Ginnie Mae Support for IMB Funding

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Since the housing crisis, commercial banks have been retreating from the single-family mortgage origination and servicing business. Independent mortgage banks (IMBs) have effectively filled the space created by the bank retreat. The transition from a commercial bank–dominated industry to one dominated by IMBs has been so successful that the industry was able to complete its two largest origination years in 2020 and 2021 without a major hiccup and concurrently deal with one of the largest servicing challenges created by the COVID-19 pandemic. Currently, more than 60 percent of conventional loans are being originated by IMBs, and more than 90 percent of government loans are being originated by IMBs.

The major challenge that IMBs face is the instability and costs of their funding. Commercial banks have filled the hole created by the demise of the savings and loan industry in the late 1980s. For more than 50 years before that, savings and loan associations and mutual savings banks originated more than 70 percent of single-family mortgages for their own portfolios. In the 1980s, savings and loan associations and mutual savings banks experienced the same fate as Silicon Valley Bank and First Republic. The Federal Reserve raised interest rates quickly to tame inflation. Savings and loan associations had 30-year fixed rate mortgages in their portfolios funded by short-term deposits, which created a negative interest carry situation and led to their bankruptcy. Commercial banks stepped in because of their diversified lines of business and access to government-guaranteed deposits, with the guarantee provided by the Federal Deposit Insurance Corporation.

Commercial banks replaced savings and loan associations as the backbone of single-family mortgages in the early 1990s to generate fee income. Commercial banks wanted to diversify their sources of income. Banks' income was heavily weighted to interest spread products. Interest spread product income had become volatile in the 1980s with the rapid interest rate increase and the deregulation of interest rates paid on deposits. Before the 1980s, the interest rate banks paid on

deposits was fixed, which slowed the increase in interest rates banks paid depositors and minimized competition for deposits by commercial banks.

During the 1990s, there was substantial consolidation in the single-family mortgage servicing industry. Because of commercial banks' access to low-cost funding and economy of scale, IMBs became correspondents of the big bank servicers. To maximize servicing profitability during the early 2000s, banks reduced servicing costs by minimizing investment in technology and minimizing staff. When the 2008 housing crisis hit, the lack of investment in technology and staff became apparent.

The inability of big bank servicers to handle the tidal wave of delinquencies opened them to massive criticism and lawsuits. Commercial banks found out that servicing single-family mortgages was more than processing payments for a fee. Commercial banks realized that the level of profitability for servicing a loan could not compensate for the reputational risk of servicing. In the 10 years after the housing crisis, banks have pulled back from servicing single-family loans. Commercial banks now understand why monoline businesses performed single-family lending before the 1990s. Monoline businesses can devote 100 percent of their technology budget to mortgage lending and servicing and have a staff that specialized in mortgage finance.

Another reason the big banks were encouraged to pull back from the single-family business was the repeal of the Glass-Steagall Act in the 1990s. The Glass-Steagall Act was passed during the Great Depression to separate commercial banks from investment banks. The repeal of Glass-Steagall allowed commercial banks to move into investment banking, which is a substantially higher-profit fee-based business. Commercial banks pulling out of single-family servicing did not create a large hole in the fee income business of banks.

IMBs have become the new monoline experts in originating and servicing single-family mortgages. Before the banks moved into single-family origination and servicing, the monoline expertise had been concentrated in the savings and loan industry. Because of the complex regulations and the reputational risk in originating and servicing single-family mortgages for commercial banks, it appears the shift back to monoline businesses dominating single-family mortgage finance is going to be the norm for the foreseeable future. Commercial banks have been major players in the single-family mortgage industry in only 20 of the past 90 years. Just as the Hoover and Roosevelt administrations in the 1930s developed programs to allow savings and loan associations and mutual savings banks to obtain stable and inexpensive funding, the Biden administration needs to find solutions to support IMB funding.

The Need for IMB Liquidity: A Primer

The scope of IMB liquidity is determined by the types of mortgages originated and serviced. There are two basic types of mortgages: government loans, which are insured or guaranteed by government agencies, and conventional loans, which are not insured or guaranteed by government agencies.

Conventional mortgage origination and servicing are more flexible in the amount of liquidity that an IMB will be required to access. IMBs play an important role in the conventional mortgage market. The

government-sponsored enterprises (GSEs) legally cannot contact consumers directly to originate loans, which forces them to acquire loans for their portfolios through contractual relationships with primary market participants. Close to 75 percent of the mortgages acquired by the GSEs in 2022 were from IMBs. Fixed income investors will contract with primary market originators to acquire loans for their portfolios because they do not have the infrastructure to work with consumers directly. IMBs sell closed loans to the GSEs and as whole loans to fixed income investors.

For ease of operations, IMBs use lines of credit from commercial banks to fund mortgages from closing to sale of the loan to a GSE or a fixed income investor versus having the GSE or fixed income investor buy the loans at closing. Like with any contract, the parties can mutually agree to change the requirement that IMBs fund their closing before the bulk sale of loans to a GSE or fixed income investor.

When servicing conventional loans, IMBs have a similar relationship with GSEs and fixed income investors as when they originate loans. An IMB is hired by a GSE or fixed income investor to service the loans sold based on the GSE or investor's requirements. The GSEs hire IMBs to service their mortgage portfolios because they are legally precluded from contacting individual borrowers. Fixed income investors hire IMBs to service their portfolios because servicing needs to be done at scale to be economically feasible. The liquidity requirements for IMBs to service conventional loans is typically limited to the first three months of delinquent borrower payments and any shortage in a borrower's tax and insurance escrow account balance when paying the borrower's bills. The obligation for an IMB to advance shortages in the borrower's escrow account or advance up to three months of a borrower's delinquent payments is spelled out in the servicing agreement with the GSE or fixed income investor. The servicer and the investor can mutually agree to further limit the servicer's advancing requirement.

Government lending through the Ginnie Mae mortgage-backed security guarantee program is different. In the conventional mortgage structure, an IMB originates a mortgage for a GSE or fixed income investor, sells the loan to the GSE or investor, and then services the loan for the GSE or the investor. In the Ginnie Mae program, the IMB originates the loan for its own portfolio, issues a mortgage-backed security that locks in funding of the mortgage portfolio and perfectly matches the duration of the life of the mortgage and the mortgage-backed security, and pays Ginnie Mae to guarantee the mortgage-backed security the IMB issued.

The difference between servicing a mortgage under the GSE and Ginnie Mae structure is best illustrated by the definition of principal and interest advances. The GSEs require servicers to advance up to three delinquent payments from a borrower. Ginnie Mae requires issuers to pass through the full principal and interest payment on their mortgage-backed security obligation. The issuer of a Ginnie Mae mortgage-backed security responsibility to pay a security holder is just like any other corporate debt the issuer has outstanding. If there are not enough principal and interest payments collected from all the Federal Housing Administration (FHA), US Department of Veterans Affairs (VA), and Rural Housing Service (RHS) loans in its mortgage portfolio, the shortfall must come from corporate funds. This is why Ginnie Mae allows issuers to use unscheduled principal payments collected from loans not collateralizing a specific mortgage-backed security pool to be used to fund another Ginnie Mae–guaranteed mortgage-backed security pool's principal and interest obligations.

The Proposal: Ginnie Mae Guarantees Commercial Paper

Ginnie Mae's charter gives it the authority to guarantee the borrowing of a private-sector firm as long as the borrowing is collateralized by assets insured or guaranteed by a federal agency. Ginnie Mae's charter is not limited to mortgage-backed securities. Policymakers should use Ginnie Mae's authority to establish low-cost and stable funding sources for IMBs over the life of a loan. Ginnie Mae–guaranteed mortgage-backed securities have worked effectively for the past 53 years to eliminate the interest rate risk that was the Achilles' heel of the savings and loan industry. The following are two suggestions for how Ginnie Mae's current charter could support the origination of government loans and the servicing of delinquent loans.

IMBs could fund the closing of government loans using commercial paper guaranteed by Ginnie Mae, and the newly closed loans would be pledged as collateral to the commercial paper. Today, an IMB uses its unsold closed mortgages as collateral to support credit lines for its warehouse. Instead, an IMB could issue commercial paper guaranteed by Ginnie Mae to fund its warehouse of closed loans. This new funding source would potentially cut the cost of originating government loans. Some commercial banks have said they could reduce the interest they would charge to fund an IMB warehouse to approximately the one-year Treasury bill yield.

The commercial paper would be repaid from the sale of the newly issued Ginnie Mae mortgage-backed security that includes the mortgage that was funded through the Ginnie Mae–guaranteed commercial paper. Using government-guaranteed commercial paper to fund the IMB warehouse would cut the cost of originating a government loan and would bring stability and needed funding during times of stress. An article in the July 9, 2009, issue of *MortgageOrb* stated that IMB warehouse lines of credit fell from $200 billion in 2007 to $25 billion in 2009. This reduction in available funding for unsold loans was not a major issue during the housing crisis, as five large banks accounted for more than two-thirds of Ginnie Mae–guaranteed mortgage-backed securities issued. We could see the same reduction in available funds for IMBs to fund the closing of loans if we have a situation where home prices are falling and lenders to IMBs will question the value of the loans collateralizing their line of credit to IMBs.

The other liquidity need for IMBs is when mortgages become delinquent. Since the housing crisis, virtually all issuer failures have been caused by issuers not being able to make required payments on their mortgage-backed security obligations. Two high-profile examples of issuers going bankrupt because they could not make the required mortgage-backed security payments include one during the housing crisis, the Taylor Bean case, and one earlier this year, when RMF, one of the main originators and servicers of reverse mortgages, went bankrupt.

People remember Taylor Bean as a bank fraud case. Taylor Bean was fraud for liquidity, not fraud for profit. Taylor Bean pledged the same loan numerous times to obtain the cash needed for its required mortgage-backed security payments. Taylor Bean management thought they could pledge loans twice until they received payments from the FHA and VA for insurance claims on delinquent loans. When the funds were received, they would pay off the loans that were fraudulently obtained. If Taylor Bean would

have had access to stable funding for their delinquent loan portfolio, one of the largest mortgage frauds probably would not have occurred.

When a reverse mortgage hits 98 percent of the loan amount, the issuer must pay off the mortgage-backed security owner and finance the payoff using its own capital or borrow the funds from a financial institution. Because of the characteristics of the borrowers in RMF's reverse portfolio, the amount of loans hitting the 98 percent drawn point overwhelmed its ability to borrow the funds needed from financial institutions. If RMF could have obtained funding from a more plentiful source, it would not have had to declare bankruptcy. The RMF bankruptcy took a substantial amount of capacity out of the reverse mortgage industry that will be needed as baby boomers continue to move further into retirement.

The commercial banks would be able to reduce the interest rates they charge because of two benefits the Ginnie Mae–guaranteed commercial paper would create.

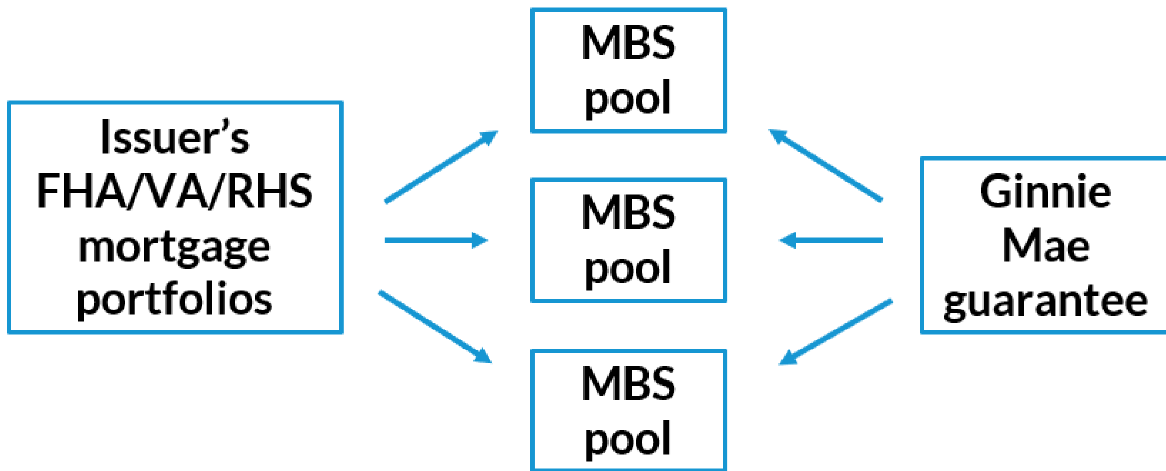
1. The commercial paper would have an explicit government guarantee, so the risk-based capital charge would be zero.
2. The commercial paper would be short term and transferable and would count toward the commercial bank's liquidity buffer.

Figure 1 shows how Ginnie Mae guaranteeing commercial paper is a natural extension of the mortgage-backed security guarantee program.

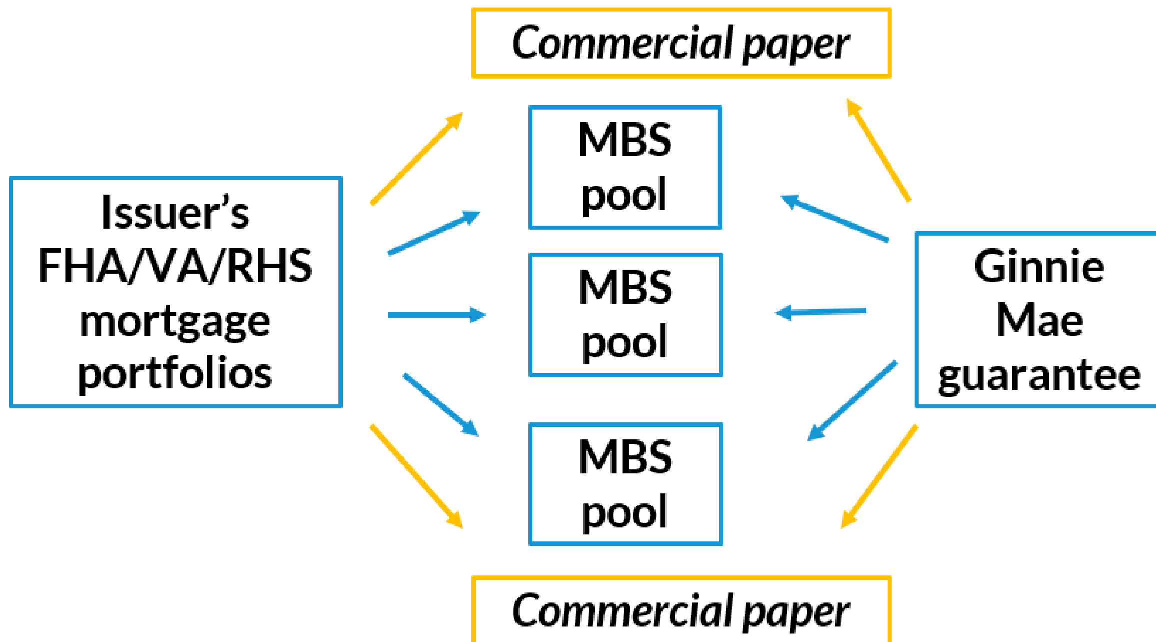
FIGURE 1

Comparing the Current and Proposed Systems

Current system



Proposed system



Note: FHA = Federal Housing Administration; MBS = mortgage-backed security; RHS = Rural Housing Service; VA = US Department of Veterans Affairs.

How Do We Avoid a Liquidity Crunch during Times of Stress?

Ginnie Mae could support the servicing of delinquent loans. IMBs use mortgage-backed securities to fund their portfolio of FHA, VA, and RHS loans at the pass-through interest rate of the mortgage-backed security, whether mortgages are current or not. IMBs could issue Ginnie Mae–guaranteed commercial paper to fund the loans that are in default and in loss mitigation. The funds from the issuance of the Ginnie Mae–guaranteed commercial paper would fund the buyout of the loan from the mortgage-backed security. The use of Ginnie Mae–guaranteed commercial paper would help take the financial stress off of servicing delinquent loans in three ways.

1. The cost of funding the early buyout would be reduced to approximately the one-year Treasury bill yield.
2. Required monthly principal and interest payments to the mortgage-backed security investors would be eliminated by the loan being bought out. Because the structure of this borrowing would be commercial paper, the issuer would not have to pay principal or interest payments on the commercial paper until maturity.
3. Because Ginnie Mae does not require a margin call on the delinquent loan when it was in the mortgage-backed security, it should allow for 100 percent of the mortgage's unpaid principal balance to be funded through the commercial paper issuance. Ginnie Mae's risk should be minimized because the issuer's complete FHA, VA, and RHS portfolio is pledged against all the Ginnie Mae–guaranteed obligations. Today, when IMBs receive funding for the early buyout of mortgages, the funding is usually based on the loan's mark to market, not the unpaid principal balance.

Home equity conversion mortgage-backed security (i.e., a Ginnie Mae–guaranteed mortgage-backed security collateralized by reverse mortgages) issuers could also use Ginnie Mae–guaranteed commercial paper to fund the Ginnie Mae–required buyouts of loans that have hit their 98 percent maximum claim amount or have become inactive. Table 1 shows the projected required home equity conversion mortgage-backed security buyouts in the next few years.

TABLE 1

Projected Required Buyouts for Ginnie Mae's Home Equity Conversion Mortgage-Backed Security Program

Year	Amount
2023	$ 4,211,897,953
2024	$ 3,867,685,951
2025	$ 3,279,150,112
2026	$ 3,267,365,373
2027	$ 2,734,102,364
2028	$ 2,547,788,616
2029	$ 2,873,870,731
2030	$ 3,546,588,198
2031	$ 3,434,181,750
2032	$ 3,078,186,066
2033	$ 2,728,916,064
2034	$ 2,321,149,327
2035	$ 1,923,273,225
2036	$ 1,600,459,716
2037	$ 1,433,517,195
2038	$ 1,220,857,283
2039	$ 991,489,075
2040	$ 775,515,199
2041	$ 625,679,338
2042	$ 490,584,024
2043	$ 372,565,596
2044+	$ 3,538,875,093

Sources: National Reverse Mortgage Lenders Association and New View Advisors.

Under this proposal, the following is a possible way the Ginnie Mae–guaranteed security's funds would flow during the life of a government loan:

1. An IMB would fund the loan closing.
2. The IMB would issue commercial paper collateralized by the recently closed loan, and the funds from the sale of the commercial paper would flow back to the IMB to replenish its working capital.
3. The IMB would include the newly closed loan that is being used as collateral for its commercial paper in a new Ginnie Mae mortgage-backed security. The funds from the sale of the security would be used to pay off the guaranteed commercial paper.
4. When a government mortgage becomes 90 or more days delinquent or is required to be bought out of a home equity conversion mortgage-backed security pool, the IMB could issue Ginnie Mae–guaranteed commercial paper that would use the bought-out mortgages as collateral for a new commercial paper issuance. The proceeds from the sale of the commercial paper would be used to buy out the loans from the mortgage-backed security pool.
5. When the loan reinstates or a claim is paid by the insuring government agency, the funds will be paid to the commercial paper investor.

A Ginnie Mae guarantee of collateralized commercial paper issued by IMBs will be a giant step toward assuring that the single-family mortgage industry will offer homeowners low-cost and stable financing. From a historical perspective, monoline entities' dominance of the single-family market is a return to normal, not an aberration. There is no indication that commercial banks will return to a dominant position in the single-family finance industry in the foreseeable future. The Biden administration needs to create structures that will allow IMBs to effectively serve the single-family mortgage market through all economic cycles. Ginnie Mae guaranteeing commercial paper will stabilize IMB funding without putting taxpayers at risk.

Q&A on This Proposal

Q: The Ginnie Mae securitization platform was designed exclusively for the issuance and support of mortgage-backed securities. How would the functions performed by the Ginnie Mae securitization platform be performed for the guaranteed commercial paper?

A: The current securitization platform was built to support the Federal Reserve's book-entry system allowing for Ginnie Mae–guaranteed mortgage-backed securities to be traded and kept on the Federal Reserve's system. Before the Federal Reserve became a paying agent for Ginnie Mae mortgage-backed securities, the issuers of Ginnie Mae–guaranteed securities acted as their own paying agents. Issuers paid the mortgage-backed security holder directly and filed the required form with the Internal Revenue Service to document interest paid to mortgage-backed security holders. I propose that issuers would act as their own paying agents and issue their own commercial paper just as they did for their Ginnie Mae–guaranteed mortgage-backed securities. The Ginnie Mae securitization platform will be used to track the mortgages used as collateral to make sure a loan is not used both as collateral for a mortgage-backed security and as commercial paper. The platform will also be used to track the total dollar amount of guarantees outstanding.

Q: How will the Ginnie Mae–guaranteed commercial paper be distributed and traded in the capital markets?

A: The commercial paper will be in a negotiable form and be highly liquid. The commercial paper will trade like any other AAA money market instrument. Issuers will be able to sell the commercial paper to investors that could trade the security or keep it in portfolio. No interest or principal would be paid to the holder of the commercial paper until maturity.

Q: Will Ginnie Mae need additional staff to manage this program?

A: Ginnie Mae will need to hire additional staff and will probably need to expand staff expertise. Ginnie Mae should charge a guarantee fee for guaranteeing the commercial paper, which would cover all additional administrative costs and properly fund the Guarantee Insurance Fund.

Q: What role would the document custodian have in this new program?

A: The document custodian's role would be the same as it is today. The custodian would hold the collateral package for the loans supporting Ginnie Mae–guaranteed securities. The document custodian would receive a mortgage's collateral package when a mortgage is collateralizing commercial paper that is funding the IMB warehouse. The document custodian would retain the collateral package until the loan pays off through a refinance or the sale of the property.

Q: What will the issuer do with funds that are received from the sale of a mortgage-backed security that includes a mortgage or the mortgage pays off funds that was collateralizing a commercial paper issue that has not matured?

A: The issuer will hold the funds in the Ginnie Mae custodial account for principal and interest until the commercial paper matures. The commercial paper investor will be paid out of the custodial account. The commercial paper holder will receive the principal and the interest that has accrued on the commercial paper over its life.

Q: Will Ginnie Mae need to develop procedures to oversee the guarantee of the commercial paper from scratch?

A: Ginnie Mae should review the processes and procedures it used when issuers were their own paying agents. Even building off the procedures used during the first 25 years of the mortgage-backed security program, the establishment of program requirements, procedures, and processes will require Ginnie Mae to invest substantial resources.

Q: What authorities and support will Ginnie Mae need to bring the secured commercial paper to life?

A: Congress gave Ginnie Mae the authority to offer this program in the National Housing Act. The major barrier to this program is the need for the Biden administration to make the development and rollout of this program a high priority. The Biden administration will need to assure that Ginnie Mae receives the resources it needs to bring this concept to life.

Q: Will issuers having access to commercial paper to fund delinquent loans in their portfolio affect servicers' ability to help delinquent borrowers stay in their homes?

A: By giving servicers the ability to issue Ginnie Mae–guaranteed 12-month-maturity commercial paper to fund loans that are delinquent, servicers will be able to work with borrowers without being pressured to either bring the loan current or put the mortgage into foreclosure as soon as possible. Today, a servicer has limited resources to make required payments on the mortgage-backed securities that fund the delinquent loans. Servicers have only their principal and interest advances reimbursed when a borrower makes all their delinquent payments or when claims are paid by the FHA, VA, or RHS. Commercial paper will allow them 12 months to work with the borrower by offering forbearance or other loss mitigation strategies without having to make any payments to creditors. The commercial paper structure requires the issuer to make only principal and interest payments when the commercial paper matures.

IMBs are going to be the backbone of single-family mortgage lending for the foreseeable future. Policymakers need to implement financing structures that will allow IMBs to have the liquidity they need through all economic cycles. Historically, housing has led the economy out of recessions. For housing to lead us out of future recessions, we need to make sure lenders can support the financing of homes during economic stress. Ginnie Mae using its broad authority will allow the housing sector to be strong through all economic cycles.

About the Author

Ted Tozer is a nonresident fellow in the Housing Finance Policy Center. Immediately before joining Urban, he was a senior fellow at the Milken Institute's Center for Financial Markets. Previously, Tozer was president of Ginnie Mae for seven years, bringing with him to the institution more than 30 years of experience in the mortgage, banking, and securities industries. As president of Ginnie Mae, Tozer managed Ginnie Mae's nearly $1.7 trillion guarantees of mortgage-backed securities and more than $460 billion in annual issuance. He also led the modernization effort of the Ginnie Mae Securitization Platform. Tozer oversaw the transition for a depository-dominated issuer base to an independent mortgage banker–dominated base. He was the Obama administration point person for rewriting the Home Affordable Refinance Program. Tozer also oversaw the transition from the Ginnie Mae I program to the Ginnie Mae II program. Before joining Ginnie Mae, he was senior vice president of capital markets at the National City Mortgage Company (NCM) for more than 25 years, overseeing pipeline hedging, pricing, loan sales, loan delivery, and credit guideline exceptions. He was instrumental in transforming NCM from an originate-and-hold lender to an originate-and-sell lender. Tozer also serves on the board of directors of PennyMac Financial Services, a mortgage originator. He holds a bachelor's degree in accounting and finance from Indiana University.

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