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Mortgage servicers remain hopeful U.S. will deliver coronavirus relief

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Despite recent comments by a federal official who questioned the need to aid the mortgage sector, servicers are holding out hope that a government liquidity backstop could still be rolled out within days.

Some servicers and other mortgage industry observers say a federal liquidity facility appears to be on the table to cover skipped payments by homeowners hit by the coronavirus pandemic. But several obstacles remain before a plan can be announced, they said.

Many say the deadline to launch a backstop with enough time to help cover May 1 payments is approaching.

“I would not be surprised to see some form of liquidity facility introduced as early as this week," said Scott Buchta, head of fixed income strategy at Brean Capital.

Treasury Secretary Steven Mnuchin and Federal Reserve Chairman Jerome Powell have both expressed support for aiding the mortgage market, but the Fed faces statutory limitations on whom it may lend to and what collateral it can accept.

Some on Wall Street have pointed the finger at Mark Calabria, director of the Federal Housing Finance Agency, as standing in the way of any potential government solution. Earlier this month, Calabria was quoted as saying recent forbearance data does not indicate servicers are on the verge of collapse.

“Nothing we are seeing as of today suggests that this is a systemic problem,” Calabria said in a recent interview with Bloomberg News. “What we are seeing suggests that for the next couple of months, this is sustainable.”

But the sharp rise in forbearance requests and the potential for massive delinquencies could force the government to finally act.

"It has to happen by mid-to-late April to be effective for the May collection period," Buchta said.

Roughly 3 million homeowners have asked for forbearance since the government announced steps to help borrowers dealing with fallout from the pandemic, according to a report by Black Knight, a mortgage data and analytics company. The report estimates that 5% of loans in forbearance are held by Fannie Mae and Freddie Mac, and 7.6% by the Federal Housing Administration and other small government agencies.

Since mortgage servicers are contractually obligated to advance principal and interest payments to mortgage-backed securities investors when borrowers stop paying their mortgage, many in the industry have urged Treasury and the Fed to establish a servicer liquidity backstop similar to other credit programs launched by the central bank in response to the pandemic crisis.

But there have been just as many questions about such a facility as there have been calls for the government to fund it.

There are still issues regarding how a Fed facility would work operationally and whether funding would flow through the government-sponsored enterprises, warehouse lenders or directly to servicers.

It also is unclear how much equity the Treasury would need to put into a special-purpose vehicle for mortgage servicers because of the difference in collateral and risk compared to other programs such as the Fed's $454 billion Main Street Lending Program.

Yet many say the Fed would have plenty of running room to fund a facility. The Dodd-Frank Act preserved the central bank's so-called "13(3)" authority to provide emergency financing as long as such aid was not focused on a single individual firm.

"The Fed’s authority is enormous and it can lend to whoever it wants in a moment of stress so long as taxpayers aren’t bearing the losses," said Diego Zuluaga, associate director of financial regulations studies at the Cato Institute. "There is a dispute as to whether the Fed can give liquidity to firms they do not supervise and their ability to gauge what the credit risk would be. But there's also an argument that the Fed is doing it for small businesses. And they are not supervised by the Fed."

In mid-March, the Federal Housing Finance Agency and the Department of Housing and Urban Development suspended foreclosures and offered six months to a year of payment deferrals for loans backed by Fannie, Freddie, the Federal Housing Administration and other government agencies.

But the government offered no recourse for servicers to cover the gap in payments resulting from the forbearance policy.

“The pressure is mounting because this is the biggest unfunded mandate in the history of man,” said Buchta.

Ed DeMarco, president of the Housing Policy Council and a former acting director of the FHFA, said the government's failure to act is putting new loan originations in jeopardy.

“The market is getting really volatile and the forbearance numbers continue to go up as we get close to May 1st payments," said DeMarco. "At some point this is going to really catch up with people as unemployment numbers surge, and by not acting at all, the market is going to price in uncertainty."

Calabria continues to be under pressure to provide liquidity through Fannie and Freddie, which are still in conservatorship. The GSEs have roughly $45 billion of retained capital and a $240 billion line of credit from the Treasury.

Kaustub Samant, an executive director at JPMorgan Chase, wrote in a report Monday that between 7% and 15% of loans backed by Fannie and Freddie "could end up in hardship forbearance as a result of COVID-19."

Meanwhile, a large, disparate group of consumer advocates, Republican and Democratic lawmakers, mortgage lenders and trade groups have all called for funding specifically for nonbank servicers. Nonbanks originate 70% of loans to low-and moderate-income consumers, typically through the FHA and the Department of Veterans Affairs.

Calabria has maintained that taxpayers should not provide funding to nonbank servicers, which is consistent with his broader view that the government should reduce its hold on the housing finance system.

“This is a rare moment when the entire universe is aligned," said Dave Stevens, chief executive of Mountain Lake Consulting and a former FHA commissioner in the Obama administration. "They are about to cause what could be a strong contraction in the housing market that could forever impair ... paid-for servicing going forward."

Yet Calabria's comments have driven a rift in the market.

"The servicers appear to face a deliberate strategy designed by the FHFA to stick the private market with the cost of dealing with COVID-19 in the conventional loan space," Michael Bright, CEO of the Structured Finance Assocoation, wrote in a blog post Monday.

Chris Whalen, chairman of Whalen Global Advisors, said the GSEs need to show their support for servicing advances and for forbearance requests covered by the Coronavirus Aid, Relief, and Economic Security Act.

"This is not just a nonbank issue. The banks have a problem here too and they are signalling that the cost of credit needs to go up because every credit line has been hit," Whalen said. "It’s going to be very clear that all the banks are fully utilized, and you're going to start seeing some significant issues on the servicing side."