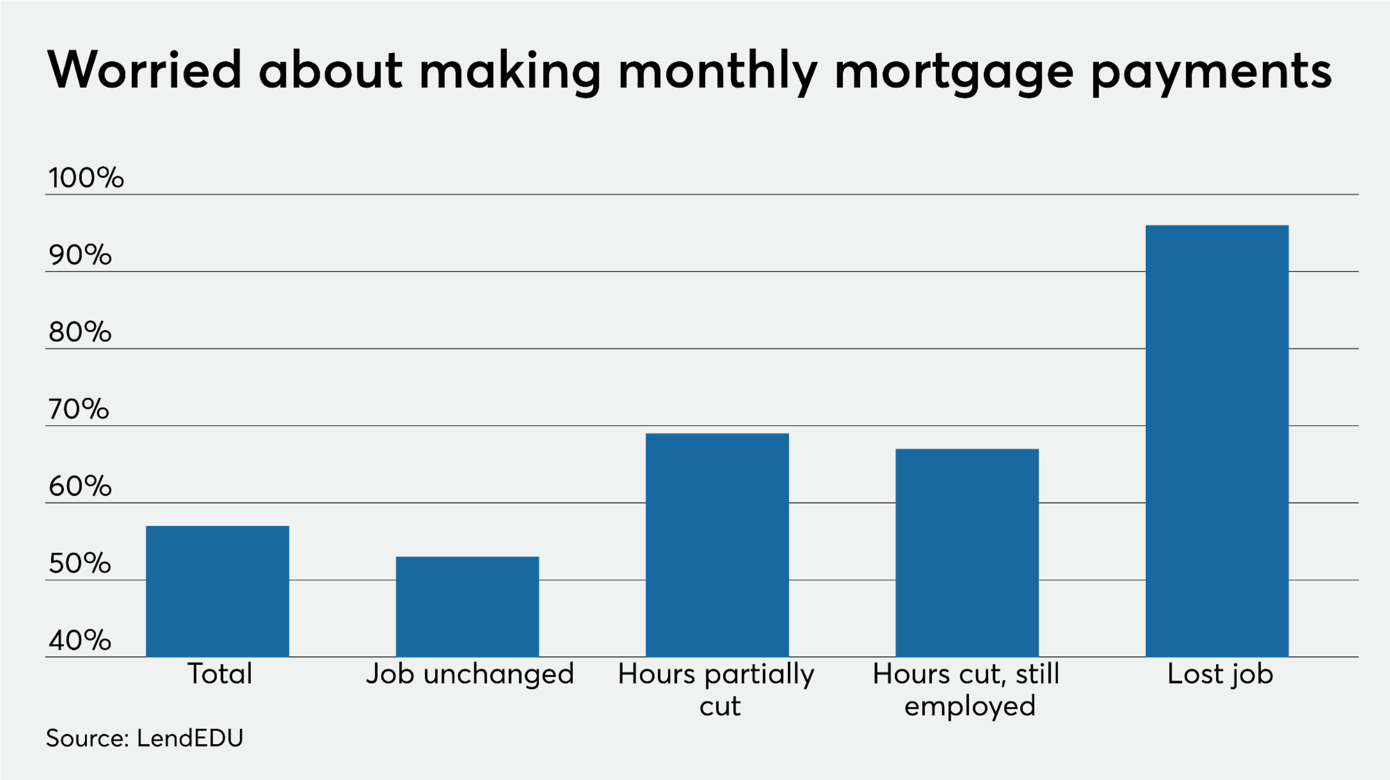
The Federal Reserve Board should create a dedicated facility for mortgage servicers to access in order to make required advances, industry participants and observers, including its largest trade group, said.

Between Fannie Mae, Freddie Mac and Ginnie Mae, there is approximately $7 trillion of government-backed mortgage debt outstanding. Using an average interest rate of 4.5%, that equates to $425 billion of principal and interest payments that must be sent to bondholders annually, Keefe, Bruyette & Woods analyst Bose George calculated.

If a forbearance were to be implemented and 20% of outstanding mortgage borrowers applied, loan servicers could end up having to advance over $40 billion to MBS owners for a six month period.

"This level of servicer advances would be impossible for the servicing industry to accommodate. We think the solution is a servicing advance facility provided by the Federal Reserve," George said in a report.



Proposed legislation in the House of Representatives introduced by Speaker Nancy Pelosi on March 23 calls on the Fed to provide mortgage servicers with such liquidity.

However, George noted, the Fed already has the statutory authority to offer such financing. It would be a better solution than the government-sponsored enterprises providing this funding, he continued.

If the money came from the agencies, "they would essentially have to turn around and finance it by issuing GSE debt and the market is probably not prepared to absorb that much GSE debt at a reasonable price given the current market volatility," he said.

Among current mortgage borrowers responding to a LendEDU survey, 57% said they were concerned about making their monthly payment because of COVID-19 and its impacts. For those whose job situation was unchanged, the share was 53%, while for those that lost their job (as 6% of all respondents had), it was 96%.

The Mortgage Bankers Association sent a letter to Treasury Secretary Steven Mnuchin and Fed Chairman Jerome Powell also asking for that the Fed use its authority to make available that liquidity to servicers. The group cites even higher possible advancing demands than George did, putting the number in excess of $75 billion, which could climb to over $100 billion.

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It is unknown how many borrowers would need to take advantage of a forbearance because the pandemic affected their ability to make their monthly payment, but "it would be very difficult for many servicers to keep advancing these payments and that's where the need for liquidity come in," Robert Broeksmit, the MBA's chief executive, said in an interview.

"But the purpose of the facility is to ensure that our members who are standing ready to provide this borrower assistance, we just want to make sure they have the liquidity to do it," Broeksmit continued.

Ginnie Mae has its Pass-Through Assistance Program, he said, adding that the MBA is calling for this to be made more broadly available to servicers. However, the proposed Fed liquidity facility would not only apply to Fannie and Freddie securities but possibly to private-label securities. "And it could also handle taxes and insurance [payments] in a way that the Ginnie Mae program is not currently set up to do," Broeksmit said.

But even without a forbearance program or a formal moratorium, there are some servicers that will see their balance sheets affected by the increased need to make advances, to the extent their ability to continue in business would be threatened, Peter Pannes, head of servicing and capital markets solutions at Covius, also said in an interview. It is "clearly the nonbank servicers are going to be hit first and hardest," he said.

"Maybe the agencies themselves will provides some sort of an emergency facility," Gagan Sharma, the president and CEO at servicer and subservicer BSI Financial, said in an interview. "The market definitely has a need for that."

A payment moratorium is also good for the private mortgage insurers. Natural disasters like Hurricane Harvey in 2017 typically result in mortgage payment forbearances as mandated by Fannie Mae and Freddie Mac, said George.

Following Harvey, "mortgage servicers continued to advance mortgage insurance premiums while the loans were delinquent and the MIs did not build a loss provision (although the accounting varied slightly by company). While there was a slight increase in required capital under the Private Mortgage Insurer Eligibility Requirements, it was small (around 30% of the capital required for a normal delinquent loan under PMIERs)," George pointed out.

While a natural disaster is the right analogy for the current situation, the duration from the effects on the economy, along with borrowers and servicers, from the coronavirus will be longer and more widespread, Sharma said.

"More states are going into lockdowns, more businesses are closing down, so our sense is this is obviously a much larger problem which will require much bigger solutions," Sharma said.

Even if there is no nationwide moratorium, the MIs should be OK because of the strong credit quality of the post-financial crisis book of business and the increased use of reinsurance, George noted.

However, Sharma pointed out that in recent days, BSI received at least 400 calls from borrowers and is getting prepared to hear from more. "We are raping up to support these borrowers. We are providing them physical tools and online tools. They can contact us online, not just on the phone."

Brad Finkelstein Originations editor, SourceMedia