During the Pandemic, Policymakers Should Maintain Forbearance but Fix Its Costs

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The pandemic has heightened the risk of delinquency and resulted in a tighter mortgage credit box. These nationwide outcomes make the Great Recession a natural analogy to the current crisis, but an assessment of the economic fundamentals of mortgage delinquency, unemployment, and house prices suggests that this crisis may more closely reflect a natural disaster such as Hurricane Katrina.

Compared with trends during the Great Recession, mortgage loans in the New Orleans metropolitan statistical area (MSA) post-Katrina were more likely to become 90 or more days delinquent but were also more likely to avoid foreclosure and return to being current. This partly reflects a quick recovery in the unemployment rate and continued house price growth, but policy tools to prevent foreclosure undoubtedly played a role as well.

Today, forbearance policy has helped delinquent borrowers remain in their homes. But it has tightened the credit box as well, which will have severe and long-term consequences. It will keep some homeowners from being able to refinance their mortgages to reduce their monthly payments, shorten their loan's period, or tap home equity to better weather this crisis. In addition, some renters who would be homebuyers will be locked out of homeownership. Black and Hispanic households will disproportionately feel the impact of a tighter mortgage credit box, potentially halting their progress toward economic security and widening the persistent racial homeownership gap.

About the Mortgage Markets COVID-19 Collaborative

Initially convened in March 2020 by the Urban Institute, the Mortgage Markets COVID-19 Collaborative (MMCC) brings together a wide range of experts and stakeholders who share data and discuss how the mortgage market's response to the current pandemic can ensure equity, inclusion, and sustainability for homeowners

The COVID-19 public health crisis has created wide-ranging disruptions and a fast-moving economic downturn, with job losses and consumer hardships that are rippling through housing markets and crippling the housing finance system. Congress has quickly passed stimulus packages, and the major federal housing agencies have enacted federal and state forbearance and foreclosure and eviction moratoriums to help homeowners struggling to make their mortgage payments during this pandemic. In addition, the Federal Reserve and the US Department of the Treasury are taking actions to bolster the housing market by buying mortgage-backed securities at unprecedented levels and creating vehicles to bring liquidity to the mortgage servicing system that supports more than 48 million homeowners with mortgages.

This crisis has the potential to be more disruptive and far reaching than the 2008 crisis, with different implications and ramifications, given its potential length, national scale, unemployment projections, and loss and default projections.

The housing crisis in 2008, natural disasters, and similar incidents have taught us that aligned, coordinated, and intentional engagement by mortgage industry, nonprofit, and consumer groups is critical to developing and implementing thoughtful, evidence-based, and effective policies and practices that will mutually benefit consumers and the mortgage industry.

The MMCC seeks to

- produce a shared repository of data, research, and policy proposals; and
- increase understanding among all participants of the existing data and research and of the concerns and perspectives of other industry and community stakeholders.

For more information about the MMCC or to see the list of collaborators and research assembled, visit the program page at http://www.urban.org/policy-centers/housing-finance-policy-center/projects/mortgage-markets-covid-19-collaborative.

Why Is Mortgage Credit Availability Tightening?

In response to the pandemic's economic impact, credit characteristics on mortgage originations have tightened. Between January and August 2020, the Mortgage Bankers Association's Mortgage Credit Availability Index showed an 18.8 percent tightening in Ginnie Mae loans and a 24.2 percent tightening in loans delivered to one of the government-sponsored enterprises (GSEs), Fannie Mae or Freddie Mac. Together, Ginnie Mae and the GSEs insure or guarantee more than 70 percent of the outstanding mortgages in the United States.

Tightening credit standards, largely caused by credit score overlays, reflect the risk of mortgage delinquency (Goodman et al. 2020a). The tightening standards have been observed on both purchase and refinance mortgages (table 1), although the extent of tightening on refinances has been more acute (Goodman and Neal 2020). In addition to a tightening of borrowing characteristics, some lenders will not accept applications for certain loan products, such as home equity lines of credit,[1] further curbing homeowners' access to their home equity.

TABLE 1

Share of Mortgages with FICO Scores below 700 and DTI Ratios above 40 Percent

	Ginnie Mae		Fannie Mae		Freddie Mac	
	Purchase	**Refinance**	**Purchase**	**Refinance**	**Purchase**	**Refinance**
Jan. 2019	44%	39%	9%	14%	6%	9%
Jan. 2020	38%	13%	6%	6%	5%	7%
Jul. 2020	36%	5%	5%	3%	4%	3%

Source: Urban Institute calculations based on eMBS data.
Note: DTI = debt-to-income.

This tightening of the credit box is largely caused by the penalty that ensues if a loan enters forbearance before it is delivered to either of the GSEs or to Ginnie Mae.[2] It also reflects the impact that forbearance has on the liquidity of many lenders—independent mortgage banks, in particular—and mortgage servicers (Kaul 2020). Conversations with industry experts suggest that lenders do not want to take the risk on borrowers with weak credit profiles. At the same time, low mortgage rates and record levels of housing equity have boosted refinancing demand, and tightening standards on refinance mortgages helps lenders better manage capacity (Goodman et al. 2019).

How Does the Current Crisis Compare with the Great Recession?

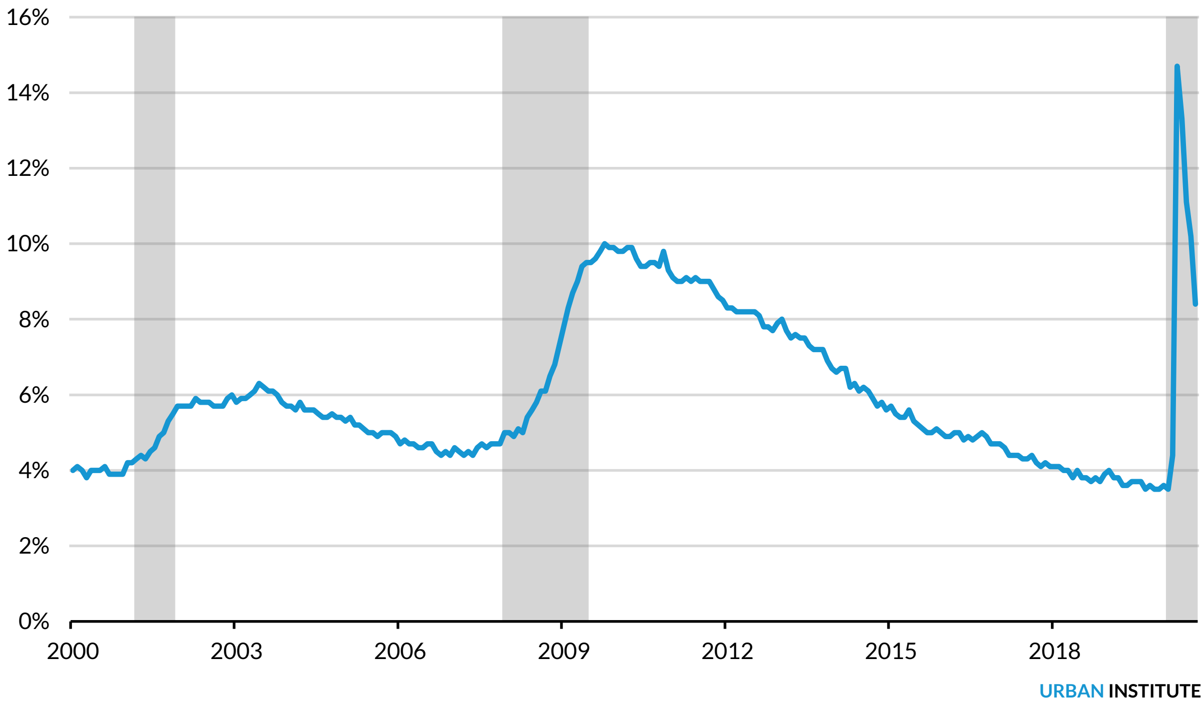
The 2003–06 housing boom was characterized by loose mortgage credit conditions that boosted home sales and cash-out refinances. The typical cash-out refinance during the boom period left the borrower with a higher mortgage rate in addition to using a portion of the home's equity.[3] The for-sale inventory reached record levels, partly spurred by the flurry of residential construction activity.

A housing bust resulted from a collapse in the for-sale housing market, which spread to financial markets and the broader economy. The mortgage credit box tightened considerably from greater borrower credit overlays while some mortgage products were no longer offered.[4] And tightening of credit was more severe for refinances than for purchase mortgages.[5]

During the Great Recession, the key economic determinants of mortgage delinquency—the unemployment rate and house price changes—showed significant stress, and many homeowners lost all their housing equity and even their homes to foreclosure. From November 2007 to October 2009, the unemployment rate rose from 4.7 percent to peak at 10.0 percent, according to the Bureau of Labor Statistics (figure 1).

Meanwhile, house prices fell. The S&P/Case-Shiller US National Home Price Index had begun to register year-over-year house price decreases in March 2007, and the pace of the declines had accelerated by December 2007, when the Great Recession began (figure 2).

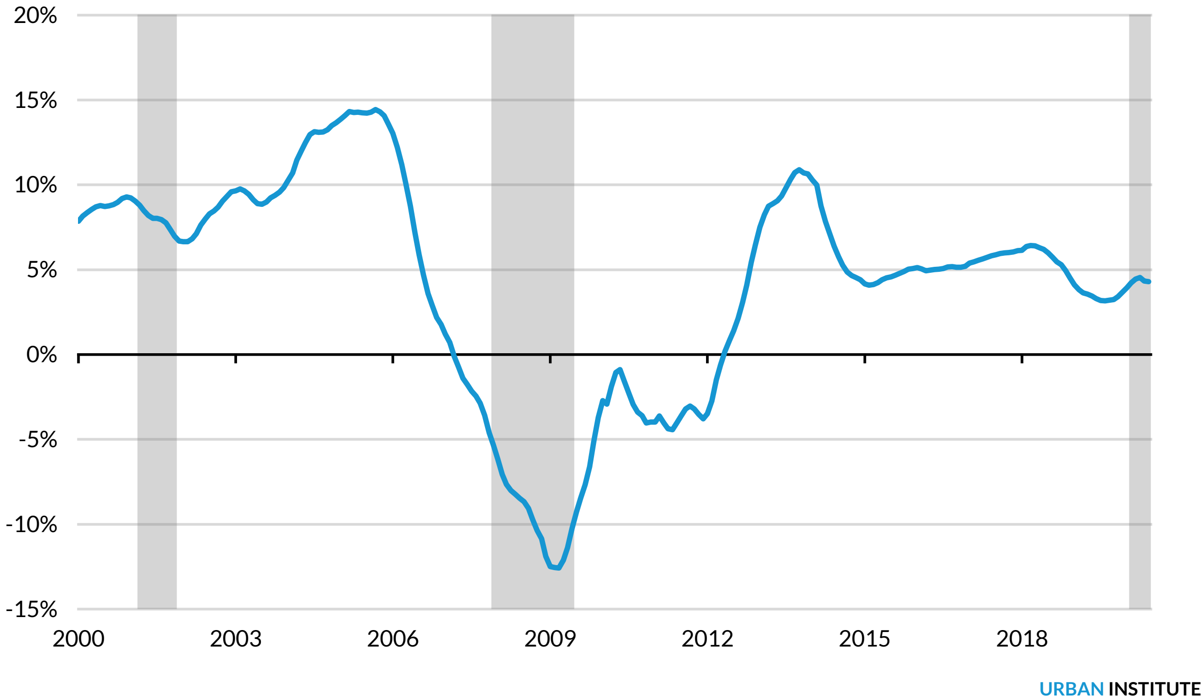
FIGURE 1
Unemployment Rate



Sources: Bureau of Labor Statistics and National Bureau of Economic Research.
Note: Gray bars indicate recessions.

FIGURE 2

Year-over-Year House Price Changes



Sources: Bureau of Labor Statistics and National Bureau of Economic Research.
Note: Gray bars indicate recessions.

Similarly, the unemployment rate has risen because of the coronavirus pandemic, but the increase has been sharper. According to the Bureau of Labor Statistics, the nationwide unemployment rate jumped from 3.6 percent in January 2020 to 14.7 percent by April. As of August, the unemployment rate had receded to 8.4 percent, but it remains historically elevated.

In stark contrast to what happened during the Great Recession, house prices during the pandemic continue to rise and have been broadly accelerating since October 2019. According to the S&P/Case-Shiller US National Home Price Index, house prices rose by 4.0 percent in January 2020, and the pace of growth quickened to 4.3 percent by June 2020. In October 2019, year-over-year house price appreciation was 3.2 percent. Continued house price appreciation has boosted housing equity to new highs (table 2).

TABLE 2

Home Equity and House Prices

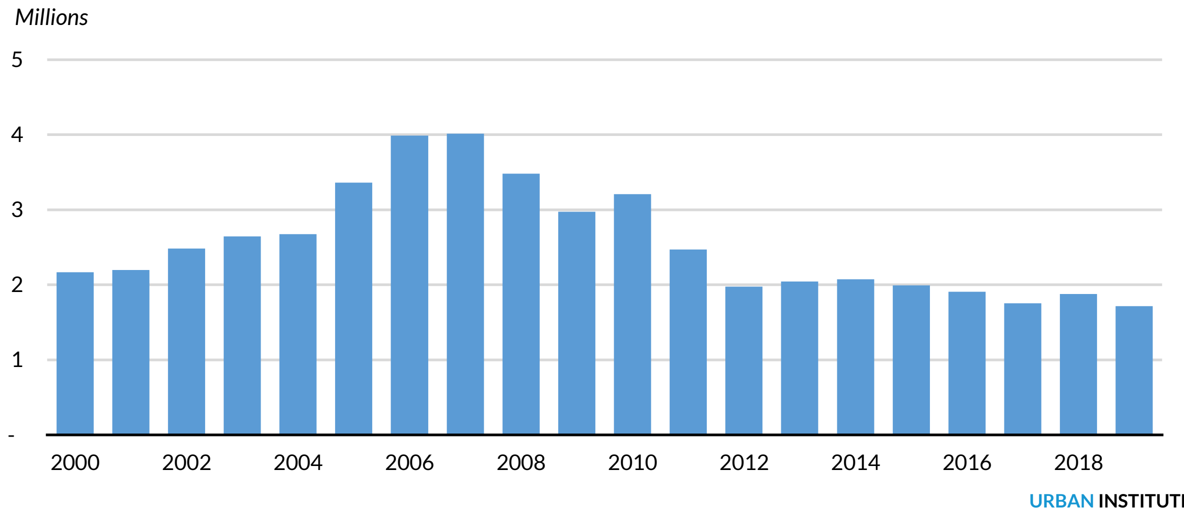
	Change in housing equity share of home values	Changes in house prices
2000–06	-2%	80%
2007–11	-22%	-26%
2012–19	40%	56%

Sources: Federal Reserve Board and S&P/Case-Shiller US National Home Price Index.

One key reason behind the difference in house price performance during the Great Recession, compared with today, is the amount of for-sale inventory. In 2007, there were 4.02 million existing and new homes for sale. In 2019, there were 1.72 million. The lower supply of homes entering the current crisis has helped support house prices.

FIGURE 3

Total Existing and New For-Sale Inventory



Sources: National Association of Realtors, US Census Bureau, and US Department of Housing and Urban Development.

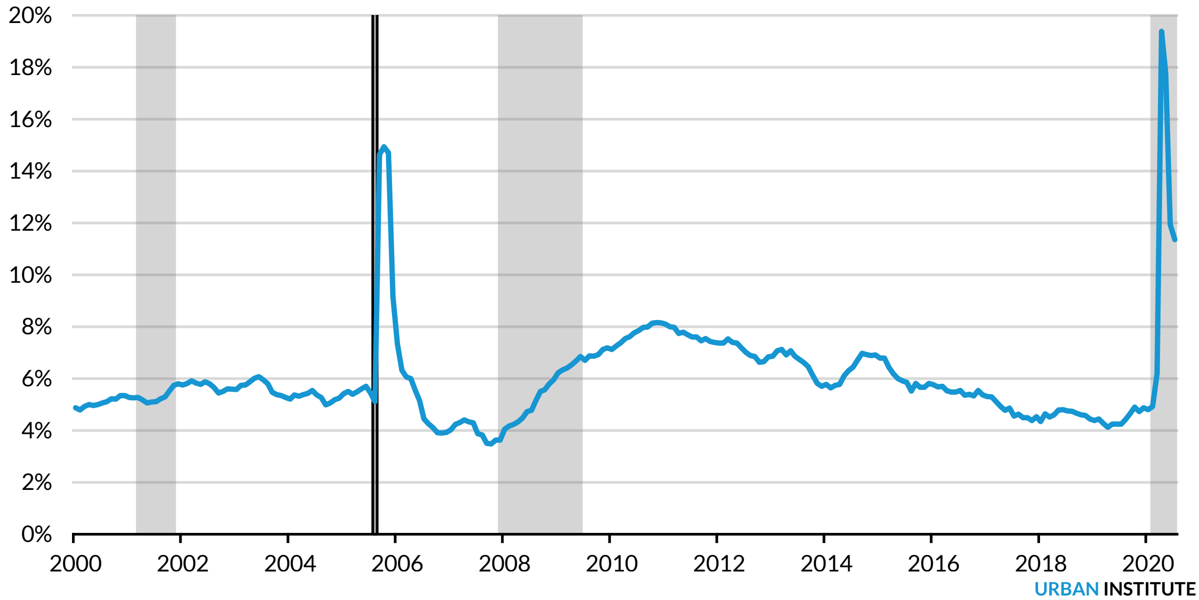
The Current Crisis Is More Similar to a Natural Disaster

Whereas the Great Recession was an economic and financial crisis largely brought on by a collapse in housing and mortgage markets, the current recession is the result of a health crisis and is, in important ways, more similar to a natural disaster.

For example, research suggests that the early spike in nationwide unemployment is more akin to the impact on New Orleans after Hurricane Katrina than to the Great Recession.[6] As mentioned earlier, the nationwide unemployment rate jumped in response to the pandemic from 3.6 percent in January 2020 to 14.7 percent by April, three months later. Similarly, in the New Orleans MSA, the unemployment rate rose from 5.5 percent in July 2005, just before Hurricane Katrina made landfall, to 14.9 percent in October 2019, three months later (figure 4).[7]

FIGURE 4

Unemployment Rate in the New Orleans Metropolitan Statistical Area

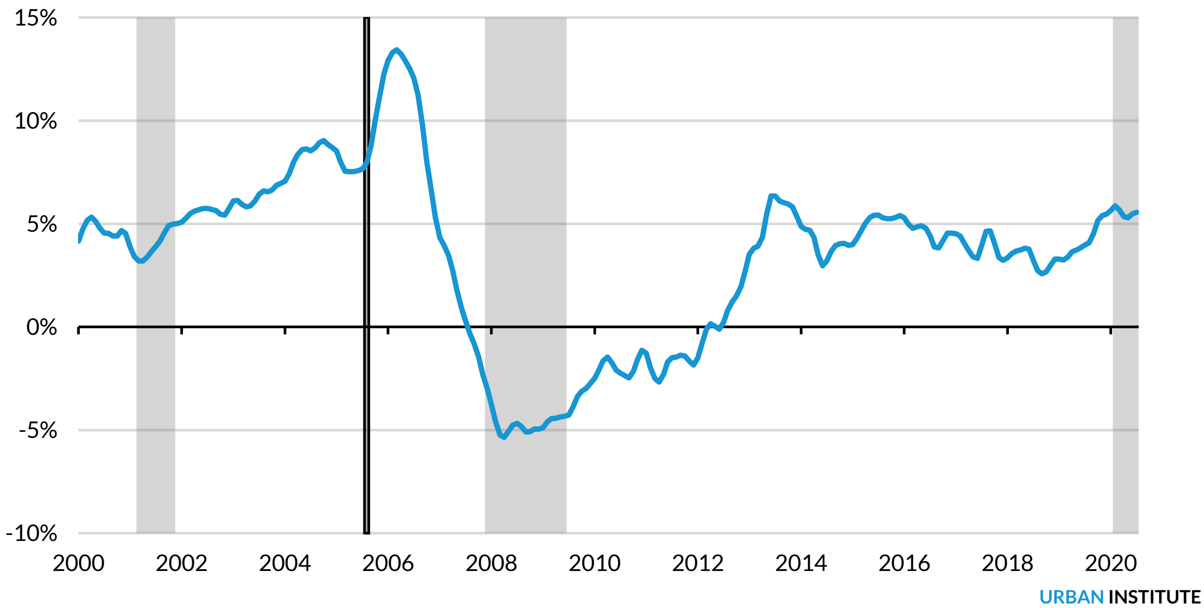


Sources: Bureau of Labor Statistics and National Bureau of Economic Research.

Notes: The vertical black line marks Hurricane Katrina. The gray bars indicate recessions.

FIGURE 5

Home Price Growth in the New Orleans Metropolitan Statistical Area



Sources: Freddie Mac and National Bureau of Economic Research.

Notes: The vertical black line marks Hurricane Katrina. The gray bars indicate recessions.

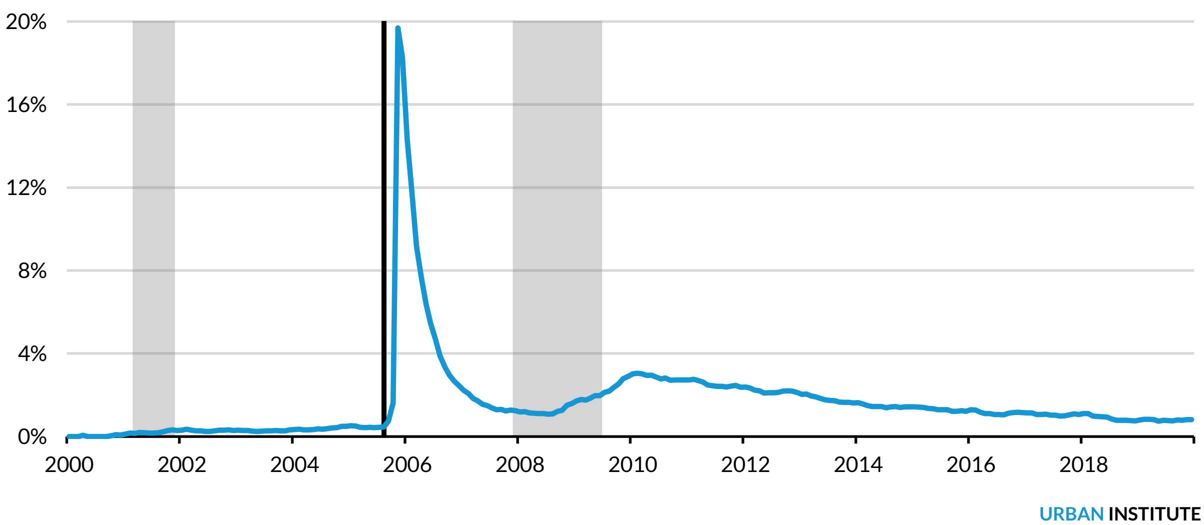
In addition, house prices across the New Orleans MSA were also rising just before Hurricane Katrina, echoing recent trends in house prices nationwide. Following Hurricane Katrina, house price growth in the New Orleans MSA accelerated, which may have reflected a smaller supply of residential housing because of the hurricane (figure 5).

Post-Katrina, Delinquency Rates Soared, but Foreclosure Rates Were Muted

Following Hurricane Katrina, the delinquency rate in New Orleans spiked. But few of these mortgages entered foreclosure. The quick recovery in the unemployment rate and continued house price appreciation, along with a moratorium on foreclosures, limited the conversion of delinquent mortgages to foreclosure. From October 2005 to November 2005, the share of loans that were 90 or more days delinquent rose from 1.6 percent to 19.7 percent. But the conversion rate (which measures the share of mortgages 90 or more days delinquent that converted to foreclosure) of these post-Katrina delinquent mortgages was only 4.2 percent.

FIGURE 6

Share of Loans That Were 90 or More Days Delinquent



Source: Urban Institute calculations from data from Fannie Mae, the National Bureau of Economic Research, and the Federal Emergency Management Agency.
Notes: The vertical black line marks Hurricane Katrina. The gray bars indicate recessions.

In contrast, most of Katrina-induced delinquent mortgages were likely to return to current. Of the estimated 10,615 mortgages that were 90 or more days delinquent following Hurricane Katrina, 95.6 percent of them cured. And the average time to cure was five months.

TABLE 3

90-Day Delinquent Loans in New Orleans

		Number of loans...					
Shock	D90+ start time	D90+	Going into foreclosure	Returning to current	Conversion rate	Cure rate	Cure time (months)
Hurricane Katrina	11/2005–12/2006	10,615	444	10,143	4.18%	95.55%	4.92
Financial crisis	9/2008–3/2010	1,240	514	708	41.45%	57.10%	15.04

Source: Urban Institute calculations of data from Fannie Mae.

Note: D90+ = loans that go 90 or more days delinquent.

Although the 90-day delinquency rate in the New Orleans MSA following the Great Recession rose as well, the increase was smaller and the peak was lower. But these loans were more likely to move into foreclosure and less likely to cure. Following the onset of the Great Recession, the 90-or-more-day delinquency rate on mortgages in the New Orleans MSA rose from 1.1 percent in September 2008 to 3.1 percent in December 2009. But of the mortgages that became 90 or more days delinquent between September 2008 and March 2010, when the delinquency rate began to noticeably decline, 41.5 percent of them shifted into foreclosure while only 57.1 percent of them cured. And the average cure time was 15 months.

These results indicate that mortgage performance was vastly different in the New Orleans MSA following Hurricane Katrina than it was during the Great Recession. The degree to which the COVID-19 shock more closely reflects a natural disaster, the post-Katrina results offer clues about mortgage performance. The comparatively better recovery in mortgage delinquency post-Katrina partly reflects the continued growth in house prices, which supported housing equity.

But these outcomes also corresponded with a quick recovery in the unemployment rate as the effects of the disaster subsided. Although the unemployment rate has recovered much of its trough-to-peak increase since May, macroeconomic policymakers believe it will remain elevated for duration of 2020.[8] And the unemployment rate for people of color would likely be even higher for the rest of this year. Forbearance was not widely used, but other policy measures (e.g., eviction moratoriums) gave mortgaged homeowners the opportunity to keep their homes (if they were not destroyed by the hurricane) and recover from delinquency.[9]

Today's Tighter Credit Box Has Important Implications for Households of Color

Homeownership is key to wealth accumulation and economic stability. But only 42 percent of Black households and 48 percent of Hispanic households are homeowners while 72 percent of white households are homeowners. Research suggests that credit score disparities are a key reason behind the wide racial and ethnic homeownership gaps (Choi et al. 2019). All else equal, more stringent credit availability will keep the racial and ethnic homeownership gap wide by disproportionately hindering some would-be homebuyers of color from achieving homeownership and locking in today's low mortgage rates.

In addition, credit score disparities will also disproportionately keep homeowners of color from being able to refinance and reduce their mortgage payments or shorten their loan's duration. And amid evidence that some homeowners of color have experienced faster house price appreciation than their white counterparts (Pew 2015), tighter credit availability on refinances and restrictions on home equity lines of credit will bar many of them from accessing their housing equity to better weather this crisis. As a result, fewer households of color will be able to obtain the benefits of homeownership, limiting their ability to further their economic security.

Public Policy Should Continue Its Forbearance Policy While Fixing Its Costs

Public policy should continue to focus on helping all homeowners remain in their homes. Helping families maintain homeownership will help them maintain stability through the crisis and better position them for the recovery. Eviction moratoriums and forbearance have so far helped homeowners keep their homes during this crisis.

Although nationwide forbearance has helped many homeowners, including the most credit constrained, remain in their homes, research suggests that the timing of forbearance has been the significant factor behind the pandemic-induced credit tightening (Goodman and Neal 2020; Goodman et al. 2020b). Both the GSEs and the Federal Housing Administration (FHA) have imposed penalties on loans that go into forbearance before they can be sold.

To lower the probability of incurring these costs, lenders have tightened standards by imposing additional overlays on top of the agency credit box. These higher standards have impaired access to homeownership, finally attainable to many in a low-rate environment, and made it more difficult for many more households to lower their mortgage payments or access their home equity. These effects have unintended consequences, especially for homeowners of color, who are disproportionately more likely to be unemployed and have government-backed loan products, such as FHA loans.

Both the Federal Housing Finance Agency and the FHA have extended foreclosure moratoriums and additional actions have already been taken to soften the impact of forbearance,[10] but more is needed to address the mortgage credit impact from penalties on forborne loans delivered to the GSEs or the FHA. First, all newly originated agency loans should be sold or insured by the loan's first payment due date without incurring a penalty. And second, servicer delivery of a forborne loan that has sat in a portfolio past the first payment due date but remains current should also not trigger a fee. These steps remain consistent with policies barring agency purchases of already delinquent loans, and they also account for the number of loans in forbearance that are current. And these steps will limit the negative implications of forbearance for the mortgage credit box and help relevel the playing field of sustainable homeownership.

Conclusion

The pandemic-induced crisis is, in many ways, the worst on record. Hurricane Katrina was also a catastrophic event that upended lives and damaged property. Similar to the current pandemic, people of color were disproportionately affected by Katrina's effects.

Mortgage performance following Hurricane Katrina suggests that even though a shock similar to a natural disaster may increase delinquencies, public policy can mute its impact on foreclosures. Foreclosure moratoriums and institutional forbearance have helped homeowners keep their homes. But forbearance policy has also contributed to a tightening of the mortgage credit box, which has kept many homeowners from accessing housing equity or low mortgage rates. And some potential homebuyers are locked out of homeownership.

In debating the extension of forbearance as part of a broader package, policymakers should recognize its benefits while working to curb its costs. Doing so will bring additional economic security to many households and positively position them when the recovery begins.

Notes

1 Peter G. Miller, "As HELOC Availability Disappears, Alternatives for Homeowners Who Need Cash," Bankrate, July 16, 2020, https://www.bankrate.com/mortgages/heloc-alternatives-when-lenders-pull-back/.

2 Mortgage Bankers Association, "Mortgage Credit Availability Decreased in June."

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4 "Housing Credit Availability Index," Urban Institute, Housing Finance Policy Center, last updated July 21, 2020, https://www.urban.org/policy-centers/housing-finance-policy-center/projects/housing-credit-availability-index.

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6 Jason Bram and Richard Dietz, "The Coronavirus Shock Looks More Like a Natural Disaster Than a Cyclical Downturn," *Liberty Street Economics* (blog), Federal Reserve Bank of New York, April 10, 2020, https://libertystreeteconomics.newyorkfed.org/2020/04/the-coronavirus-shock-looks-more-like-a-natural-disaster-than-a-cyclical-downturn.html.

7 "Historic Disasters–Hurricane Katrina," Federal Emergency Management Agency, last updated July 17, 2020, https://www.fema.gov/disasters/historic/hurricane-katrina.

8 "September 16, 2020: FOMC Projections Materials, Accessible Version," Board of Governors of the Federal Reserve System, Federal Open Market Committee, June 10, 2020, https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20200916.htm.

9 See Fannie Mae (2017). Fannie Mae points out that forbearance was not extensively available for Hurricane Katrina.

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