Economic *SYNOPSES*

short essays and reports on the economic issues of the day

2011 ■ Number 26

Changes in the Mortgage Market Since the Crisis

Rajdeep Sengupta, *Economist*
Bryan J. Noeth, *Research Associate*

The housing market has deteriorated significantly since 2006: Home prices, housing starts, and home sales have all declined sharply, and long-term delinquencies and foreclosures have risen well above historic norms. Moreover, the composition of mortgage originations has also changed significantly.

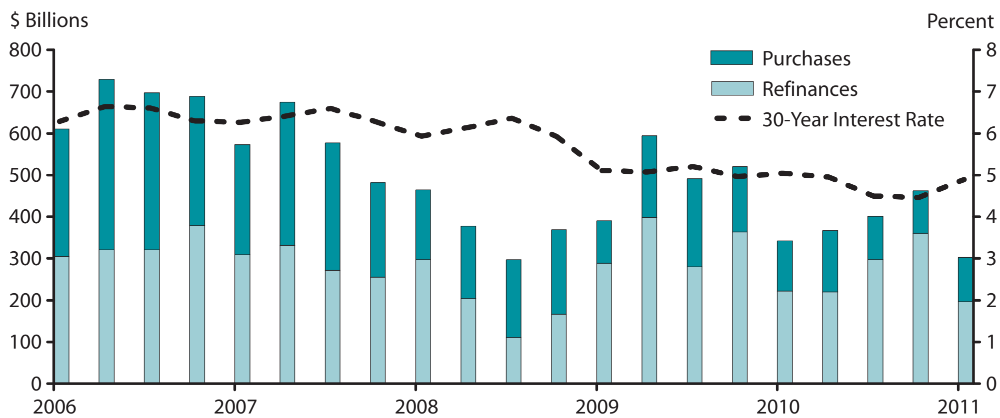
With declining home prices, the total value of mortgage originations from 2006 through 2010 decreased by 42 percent (see the first chart). At the same time, origination volumes have declined considerably both due to a decline in purchases and tightened lending standards for new mortgages. The demand for mortgages has also declined as prospective homeowners opt to rent instead. Not surprisingly, most recent mortgage originations have been refinances. Borrowers with sufficiently good credit and modest declines in home equity have successfully refinanced their mortgages to take advantage of historically low interest rates. However, refinancing has been a challenge for most homeowners, especially those with significant declines in home values.

The composition of mortgage types has changed significantly over the same period (see the second chart). Originations of loans within conforming guidelines have changed little: Borrowers with good credit histories can still qualify for mortgages, although as noted earlier, much of the activity in this category is refinancing of existing mortgages. The large decline in jumbo loan originations could be attributed to both the decline in home prices and the near disappearance of private-label securitization. Most remarkably, all private-label securitization of non-prime originations has disappeared since the collapse of both the subprime and Alt-A segments of the mortgage market. This raises the question of whether these market segments are viable without government support.

It appears that mortgage origination and securitization is currently "in limbo": Private securitization has all but disappeared and is being absorbed by government-sponsored enterprises.

Another important factor here is the sharp decline in the popularity of adjustable-rate mortgage (ARM) products. As the second chart shows, the share of ARMs declined from a peak of 45 percent of all products in 2006 to 9.5 percent of all products in 2010. Without a doubt, low interest rates have encouraged borrowers to choose fixed-rate mortgages over ARMs. But this period also witnessed the complete disappearance of some less-traditional mortgage

Mortgage Originations

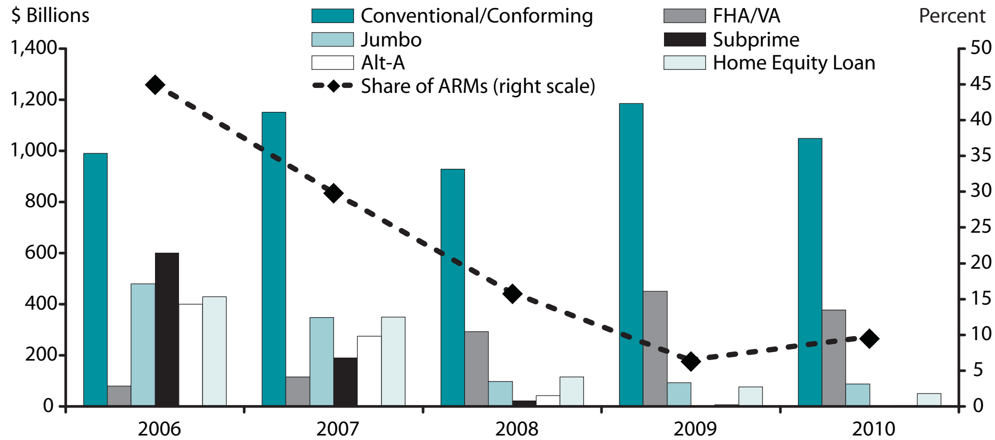


SOURCE: Mortgage Bankers Association, Federal Reserve Board/Haver Analytics.

products, such as hybrid ARMs, option ARMs, and interest-only ARMs. These products made up a significant proportion of the subprime and Alt-A private-label securitization markets before 2007.[1]

A noticeable recent trend has been the increase in the home loan programs of the U.S. Department of Veterans Affairs (VA) and the Federal Housing Administration (FHA). These programs, in existence for many years, have been rejuvenated to help eligible borrowers in the aftermath of the mortgage crisis.[2] As a result, originations in this category have increased significantly.

Mortgage Originations by Type



SOURCE: Inside Mortgage Finance.

It appears that mortgage origination and securitization is currently "in limbo": Private securitization has all but disappeared and is being absorbed by government-sponsored enterprises (GSEs). However, as uncertainty in the housing market subsides, private-label securitization will likely see a resurgence as financial institutions seek to expand their portfolios. ■

[1] See Moench, Emanuel; Vickery, James and Aragon, Diego. "Why Is the Market Share of Adjustable-Rate Mortgages So Low?" Federal Reserve Bank of New York *Current Issues in Economics and Finance*, December 2010, *16*(8), pp. 1-11; www.newyorkfed.org/research/current_issues/ci16-8.pdf.

[2] For a full list of FHA programs and their response to current mortgage events, see "Programs of HUD: Major Mortgage, Grant, Assistance, and Regulatory Programs 2011"; http://portal.hud.gov/hudportal/documents/huddoc?id=ProgramsofHUD.pdf.