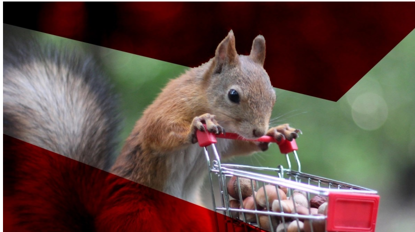
The MSR sector continues to shine, but there is a looming concern

If the economy worsens, loan delinquencies in Ginnie Mae mortgage servicing portfolios will accelerate

October 24, 2022, 10:00 am *By Bill Conroy*



The mortgage-servicing rights market just keeps on ticking even as the overall housing market takes a licking. And while depository banks that are fueling that growth, concern is mounting over Ginnie Mae MSRs held by nonbanks.

Mortgage advisory firms **Prestwick Mortgage Group** and partner **Mortgage Capital Trading** (MCT); **Incenter Mortgage Advisors;** and **MIAC Analytics** are out with a total of 10 bulk mortgage-servicing rights (MSR) offerings with bid-due dates in October. The 10 offerings together involve **Fannie Mae**, **Freddie**

Mac and **Ginnie Mae** loan pools valued collectively at $12.77 billion.

MIAC is handling one of those bulk offerings, one of the largest, valued at $2.44 billion and involving a combination of Fannie, Freddie and Ginnie MSRs.

Prestwick is marketing four separate deals, two in partnership with MCT, valued in total at $2 billion —which together also feature MSRs for single-family residential loan pools from all three agencies.

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>
> **TOM PIERCY, MANAGING DIRECTOR OF INCENTER MORTGAGE ADVISORS**

Incenter has the highest deal count and the largest deals by volume, at five offerings valued collectively at $8.33 billion, Together they involve MSRs for single- family mortgage pools across all three agencies.

Two of those offerings, one an all-Ginnie package and the other a Fannie and Freddie bulk offering, each involve loan-servicing pools valued at $4.1 billion.

Over the first nine months of this year, banks have far outstripped nonbanks in buying up MSRpackages.

Banks have been net purchasers of MSRs, to the tune of $107.8 billion —compared with $51.1 billion for all of 2021, according to a report by mortgage-data

analytics firm **Recursion**.

Tom Piercy, managing director of Incenter Mortgage Advisors, said many independent mortgage banks stockpiled huge volumes of low-rate loans in 2021, understanding that rates would eventually rise, and they are cashing in on the new rate environment —a climate that also is wreaking havoc on loan-origination volumes. In addition, banks who are nowbuying, he added, can take advantage of the product cross-selling opportunities through loan servicing and, more importantly, they can leverage the escrow float opportunities MSRs offer.

"The deck is stacked in favor of the depositories when it comes to owing MSRs, and that is because of what they can do with the escrow [accounts]," Piercy explained. "Banks can leverage these [escrow] deposits [using them as collateral to borrow] through the **Federal Home Loan Banks** to reinvest into higher yielding assets.

"And so that's why banks have always been in a much better position to own the MSRs."

Digging down deeper into the numbers, the Recursion report shows that over the first nine months of 2022, banks have been net buyers of Fannie Mae and Freddie Mac MSRs and net sellers of Ginnie Mae MSRs, while nonbanks are selling off Fannie and Freddie MSRs and still far outstripping banks in issuing and buying Ginnie Mae MSRs.

The weak link?

In stark contrast to banks, nonbanks had a legacy portfolio of $1.77 trillion Ginnie Mae MSRs as of the end of September, the Recursion report shows. That's more than five times the size of the banks' aggregate Ginnie MSR portfolio of $334 billion as of the same date.

Those Ginnie MSRs, however, represent a weak link in the nation's housing system when the economy is under stress, as it is now.

Ginnie serves as the government-backed securitization pipeline for loans insured by government agencies that provide loan-level mortgage-insurance coverage through their lending programs. Unlike Fannie and Freddie, however, Ginnie does not purchase loans.

Rather, under the Ginnie program, lenders originate qualifying mortgages that they can then securitize through the agency. Ginnie guarantees only the principal and interest payments to purchasers of its bonds, which are sold worldwide.

The underlying loans carry guarantees, or a mortgage insurance certification, from the housing agencies approving the loans —which include single-family mortgages backed by **Federal Housing Administration** (FHA), the **U.S. Department of Agriculture's Rural Development** program, the **U.S. Department of Housing and Urban Development's Office of Public and Indian Housing**and the
U.S. Department of Veterans Affairs (VA).

The largest volume of loans, however, is delivered through the FHA and VA lending programs.

The holders of Ginnie Mae MSRs, primarily nonbanks today, are the parties responsible for assuring timely payments are made to bondholders. And when the underlying loans go unpaid due to delinquencies, those servicers still must cover the payments to the bondholders.

And in the FHA program, in particular, according to Richard Koss, chief of research at Recursion, 30-day loan delinquencies have been ticking up since the beginning of the year. The same is true, but to a lesser degree, for the VAprogram, he said.

As of September, the 30-day delinquency rate for FHA loans stood at 3.77%, up from 3.02% as of the beginning of the year, Recursion data shows. The overall FHA delinquency rate —for loans 30-days late or more, excluding foreclosures —stood at 8.85% as of the second quarter of this year, compared with 4.22% for VA loans and 2.64% for conventional loans, according to the **Mortgage Bankers Association**.

"The demographic of the FHA borrower is the first- time homebuyer, with very little to no down- payment," Piercy explained. "The profile has shown over the years to be susceptible to poor performance when national economic numbers start slowing.

"And what's happening in an inflationary environment is everything's getting more expensive."

The deep downside risk for nonbanks holding a large volume of Ginnie Mae MSRs is loan defaults. Defaults kick in the underlying loan insurance provided through the agency guaranteeing the loan, such as

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> **RECURSION'S RICHARD KOSS ON GINNIE MAE MSR RISKS.**

FHA. Another wrinkle in the picture for the short-term for mortgage servicers is that in most cases, borrowers can still "request an initial COVID hardship forbearance as long as the COVID-19 National Emergency is in place," according to the **Consumer Financial ProtectionBureau**.

Although principal recovery is ultimately guaranteed through FHA in the event of a default, there often is a bureaucratic time lag in obtaining interest due, according to a report by **Kroll Bond Rating Agency** (KBRA). In addition, interest rate recoveries are at the HUDdebenture rate, "which is typically substantially below the loan note rate," according to KBRA. That could potentially create cash-flow issues for some of the nonbanks holding the Ginnie MSRs.

"Yes, it's a source of concern I don't think is broadly understood," Koss said. "The main mitigating factor is the still-huge amount of equity most buyers have in their homes.

"It's the most recent cohort of buyers [with the highest-rate loans] that can be struggling with this to a large degree."

Piercy, however, said the nonbanks originating the loans and issuing the Ginnie Mae securities are prepared to handle an uptick in defaults, which he said has been anticipated by the industry.

"I don't think you're going to see the calamity of the Great Recession," Piercy said. "These servicers have acted very responsibly in fortifying balance sheets and anticipating what their capital requirements will be.

"So, delinquencies will increase, and there's really little to no modification capabilities right now because of where interest rates are. And home prices will devalue, so we're going to have a decrease in home prices, and that means default curves will pick up, and [MSR holders, like the nonbanks] will have to run those [payment] advances, and all of these services are aware of this and are positioned to handle it."

Stockpiled loans

Whether Piercy's prediction will hold true remains to be seen, but it is the case, he said, that much of the all-agency MSR sale activity we are seeing now still involves loans made at lower interest rates, which Koss points out are at lower risk of default than the higher-rate

loans just now coming into the nation's mortgage pipeline.

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> **BILL SHIRREFFS, SENIOR DIRECTOR AT MCT**

"So much servicing was stockpiled in 2021 by all originators because of what they perceived as the historical low rates and the inequitable value that was being offered for it at the time," Piercy said. "They knew … rates were going to spring back in some capacity at some point, and sure enough, that's what they began to do the first quarter of 2022."

In fact, the weighted average interest rates for the loan pools for the nine MSR deals being marketed by Incenter, Prestwick/MCT and MIAC, reflect those lower rates from last year. The rates in those MSR offerings range from 2.94% to 4% —with the higher rate involving a Ginnie Mae MSRbulk-servicing offering being marketed by Incenter. The average rate for a

30-year fixed mortgage as of Oct. 13 was 6.92%, according to Freddie Mac's Primary Mortgage Market Survey.

"Overall, the MSR asset should remain strong in 2023, because most of the servicing holders have built very low WAC [weighted average coupon] portfolios that should experience favorable [low] prepayment speeds," said Bill Shirreffs, senior director and head of MSR services and sales operations at MCT.

Leo Wong, a partner with **Waterfall Asset Management**, a global alternative investment manager with some $11 billion in assets under management, said the MSR market is still strong, but concedes some of the froth is starting to settle. He said
prices for MSR offerings reached multiples of "around 5.5 in the second quarter of this year," but are now in the "high 4s" and likely "to dip into the low 4s in the fourth quarter."

A multiple is a measure of the price of an MSR loan pool expressed as percentage of the unpaid principal balance divided by the servicing fee.

Tom Capasse, managing partner and co-founder of Waterfall Asset Management, said the downward pricing dynamics in the MSR market currently are being driven by the fact that there's more supply than demand. "There's more sellers and a fixed amount of buyers," he added.

Piercy echoed Wong and Capasse's analysis.

"We just don't have the pricing that we did in the first half of the year," he said. "But we still now have reasonable pricing for an asset that does provide value to the purchasers," Piercy said. "MSR volumes and activity remain robust."

Shirreffs added that MSR portfolios grew substantially in 2020 and 2021, "and the revenue generated from those portfolios has undoubtedly softened the blow of dramatically reduced mortgage production revenue."

"But a number of factors will impact the MSR asset materially in the coming year," he added. "The cost of servicing continues to rise, particularly labor cost.

"With sustained lower production volumes and higher servicing costs, this could potentially lead to increased M&A [merger and acquisition] activity during 2023 and 2024."

Whose MSR appetite is growing?

The top buyer of MSR portfolios overall (all three agencies combined) year to date through September 2022 was **J.P. Morgan Chase**, $99.9 billion, Recursion data shows. **FreedomMortgage** was second, at $96.8 billion, followed by **Onslow Bay Financial LLC**[a subsidiary of **Annaly Capital Management**], $82.2 billion.

Mr. Cooper, at $78.8 billion, and **Lakeview Loan Servicing**, $72.5 billion, rounded out the top five purchasers over the period. The top sellers over the first nine months of 2022 for all-agency MSR portfolios were **United Wholesale Mortgage** (UWM), $107.4 billion; **Home Point Financial Corp**., $68.9 billion; **Rocket Mortgage**, $50.5 billion; **loanDepot**, $25.3 billion; and **AmeriHome Mortgage Co.,** $22.9 billion.

Wells Fargo is the largest holder of all-agency MSRs based on loan principal balance, $615 billion as of the end of September, or 7.4% of the market, followed by **Pennymac**, at $515.5 billion, 6.2% market share; and J.P. Morgan Chase, $488.4 billion, a 5.9% market share, Recursion data shows.

For Ginnie Mae MSRs only, as of the end of September, Freedom Mortgage led the pack, with a $253.1 billion portfolio, or a 12% share
of outstanding Ginnie MSRs based on loan-pool principal balance. Pennymac was second, at $241.8 billion, 11.5%; followed by Lakeview Loan Servicing, $239.1 billion, and an 11.4% slice of the market.

Freedom's portfolio accounted for 14.4% of all Ginnie MSR loan delinquencies 30 days or more past due as of the end of September, according to Recursion. For Pennymac, the same loan-delinquency ratio was 10.3%; for Lakeview it was 13.8%. Overall, nonbank's portfolios combined accounted for 88.4% of Ginnie MSR loan delinquencies 30 days or more overdue as of the end of the third quarter, according to Recursion.

In total, as of the same date, banks controlled 15.9% of the Ginnie MSR market, with nonbanks held an 84.1% market share, according to Recursion.

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