“You can be sure that the American spirit will prevail over this tragedy.”

— Colin Powell, addressing the developing events of September 11, 2001

In this week’s Examiner, we're revisiting some of our most read coverage of the COVID-19 pandemic and its economic effects throughout the spring and summer.

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Mortgage Forbearance Requests are Manageable…For Now

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.

COVID-19 and the Value of Community Banks

By Thomas F. Siems, Ph.D., CSBS Senior Economist

The potential economic impact from COVID-19’s spread into the United States has unsettled community bankers across the nation. Responding to CSBS’ first quarter 2020 survey used to compile the Community Bank Sentiment Index (CBSI), community bankers judged that business conditions and profitability will be significantly worse in the future as an unprecedented number of companies suspend economic activity. Not only have concerns over economic disruptions been felt on Wall Street, but many Main Streets across America have turned into ghost towns in a very short time.

Overall, for this survey, the CBSI dropped an alarming 32 points from an index reading of 123 last quarter to 91 currently. As shown in the chart below, six of the seven components that make up the index declined, with five components plummeting more than 35 points each. The three components with the lowest index readings include business conditions, falling 37 points from 97 to 60; profitability dropped 43 points from 109 to 66; and monetary policy dove 39 points from 108 to 69. Even with these momentous falloffs, there is some good news in this survey. Community bankers maintain a positive sentiment, albeit by not as much as in the previous survey, to expand operations, increase capital spending, and boost franchise value.
What industries are community bankers most concerned about? Our survey included a special question asking bankers to provide an outlook for each of 10 economic sectors, ranging from 1 (negative) to 5 (positive). The overall scores using this 5-point Likert scale are shown in the chart below, with the sectors ranked from the highest, or best outlook, to the lowest, or worst outlook.

Community bankers are clearly most concerned about future economic activity in the energy sector and “high-touch” service industries like tourism, restaurants and retail. And based on the recent monthly payroll employment report and the last two weeks of initial jobless claims, the outlook does indeed seem to be bleakest in these sectors as businesses and consumers learn to adjust to an economy that is, in many ways, shutdown.
Because our survey accepted responses throughout the month of March, we were able to also track the responses on a weekly basis and found some revealing trends in bankers' outlooks for the various economic sectors. The middle of March—say March 11, when the WHO declared COVID-19 as a global pandemic and many U.S. businesses began postponing and cancelling scheduled events—marks a clear turning point in how bankers reassessed the negative impact from the spread of COVID-19. The chart below shows how bankers judged each of the 10 economic sectors included in our survey on a weekly basis. As shown, the outlook for every economic sector deteriorated during the month across the board, but most significantly for consumers (down 1.65 on the Likert
Our economy depends heavily on the health and confidence of consumers. Gross Domestic Product (GDP) is the value of all final goods and services produced in the economy. In the United States, 70% of our GDP comes from consumption. Without a strong, confident, active consumer, our economy will continue to struggle. But, of course, consumers rely on businesses, both large and small, to provide them with the goods and services they most desire and need. Yet with most businesses forced to shutter, or significantly scale-back operations, revenues have stalled, and cash flow problems have intensified.

And this is where the banking industry can step in and help. I have been greatly encouraged by stories from my friends who are community bankers. For them, this is a great opportunity to help their customers, especially small businesses in their
COVID-19 will end. The economy will recover. In the meantime, as we all navigate the fires of hell from COVID-19’s economic destruction, celebrate and thank your local community banker for helping bridge the gap.

COVID-19 Infects U.S. Financial Markets

By Thomas Siems, CSBS Senior Economist and Director of Research

On Jan. 11, 2020, China reported the first known death from the novel coronavirus, now known as COVID-19. At the time, the Dow Jones Industrial Average (DJIA) Index of 30 large companies based in the United States stood at 28,824, still 2.5% below the peak level of 29,551 that it would eventually reach one month later. As of this writing, the Dow has been down more than 30% since it peaked on February 12, just five weeks ago. Moreover, the 10-year constant maturity Treasury Note, which was trading around 1.8% at the beginning of the year, has seen its yield drop to record lows below 1%, even trading below 0.5% in early March.

The nearby chart presents a timeline of when COVID-19 seriously infected these U.S. financial markets. As shown, the Dow continued to advance following news of China’s first known death from the virus, after the first case was confirmed in the U.S., after the World Health Organization (WHO) declared a global health emergency, after President Trump declared a national health emergency and banned travel with China, and after the Diamond Princess cruise ship carrying more than 3,700 people was quarantined in Japan. But in mid- to late-February, once COVID-19 cases emerged and subsequently surged in Italy, South Korea and Iran, and cases outside of China exceeded those within its borders, equity and bond markets both collapsed.
On February 29, the first U.S. patient died from COVID-19 in Washington state. And in early March, the Federal Reserve announced a 50-basis point reduction in the Federal Funds rate, in recognition that COVID-19 had, in effect, “mutated” to infect U.S. financial markets. A few days later, the WHO reported that COVID-19 has a much higher death rate than seasonal influenza and declared a global pandemic. Shortly thereafter, U.S. professional sports leagues, colleges and universities, conferences and concerts, and other events were postponed and cancelled across the nation. Businesses and schools were encouraged to allow telecommuting where possible, cancel/reschedule events, and temporarily close operations where large groups can gather. Additionally, U.S. residents were encouraged to stay at home and not congregate in large groups.

In the past week, as equity markets have fallen further and funding markets strained, the Fed has unleashed several actions intended to provide liquidity to banks and businesses. The Fed dropped the Fed Funds rate to near zero percent, and as “the lender of last resort” they reinstituted several 2008-09 financial crisis era programs to further support
smooth market functioning and facilitate the availability of credit to businesses and households. Moreover, fiscal policymakers have also recognized the need to help businesses and households and are actively working on legislation to provide emergency economic stimulus to the parts of the economy most in need.

The protective health measures encouraged by the government—designed to decrease the rapid spread of the virus and ease pressures on the U.S. healthcare system—has significantly transformed the way Americans interact, work and play. The short-term consequences have resulted in airlines significantly curtailing flight schedules; retail outlets, restaurants, bars, casinos and theme parks closing; and manufacturers and energy firms shuttering.

While it seems very likely that the U.S. economy has fallen into a recession, we lack official statistics to accurately assess the condition of the economy in real-time. But the recent magnitude of market intervention by fiscal and monetary policy authorities is clearly an attempt to lessen the impact on economic actors during this extensive “pause” in activity in many sectors of the economy.

So where will the U.S. economy and financial markets go from here? How much damage will COVID-19 do to the economy and how long will it continue to infect financial markets? I wish I knew. Because COVID-19 is highly contagious, more deadly than seasonal influenza, and has a longer incubation period than many viruses, no one really knows how long this will last. But I am confident we will all get through this together. Our nation and people are resilient. Take care of yourself. And take care of others.

What Is Happening in the Mortgage Market?
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 mitigation.

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.

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COVID-19 Ravages U.S. Employment

*By CSBS Senior Economist and Director of Research Thomas Siems*

If you thought last week’s 3.3 million initial weekly jobless claims were extraordinarily extreme, the 6.6 million individuals added to the unemployment rolls for the most recent week ending March 28 are astronomical (see Chart 1). According to the U.S. Department of Labor, nearly 10 million Americans filed for unemployment insurance over the last two weeks. By comparison, during the 2008-09 financial crisis, the U.S. economy lost 8.7 million jobs. Let that sink in. More people have been removed from payrolls in the last two weeks than the number of jobs lost over two years during the nation’s most severe recession since the Great Depression of the 1930s.
Like I did in last week’s blog, using only the new initial claims data from the past two weeks, a rough calculation suggests the U.S. unemployment rate would immediately rise from its February level of 3.5% to roughly 9.6% today, an increase of 6.1 percentage points. USA Today estimates that 36 states have some kind of “stay-at-home” order in place, affecting nearly 90% of the population. The spread of COVID-19 has led to the closing of many nonessential businesses which has resulted in an overwhelming number of employee layoffs.

The impact on employment has been felt across all 50 states and the District of Columbia. As an update to last week’s blog, I add one additional chart to show the expected immediate impact on state-level unemployment rates using the March 28
numbers. Chart 2 shows the state-level unemployment rates for January 2020, before COVID-19 was generally considered a major concern; Chart 3 shows the potential unemployment rate for each state projected by factoring in last week’s (March 21) initial jobless claims data; and Chart 4 shows the potential unemployment rate for each state projected by factoring in this week’s (March 28) initial jobless claims data. Chart 5 shows the expected change in the state-level unemployment rates between January 2020 and today.
Based on these calculations, through March the states with the largest projected increases in state-level unemployment rates are expected to be Pennsylvania (4.7% to 16.7%), Rhode Island (3.4% to 14.8%), Nevada (3.6% to 14.2%), and Michigan (3.8% to 12.7%). These four states are also projected to be among the five states with the highest unemployment rates, along with Louisiana which is expected to rise from 5.3% to 13.4%. For the most populous states, the projected unemployment rate increases are as follows: California (3.9% to 9.3%), Texas (3.5% to 6.5%), Florida (2.8% to 5.7%) and New York (3.8% to 8.5%).

Earlier this week, President Trump extended his administration’s COVID-19 social distancing guidelines to go through April 30. As a result, and because the number of COVID-19 cases and deaths continue to rise, the economic pause around the world will continue and we should expect higher unemployment rates still to come. Some estimates for the overall U.S. unemployment rate run as high as 32%, above the peak rate of 24.9% in 1933 during the Great Depression. An unemployment rate of 25% today would result in layoffs of nearly 38 million Americans, returning the total number of U.S. jobs back to 1994 levels.

But if there is any good news it is that going into this crisis the economy was doing reasonably well. Indeed, just over a month ago the major stock indices were hitting all-time highs, the U.S. unemployment rate was at a 50-year low, and the economy added more than 270 thousand jobs. With this foundation and swift action by monetary and fiscal policymakers, many economists expect the downturn to be followed by a quick and strong recovery. Of course, that remains to be seen because the open question is “how long will this go on?” which no one can clearly answer.

Even so, I remain confident that as a nation we will come through this stronger and better. It has been awe-inspiring as individuals and businesses step up to face the challenge we are all experiencing. Continue fighting this invisible enemy. Take care of yourself and take care of others.
My thanks to Brennan Zubrick and Jake Vick on the CSBS Data Analytics Group for their help creating these charts.