# Lakeview, PennyMac step up Ginnie Mae EBOs in potential 'calm before the storm'

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The available supply of distressed, government-insured loans may finally be growing, as long predicted by investors who have been speculating that borrowers most affected by the pandemic's economic toll can't be helped by forbearance alone, according to a strategist and Recursion data.

Scott Buchta, Brean Capital's fixed income strategy chief, and analysts at Recursion took notice earlier this month when at least one big non-bank servicer accelerated its pace of early buyouts from Ginnie Mae securities. The tip-off involved Lakeview Loan Servicing, the second largest in the business, whose one-month CDR jumped to 25.5% in January from 15.1% in December, 10.2% in November and 0.5% in October, according to Recursion. CDR is a clear indicator of EBOs, the data company said.

CDRs for PennyMac, the top Ginnie servicer, have inched up to around 9% for the past three months from 6% in October, Recursion data show. The CDRs for number three Ginnie servicer Freedom Mortgage have been below 1% since October, however.

Buyouts rose among all non-banks with the average CDR rising to 7.3% in January from 5.4% in December, Recursion data show.

The potential number of distressed loans stripped from Ginnie securities is vast. About USD 150bn of loans in Ginnie MBS are more than 60 days delinquent, according to Buchta's data. Many investors assume Ginnie borrowers will have trouble meeting obligations when their forbearance periods end because they are typically less creditworthy at origination than those whose loans are purchased by Fannie Mae or Freddie Mac.

A stack of rules and regulations issued by the government and changing incentives for the servicers has kept MBS and credit investors guessing as to how quickly, or if, EBOs would materialize in a big way. Among those rules is a new Ginnie directive restricting the re-pooling of EBOs and new servicing requirements of the US Department of Housing and Urban Development.

One important rule is that a servicer has 90 days to complete set loss mitigation efforts for the borrower once a forbearance period ends, Buchta said during a client-only webinar he prepared after getting “a ton” of inquiries, ostensibly including MBS investors concerned about prepayments. Where a modification is involved, it’s likely that the loan will be bought out, he said on the webinar.

Considering that USD 37bn in forbearance plans are set to expire in March and April alone, the EBO activity could soar, Buchta said.

“What you want to be thinking about is what’s going to happen with a lender like a Freedom, or a Quicken [Loans] … that really haven’t done a lot of buyouts to date, but they’ve got this huge wall of loans coming up on these forbearance maturities,” he said. It could be the “calm before the storm.”

There are caveats, however. Servicers, especially for FHA-insured loans, can opt to defer payments in arrears and leave the loans in the Ginnie MBS, Buchta said. He expects the Biden administration to extend CARES Act forbearances in a relief bill, which would delay the wall of expired plans.

EBO investors are accustomed to the uncertain supply, said David Rosenblum, a partner at Prophet Capital Management, which is known for legacy RMBS trades coming out of the last financial crisis. Prophet managed to purchase more than USD 1bn in EBOs last quarter through mostly quiet transactions but Rosenblum isn’t ready to predict that the floodgates would open.

“That’s a question we’ve struggled with,” Rosenblum said. “There’s potential for ‘X’ but what will the reality be? It’s really hard to know. Will we be able to buy several billion this year? I hope so.”

The supply conundrum isn’t the only thing frustrating for investors.

HUD must approve investors after a mountain of paperwork and an evaluation, all of which can take up to six months and rack up tens of thousands of dollars in legal fees, said one investor who considered the EBO trade but decided against it. The HUD loss mitigation waterfall is so inflexible that all options are not explored for fear of losing insurance coverage, he said. The amount of leverage needed to juice returns to acceptable levels can be high, he said.

“I don’t see any viable, realistic path forward for someone who does not have their Ginnie Mae issuer status, or FHA and VA servicing status getting into that space any time soon,” said a capital markets source at a servicer. “That’s just a long, arduous process,” though there is a “very substantial opportunity that’s going to matter at some point,” he said.

The complexities of the trade and government requirements have resulted in some joint ventures, including one between mortgage servicer Carrington Mortgage Services, alternative investment manager Waterfall Asset Management and NPL buyer Rocktop Partners, as reported.

Still, there is so much money chasing EBOs that the trade has already become a crowded one, Buchta said. Buyers confident that they'll be able to re-pool loans at a hefty premium have pushed prices on some pools even above par, he said. The risk to those investors is that if anything goes wrong, and the borrower doesn't become current, they are left with loans that are notoriously difficult to service, he said.

Higher prices on EBOs are getting sellers off the fence, as reported. RAMS Mortgage Capital has put hundreds of millions of dollars in EBOs out for bid recently, and Incenter Mortgage Advisors hit the market today with a USD 146m EBO bulk offering and a separate flow offering from an independent mortgage banker looking to manage its Ginnie portfolio.

Prophet's Rosenblum said the barriers to entry would limit the field of investors.

"I think there's a player or two trying to bust in" on the trade, Rosenblum said. "But I don't think it's being widely pursued … and I don't think people are particularly missing out. It's government-insured risk and it's not like you are going to earn double digits on it."

by Al Yoon