Due to the pandemic, the past several weeks have witnessed enormous turbulence in the U.S. residential mortgage market.

In early March, equity investors began a flight to safety, sending bond yields plunging and creating an instant refinancing boom in the mortgage market. Indeed, mortgage rates fell to as low as three percent, the lowest since 1971, according to Freddie Mac.

Mortgage applications and the refinancing index increased to their highest levels since 2009, according to the Mortgage Bankers Association (MBA). And the MBA raised its forecast for total annual originations to $2.61 trillion, or 20 percent more than in 2019. All this activity quickly filled lender pipelines to capacity.

Then, in mid-March, bond markets locked up and sent mortgage rates soaring. A few reasons behind this development: 1) the secondary market maxed out its ability to buy mortgage-backed securities (MBS); 2) equity investors fleeing the stock market began to move their money to cash instead of bonds; and 3) some lenders priced up new loans to slow down refi volume they could not process.

These developments prompted the Federal Reserve to try unlocking these markets. In early and mid-March, the Fed cut rates by a whopping 150 basis points in two separate actions and made purchase commitments of up to $500 billion in Treasuries and $200 billion in agency MBS (a term that mostly refers to securities issued by Fannie Mae and Freddie Mac). However, bond markets did not respond to these actions and kept rates high.

Then, in late March, the Fed increased its purchase commitments to an unlimited volume
of Treasuries and agency MBS, as well as providing aid to commercial and municipal bond markets. Bond investors reacted favorably this time and sent mortgage rates lower, although not (yet) to previous lows.

**A Market with Heightened Risks**

In this environment, there are several risks to consumers and industry, such as:

- Lenders being unable to absorb new originations
- Consumers losing the ability to lock in at favorable rates and become more vulnerable to refi scams
- Lenders being unable to meet margin calls on pipeline hedges
- Mortgage servicers being forced to write down the value of mortgage servicing rights (MSR) and unable to meet margin calls on MSR credit facilities, due to lower collateral values

Particularly vulnerable: nonbanks. These non-depositories originate roughly two-thirds of all new home loans today and service nearly half of all existing ones. But nonbanks rely heavily on warehouse lines of credit or other facilities. And some have lower capital cushions and potentially insufficient liquidity.

Then, we saw an historic spike in unemployment related to the pandemic. And the risks just multiplied by a factor of many. For instance, more consumers will not be able to make their monthly payments and become even more vulnerable to loan modification or refi scams as well as the broader economic harm from the loss of income.

At the same time, more servicers will be tasked with administering higher loan delinquencies and foreclosures in their servicing books. And yet, these servicers will still be obligated to advance delinquent principal and interest to bond holders. Moreover, more servicers will be challenged with hiring staff for both originations and loss
Now, an important point to keep in mind is that the mortgage market today is in a very different position that during the last nationwide financial crisis in 2008-09.

Then, the mortgage market was the leading cause of the financial crisis, chiefly due to a huge volume of subprime and non-traditional mortgages on which many consumers could not sustain monthly payments and resulted in the largest volume of home foreclosures since the Great Depression.

In the years since, though, regulations and market practices have resulted in a shift to more conventional loans that are better underwritten, with higher credit quality, and reflecting a borrower's ability to continue making payments on the loans.

Net homeowner equity also is much improved. During the 2008-09 crisis, homeowners collectively were underwater: their mortgage debt was roughly $4 trillion higher than their home equity, according to the Urban Institute; today, the opposite is true, with net homeowner equity in the positive by roughly $6 trillion.

But there are still a lot of unknowns on how the current crisis will play out. That is why financial regulators are stepping in to help.

**Regulatory Actions**

Regulators are tasked with the jobs of ensuring the safety and soundness of the financial system as well as protecting consumers. State regulators share these mandates as well as one to support local economies. Given these mandates, financial regulators and other government agencies are taking actions to stabilize markets and consumer finances by preventing foreclosures and supporting refis.

At the federal level, the Federal Housing Finance Agency (FHFA), through Fannie Mae and Freddie Mac, has authorized servicers to offer streamlined processing of
forbearance plans for up to 12 months. The U.S. Department of Housing and Urban Development, through the Federal Housing Administration (FHA), has encouraged its servicers to offer its suite of loss mitigation options to distressed borrowers, including short- and long-term forbearance.

In addition, Fannie and Freddie have suspended all foreclosure sales and evictions for 60 days, beginning March 18. And the FHA has suspended initiation of foreclosures and foreclosure sales for 60 days on FHA-insured loans, also beginning March 18. FHFA also has relaxed certain rules to allow Fannie and Freddie to purchase more refi loans.

Of course, homeowners are only one part of the housing equation. For renters, FHFA has granted forbearance on multifamily borrowers -- think property owners -- if they forgo evictions. And the FHA has suspended evictions for 60 days on properties secured by FHA-insured single family mortgages, beginning March 18.

At the same time, state financial regulators have begun taking actions that complement federal moves. In our financial regulatory system, state regulators are the primary oversight mechanism for the mortgage industry through the use of licensing and supervisory powers.

Accordingly, state regulators are actively encouraging servicers to grant loan forbearance, where possible.

For instance, in New York, the Governor and regulator have ordered 90-day forbearance on mortgages that are not federally-backed. California has extended forbearance relief to 90 days for mortgages held by several national banks and servicers, credit unions and hundreds of state-chartered banks. Washington State also has extended forbearance to 90 days and, if necessary, given consumers and mortgage servicers flexibility to modify their loans. Maryland has halted all foreclosure proceedings indefinitely. More states have taken action as well.

In addition, state regulators are adjusting requirements to accommodate the need for
originators to conduct business from home. To protect consumers, state regulators are conducting awareness programs on how to detect and avoid financial scams. New York also is eliminating fees for ATM withdrawals, bank overdrafts, and credit card late fees for consumers experiencing financial hardship due to the pandemic.

Lastly, state and federal regulators are working together to achieve market stability. They are collaborating to support market liquidity and working directly with servicers to understand their operational and financial conditions. CSBS has called on the Federal Reserve to create a credit facility so mortgage servicers can support their borrowers, fulfill their contractual obligations to investors, and retain adequate access to capital and liquidity in doing so. Such a credit facility would be especially important to nonbank servicers.

In summary, the mortgage market is experiencing enormous turmoil. The financial impact of the pandemic is damaging to consumers and industry, especially those who become unemployed. To help stabilize markets and protect consumers, financial regulators at the federal and state levels are taking aggressive actions. And with regulators continuing to monitor the situation, expect to see further actions in the days and weeks ahead.