Jumbo Mortgage Sector

Uncertainty Breeds Indecisiveness and Illiquidity.

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The problem with the Jumbo Market and Securitization is uncertainty abounds.

Like a wounded animal, limping off to safety, the anemic securitization and shadow banking systems have not been able to get back on its feet and offer any substantial solution to meet the demand for the secondary market, especially in the jumbo mortgage sector. A lack of confidence in the marketplace still prevails. Until we see stability and sufficient recovery of the non-jumbo sector, we are unlikely to see a recovered jumbo market; however, we should. The non-jumbo markets remain uncertain as new and ever-changing regulations and guidelines keep it so. Moreover, the new promised restructuring of the regulatory system including the consumer financial protection agency, adds uncertainty to the non-jumbo and jumbo market concerns. The private label jumbo market should step up and revitalize itself, but with unknown and ever-changing regulations and new product rules on the horizon, it impedes its development.

The Government Prospective: As the agency market was plagued with illiquidity, Fannie and Freddie stepped up but shortly thereafter landed on the government conservatorship-life-support list. The other GSE (the Federal Home Loan Bank System) remains under capital constraints. The Federal Housing Administration/Government National Mortgage Association ("FHA/Ginnie Mae") tag-team is now ballooning into the next Fannie Mae/Freddie Mac ogre. The GSEs and its growing cousin, Ginnie, cannot meet the demand in the marketplace. If FHA/Ginnie continue its efforts at the pace seen in 2009 ($577 billion, about to reach an estimated $680 billion for COB 2009), Ginnie will have guaranteed nearly $1 trillion by year end, 2010.

New solutions were recently offered by the MBA which suggest an effective replacement of Fannie Mae and Freddie Mac with a new MBS product comprised of (1) a Ginnie Mae style federal government 'wrap' (GG) and (2) mortgage credit-guarantor entities or MCGEs (MBA's Mortgage Credit-Guarantee Entity Proposal; August 2009). The MBA is suggesting that we need both an explicit credit risk '*security-level*' credit guarantee backstop based upon risk-based premiums funding a federal insurance fund, and '*loan-level*' guarantees funded by privately owned government-chartered mortgage credit-guarantor entities (MCGE), designed to absorb all mortgage related credit losses. In essence the resources, assets and staff of Fannie and Freddie would be subsumed into a segregated entity model with security-level and loan-level risk mitigation. The MBA has suggested that there is a role for government credit guarantee programs and in extreme market distress; the government should supply a liquidity backstop. The MCGEs and the MBS they issue would only address "core" mortgage products, leaving the private sector the opportunity or obligation to provide alternative products such as jumbo mortgages. To raise capital, private-label MBS, or other similar devices will have to be used or developed. The proposal would subsume all the resources and assets of Fannie Mae and Freddie Mac but not the debts or obligations, probably requiring a good bank/bad bank liquidation process. The FHA, VA, RHS and Ginnie Mae would continue to supply government credit support for affordable housing. The private sector would have to step up with fully supported private financing for mortgages outside of the ‘core’ conventional products; relying on private capital and risk management for viability. The secondary market would be funded by investors who take credit, interest rate and market risks in return for market yields.

Other devices may include covered bonds or new hybrid (public/private) variations of same. Although Secretary Paulson authorized “Covered Bonds” over a year ago (on July 28, 2008), uncertainty feeds investor indecision. New covered bond legislation has only recently been offered in an effort to ensure: that insolvency priorities would not be changed by ever-changing ‘regulatory’ schemes, and that upon an issuer’s insolvency, investors would be made whole through a new measure of damages, not the current less favorable investor formula. Moreover, the private sector has yet to stake its claim and capture the vast void in the private label securitization pie.

Uncertainty related to government regulations, and the ability of government to change the rules is causing massive indecision. The new proposed regulatory system and consumer finance protection agency, and state and federal preemption rules remain a great concern. Even GSE loan limits remain a cause of concern and uncertainty. Recall, Congress temporarily increased the CLL from $417,000 to $625,500 ($729,750 max in high cost areas) in the Economic Stimulus Act of 2008. This allowed the GSEs to purchase higher loan limit loans keeping interest rates down and enhancing liquidity. Investors however would not purchase bundles of loans with more than 10% of the loans over $417,000. Since most pools contain exceed the 10% cap, lenders were again stuck with higher cost alternatives. When the increases expired on December 31, 2008, illiquidity rose again as loans above the Housing and Economic Recovery Act (HERA) limits became more expensive and harder to obtain. The American Response and Recovery Act of 2009 raised the loan limits again but only for one year. These loan limits must be permanently raised.
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Need for Certainty & Confidence

If certainty and confidence could return, the private label jumbo market could regain its function. But uncertainty of new laws, rules, regulations, product restrictions and associated costs, are reasons driving indecision.

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