Economic SYNOPSES
short essays and reports on the economic issues of the day

2008 ■ Number 18

Mortgage Originations: 2000-2006

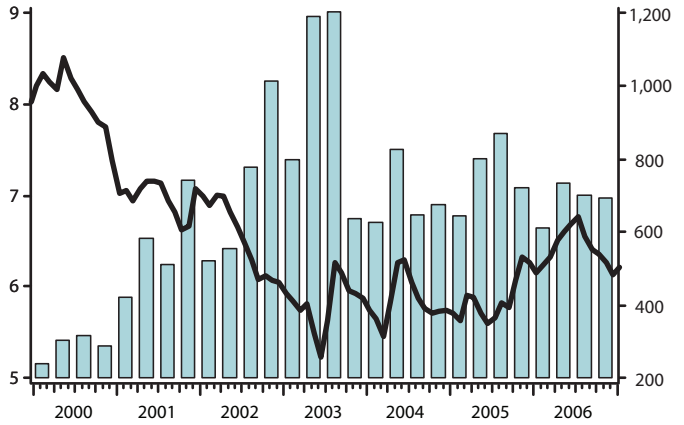
Rajdeep Sengupta and Yu Man Tam

The Freddie Mac Primary Mortgage Market Survey indicates that the interest rate on commitments for 30-year fixed-rate mortgages declined from a peak of 8.52 percent in May 2000 to 5.23 percent in June 2003 (Figure 1). A sharp decline in interest rates typically leads to increased demand for mortgage originations: First, potential homeowners seek to take advantage of the low rate to purchase a home. Second, existing mortgage holders are keen to refinance their mortgages at the lower interest rate. Mortgage lenders were able to meet this increased demand because of a low cost of funds during this time period, thereby resulting in a steady increase in total mortgage originations. According to the Mortgage Bankers Association, the dollar value of total mortgage originations for 1- to 4-family homes steadily increased from $238 billion in 2000:Q1 to roughly $1,200 billion in 2003:Q3 (Figure 1).

If this growth in originations reflects the decline in the interest rate, then mortgage originations might be expected to decline when the contract rate increases. Indeed, mortgage originations did decline when contract rates rose after 2003. However, as Figure 1 shows, the level of originations continued to remain higher on average than pre-2003 levels. Why? Two reasons: First, interest rates in the post-2003 period remain below the high levels attained in the pre-2003 era. Second, there was a change in the composition of originations, with substantial growth in the nonprime segment affecting the overall market.

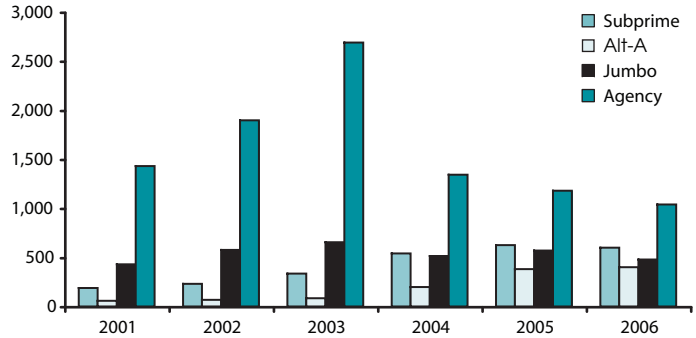
Figure 2 shows the breakdown of mortgage originations by market segment. Prime mortgages include loans securitized by an "agency"—namely, Freddie Mac, Fannie Mae, and Ginnie Mae. Jumbo loans are prime mortgages but are for amounts exceeding agency-conforming limits. Nonprime mortgages include both subprime and Alt-A markets. Subprime mortgages generally include loans to borrowers with incomplete or impaired credit histories, while Alt-A mortgages include loans to borrowers who usually have high credit scores but are unable or unwilling to document a stable income history or are buying second homes or properties for investment purposes.[1] Figure 2 shows that an increase in agency mortgages is the major factor behind the growth in total mortgage originations between 2000 and 2003. However, prime originations declined sharply after 2003. The growth of originations after 2003 was sustained by the subprime and Alt-A segments of the mortgage market. ■

Figure 1



SOURCE: FHLMC: PMMS Survey, Mortgage Bankers Association.

Figure 2



SOURCE: Inside Mortgage Finance Publications, Inc.

[1] Fabozzi, Frank J. (editor). *The Handbook of Mortgage-Backed Securities*. New York: McGraw-Hill, 2006.