



A Liquidity Vehicle for Mortgage Servicing Advances Is in Consumers' Best Interest

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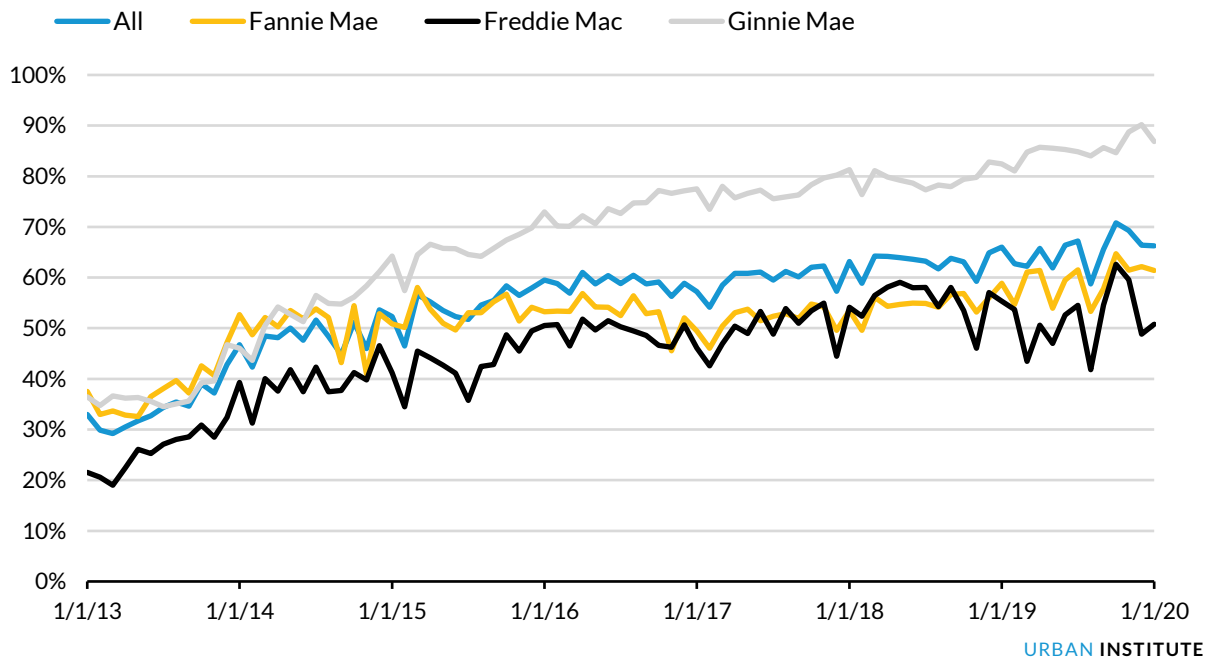
In response to the COVID-19 crisis, federal mortgage agencies have promptly rolled out mortgage forbearance for consumers facing hardships.¹ The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) codified this, allowing borrowers who cannot make their regular mortgage payments and who have federal (i.e., agency-backed) mortgages to seek up to 12 months' forbearance. The scale of these programs is monumental, covering 70 percent of all outstanding mortgages (33.4 million loans), with an unpaid principal balance of \$6.9 trillion. Forbearance programs provide relief to borrowers facing hardship, allowing for a temporary suspension of payments. Borrowers must repay these funds eventually, but in the interim, mortgage servicers are contractually required to keep making payments to the end investor. This obligation can create cash-flow problems for servicers, leading to liquidity crunch. If unresolved, many servicers will likely experience financial distress, causing insolvencies industrywide. Servicer failures at a time when struggling borrowers need assistance the most will have severe consequences for consumers and the entire housing finance system.

Why Do We Need a Liquidity Facility for Servicing Advances?

Regulations require servicers to keep a rainy-day buffer for delinquent advances, but these requirements vary (Kaul and Goodman 2016). Bank depository servicers often have larger buffers than nonbank servicers. Banks also have access to low-cost liquidity facilities via the Federal Reserve and the Federal Home Loan Banks. Nonbanks have access to neither and instead rely on bank-provided warehouse lines of credit, which can be terminated or repriced during economic downturns. At the same time, nonbank lenders and servicers play a large role in the agency mortgage market. In the years since

the last housing downturn, nonbanks have originated as much as two-thirds of all agency mortgages, with banks accounting for one-third.

FIGURE 1
Nonbank Originator Share, by Agency



Source: Urban Institute calculations based on eMBS data.

This creates a huge mismatch between the availability of federal liquidity facilities and the firms that need it the most. As more borrowers seek relief through the CARES Act’s forbearance in the coming weeks, servicers will quickly be on the hook for temporarily advancing tens of billions of dollars to investors while not getting paid anything.² According to a Mortgage Bankers Association (MBA) survey covering about half of all loans, 4.31 percent of Ginnie Mae borrowers and 1.69 percent of government-sponsored enterprise (GSE) borrowers received forbearance in March. This adds up to more than 1.7 million borrowers (MBA 2020). Absent a liquidity facility, many nonbank servicers will run out of money and face insolvency as the number of forbearance requests increases, turning the COVID-19 economic shock into a systemic mortgage market crisis. Ultimately, this will harm borrowers seeking assistance but will also have a broader economic impact, making it difficult to manage the current crisis and protracting recovery after the virus is contained. Two important points are worth noting:

- **Servicing failures will lead to poor loss mitigation and consumer harm.** Mortgage servicers are the first resource consumers reach out to when seeking mortgage assistance. A financially stressed industry will not be able to ramp up operations to meet increased demand. To the contrary, cash-starved servicers will cut expenses and reduce customer service to stay afloat, adversely affecting borrower outcomes. The potential for borrower harm is greater post-

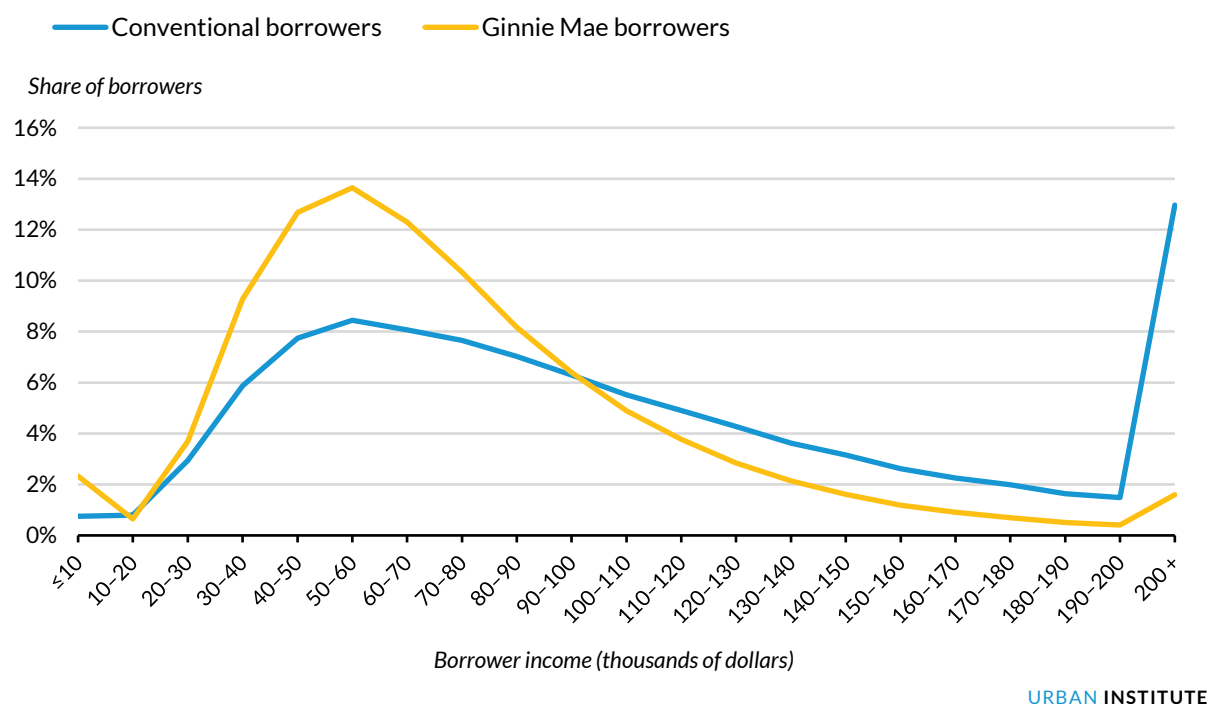
insolvency, as servicing is abruptly transferred to another firm amid the crisis. Borrowers seeking relief would face confusion and disruption. Servicing industry failures after the Great Recession in 2008 led to significant consumer harm via delayed assistance, wrongfully denied loan modifications, improper foreclosures, and distressed and blighted communities. This was often caused by loss of consumer data and documentation during servicing transfers, forcing distressed consumers to restart conversations with new servicers, resubmit lost documentation, or simply give up, especially when servicing was transferred repeatedly (Kaul et al. 2018). Although the postcrisis reforms put the industry on a stronger footing, the sweeping coverage of the CARES Act's forbearance is something that was never contemplated. We learned after 2008 the importance of acting promptly. We should apply those lessons now to ensure all borrowers can get the relief they need during this public health crisis.

- **Constrained credit availability.** Nonbank servicers are not stand-alone monolines. Most originate loans and specialize in lending to creditworthy low- and moderate-income borrowers (State Street and HFPC 2017). Nonbanks originate nearly 90 percent of all Federal Housing Administration (FHA), US Department of Veterans Affairs (VA), and US Department of Agriculture (USDA) mortgages. These borrowers are disproportionately more likely to be first-time homebuyers, people of color, and veterans. If one or more large servicers were to fail, origination capacity would be taken out of the system. Moreover, this issue is systemic, as all nonbank servicers face the same liquidity risk, making it unlikely that only one would fail. The result would be tight credit, which will make it difficult and more expensive for current homebuyers to refinance and for future homebuyers to obtain mortgages. First-time homebuyers and low-income households will be affected the most, as these are the least profitable loans to originate.

First-Time Homebuyers, Low-Income Households, and Minorities Will Bear the Brunt of the Crisis

Low-income borrowers, minorities, and first-time homebuyers tend to rely disproportionately on government-insured mortgages via the FHA, VA, or USDA, which are pooled into Ginnie Mae securities. Figure 2 shows the income distribution of Ginnie Mae and conventional borrowers in 2018. Fifty-four percent of Ginnie Mae borrowers (yellow line) had annual incomes below \$70,000, compared with 34 percent of borrowers with conventional loans (blue line). About 28 percent of Ginnie Mae borrowers had annual incomes below \$50,000, compared with only 18 percent of conventional borrowers.

FIGURE 2
Distribution of 2018 Borrower Household Income



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Source: 2018 Home Mortgage Disclosure Act data.

Note: Conventional loans include government-sponsored enterprise, portfolio, and other private loans.

Collectively, lower incomes, lower credit scores, higher loan-to-value ratios, and higher debt-to-income ratios put Ginnie Mae borrowers more at risk than conventional borrowers of experiencing hardship from COVID-19 and more likely than conventional borrowers to be adversely affected by servicer failures (State Street and HFPC 2020). Ginnie Mae borrowers are also more likely to be minorities. In 2018, 55 percent of mortgage lending to Black borrowers and 42 percent of mortgage lending to Hispanic borrowers was government-insured by the FHA, VA, or USDA, compared with only 26 percent of mortgage lending for white borrowers.

Early data on forbearance use support increased forbearance take-up for Ginnie Mae loans. As stated earlier, 4.31 percent of all Ginnie Mae loans serviced were in forbearance as of April 1, compared with 1.69 percent of GSE loans and 2.96 percent of private loans, per MBA data. Also, the share of loans serviced by nonbanks that were in forbearance was larger (3.45 percent) than it was for banks (2.24 percent).

Recognizing this crisis, Ginnie Mae recently announced an emergency pass-through assistance program for servicers of mortgages it guarantees, though full implementation details have not yet been announced. But only 11.3 million agency loans, or a third of the 33.4 million loans, are backed by Ginnie Mae. Moreover, the facility, though valuable, will likely not cover all advances that servicers make. That is, the servicer must advance not only principal and interest payments, which the facility would cover,

but also real estate taxes and homeowners' insurance payments, which the facility would not cover. In addition, the remaining 22 million loans backed by Fannie Mae and Freddie Mac are not covered by any similar program. The Federal Housing Finance Agency has announced there will not be a pass-through liquidity facility for GSE mortgages for now. Instead, the agency plans to transfer servicing from weak servicers to stronger servicers as needed. As discussed above, this often results in a period during which borrowers are in limbo and highly vulnerable to harm. Some experts have proposed a single Federal Reserve liquidity facility for all agency loans, which, if implemented effectively, would cover all agency mortgages.³

The nationwide forbearance relief provided by the CARES Act is essential in delivering immediate payment assistance to borrowers affected by COVID-19. But providing interim financing for these payments has now fallen to servicers, who were never set up for or expected to take on such a role. A liquidity facility to finance these payments must be made available quickly. Left unaddressed, this situation will quickly erode servicer finances in a matter of weeks, pushing many firms into insolvency and leaving vulnerable borrowers stranded at the worst possible time.

Notes

- ¹ Karan Kaul and Laurie Goodman, "The Price Tag for Keeping 29 Million Families in Their Homes: \$162 Billion," *Urban Wire* (blog), Urban Institute, March 27, 2020, <https://www.urban.org/urban-wire/price-tag-keeping-29-million-families-their-homes-162-billion>.
- ² Kaul and Goodman, "The Price Tag."
- ³ Gene Slater, Ted Tozer, and Stockton Williams, "A Federal Liquidity Solution for the Mortgage Servicing Industry," National Council of State Housing Agencies blog, April 1, 2020, <https://www.ncsha.org/blog/a-federal-liquidity-solution-for-the-mortgage-servicing-industry/>.

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About the Author

Karan Kaul is a senior research associate in the Housing Finance Policy Center at the Urban Institute. He publishes innovative, data-driven research on complex, high-impact policy issues to improve the US

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