Mortgage Forbearance Requests are Manageable...For Now

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By Kevin Byers, CSBS Senior Director of Nonbank Supervision and Enforcement, and Thomas F. Siems, Ph.D., CSBS Senior Economist and Director of Research

Following the COVID-19 pandemic and subsequent economic lockdown, one question on the minds of bankers, mortgage service providers, investors, regulators and policymakers is: Will Americans be able to continue to pay their mortgages?

Given that over the past three months, total nonfarm payroll employment has dropped by about 20 million employees and the unemployment rate has increased from 3.5% to 13.3%, this appears to be a legitimate and genuine concern. While it is too early to gauge the long-term impact, recent data show that mortgage forbearance requests have stabilized and are manageable...for now.

When mortgage borrowers cannot make their required payments, lenders may eventually opt to foreclose on the loan. But to avoid this costly and oftentimes messy process and help borrowers get back on their feet, a loss mitigation option for hardships deemed temporary in nature is a forbearance plan: an agreement that allows a borrower to pay less than the full contractual monthly payment due on their mortgage or to suspend monthly payments entirely during the forbearance period.

Because of potential COVID-19 related hardships, in late March 2020, Congress passed and President Trump signed the CARES Act into law. This Act provides for streamlined mortgage forbearance that allows borrowers in federally backed mortgages up to 12 months of forbearance upon assertion of a COVID-related hardship regardless of delinquency. Servicers of loans in private portfolios and private-label securities followed suit with similar programs, though non-CARES Act forbearance programs are much less...
uniform and often shorter in length.

According to survey data from Black Knight Financial Services, of the approximately 4.7 million borrowers on a forbearance plan, 3.4 million are in a loan that is “federally backed,” or owned, insured, or guaranteed by a government-sponsored entity (GSE) or unit of government and thus covered by the CARES Act. Total loans in forbearance represent approximately 9% of all mortgage loans and just over $1 trillion of unpaid principal balance within the roughly $11 trillion mortgage market.

As noted, the CARES Act allows borrowers in covered mortgages to request forbearance regardless of delinquency and upon the assertion of a COVID-related hardship. Data from the Mortgage Bankers Association (MBA) indicates that the vast majority of loans now in forbearance were not prior to the onset of the COVID-19 crisis. (In fact, the MBA’s weekly survey notes that only 0.25% of all loans were in forbearance as of March 2, 2020).

Mortgage servicers have advancing obligations in varying degrees to pay principal and interest to investors in agency mortgage-backed securities, as well as for any real estate taxes or hazard and flood insurance premiums that cannot be covered by escrow balances. As a result and given the length of CARES Act-required forbearance plans, cashflows and liquidity needed to fund these obligations may strain nonbank servicers. Earlier this month, Black Knight Financial Services estimated that the advancing requirement for all servicers of federally backed loans will total $5 billion monthly plus another $2.8 billion for non-federally backed loans (those in portfolios or private-label securities).

Despite these daunting numbers, there are mitigating factors that appear to have helped keep these challenges manageable, at least for the time being. As shown in the nearby chart, the number and percentage of mortgages in forbearance increased significantly in late March and early April as the first wave of layoffs commenced following the unprecedented lockdown of many segments of the economy. Since early May, however, growth in new forbearance plans has leveled off considerably. And by June, the number
and percent of homeowners in forbearance plans appears, at least for now, to have stopped growing and actually begun to decrease across all categories of loans.

Two additional factors have helped mortgage servicers manage the potential liquidity strain:

1) Booming refinancing volumes and wider origination margins have boosted mortgage company cashflows even through the onset of the COVID-19 crisis. High levels of prepayments have also boosted excess custodial funds temporarily available to mortgage servicers to fund principal and interest advancing obligations for GSE and Ginnie Mae loans.

(Prepayments from refinancing and home sales result in custodial fund balances that do not have to be remitted to investors until the subsequent month. The GSEs and Ginnie Mae allow servicers to use these float balances to temporarily fund shortfalls of principal and interest from month to month, which relieves liquidity pressure on servicers.)

2) Borrowers in forbearance have continued to make full or partial payments: Black
Knight Financial Services reports that for borrowers on forbearance plans, 46% made their April payment, 22% made their May payment, and roughly 10% have made their June payment.

While these numbers and percentages of borrowers in forbearance are nowhere near those originally projected at the onset of the COVID-19 crisis, these borrowers will still present potential challenges to servicer operational capacity for loss mitigation when forbearance terms end. Managing the liquidity requirements of advances could also prove challenging in the longer run as tax and insurance payments become due, though many factors will influence the ultimate cost and ability of mortgage servicers to fund these obligations.

While borrowers in forbearance are not being reported to credit bureaus as delinquent, for investor reporting they are counted in a delinquency bucket (30 days past due, 60 days past due, etc.). As of the end of April, data from Black Knight Financial Services show where delinquencies across the industry are hitting the hardest and where mortgage industry participants and state regulators can expect greater challenges due to the higher relative levels of consumer distress. While every state has seen an increase in delinquencies from January to April 2020—the national average of 30-60-90+ delinquencies increased from 3.2% to 6.4%—some states are clearly being hit harder as seen in the maps below.

Southern states generally had higher than average delinquency levels both before and after the onset of the COVID-19 pandemic, but other states—notably Nevada, New Jersey, New York, Florida, Hawaii, Alaska, Connecticut, Georgia, California, Louisiana and Maryland—had disproportionate increases in their share of delinquent loans relative to the rest of the country (defined as percentage point increase 50% or more higher than the median increase for the country).
While borrowers and lenders are still in the early innings of the COVID-19-related impact on continuing payments, the geography of delinquency and forbearance will greatly impact the mortgage industry as well as the economic landscape of communities, states and regions.