Mortgages

Beware of the "Mortgage Massacre" – the Next Crisis in Our Pandemic Economy

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While much of the country has been focused on the U.S. Senate hearing on the COVID-19 response… and if our plans to "reopen America" will trigger another spike in coronavirus cases and hospitalizations… and the 14.7% unemployment rate that represents 23.1 million Americans out of work… there's a looming implosion that everyone's been ignoring.

I'm talking about Mortgage Massacre 2.0.

And it's right around the corner.

"Forbearance" and "rent strikes" are already impacting the mortgage market. What's barreling down on us will make 2020 look like 2008 all over again.

U.S. households are cracking under the weight of the debt they're carrying.

Household debt has risen for 23 straight quarters – and as of April, it stands at $14.3 trillion, according to the Federal Reserve Bank of New York.

Auto debt's been rising steadily for 36 months and now totals $1.35 trillion.

Student loan debt exceeds $1.42 trillion.

Credit card debt totaling more than $1.079 trillion just saw delinquencies rise 9.09% in April – to their highest level in two years.

And most frighteningly, mortgage debt at $10 trillion is up $150 billion in a year, climbing a whopping $29 billion in the first quarter of 2020.

As job losses increase and furloughs turn into permanent layoffs, households are going to have a harder and harder time paying their bills, especially their biggest monthly bill, their mortgage or rent.

Or, maybe they won't have to pay it…

Calling In the Backstop Brigade

The home is the single biggest expense for most Americans – accounting for a hefty 33% of their household budget, the Bureau of Labor Statistics found in its most recent Consumer Expenditure Survey.

And here during the coronavirus pandemic, the American home has taken on an even greater emotional role. Not only is it our shelter, but during the "isolate in place" shutdown, it's also our protective cocoon – the place where we work, entertain ourselves, and keep our families safe.

About three-quarters of all mortgages in the United States are federally guaranteed. The rest are private, or non-agency mortgages.

The Coronavirus Aid Relief and Economic Security Act (CARES, because Congress does…) grants relief, or "forbearance," to homeowners whose mortgages are federally guaranteed by Fannie Mae (Federal National Mortgage Association), Freddie Mac (Federal Home Loan Mortgage Corporation), the FHA (Federal Housing Administration), the VA (Veterans Administration), or Ginnie Mae (Government National Mortgage Association).

Under the CARES Act, mortgagors (borrowers) with federally backed loans are granted 180 days of forbearance, when loan payments are postponed or reduced but interest still accumulates, and don't have to pay anything, or give a reason, or document, or show proof of hardship to get a pass on paying.

After 180 days, these borrowers can apply for an extension of another 180 days – and have it automatically granted.

Non-agency mortgagees (lenders) are mostly granting forbearance, too. Borrowers must contact their mortgage servicer and request a repayment schedule or plan.

According to the Mortgage Bankers Association, as of April 30, 7.3% of all active mortgagors, with $841 billion in unpaid principal, asked for and got forbearance. Holders of 6.15% of all Fannie and Freddie guaranteed mortgages got forbearance. And borrowers of 10.5% of all FHA and VA-backed loans have gotten forbearance.

Mortgage servicers say more than half a million mortgagors a week are adding to the growing number of borrowers not paying their mortgages, and they expect that number to increase every week for at least the next 8-12 weeks.

As big as those numbers already seem to be, they could turn out to be a drop in the bucket if the St. Louis Federal Reserve Bank's projection of 47 million Americans eventually becoming unemployed becomes reality.

Renters around America – many of whom are protected under non-eviction orders by local governments – aren't paying their rent. The owners of most homes and apartments experiencing rent strikes are mortgagors, which in renters' eyes justifies them not paying rent on account of their landlords receiving forbearance.

The FHFA website advises renters that if they're living in a property financed by Fannie Mae or Freddie Mac (use the "loan lookup" tools for Fannie Mae [**here**](https://www.knowyouroptions.com/rentersresourcefinder?utm_medium=email&utm_source=govdelivery) or Freddie Mac [**here**](https://myhome.freddiemac.com/renting/lookup.html?utm_medium=email&utm_source=govdelivery) to find out), they're covered by a temporary eviction moratorium: *Renters are still expected to pay their rent during the eviction moratorium period, if they can. Those experiencing financial hardship should reach out to their landlord to discuss their situation and potential solutions.*

Great for Borrowers – but What About Investors?

Mortgage servicers, bank and non-bank intermediaries who collect mortgage payments from borrowers and pass through interest and principal to investors who own the mortgages, usually in bundles of "mortgage-backed securities" (MBS), aren't getting payments.

But they still have to pay investors what they're due.

To continue paying investors, servicers must dig deep into their own pockets to pay up. That got so bad so quickly in March, the Mortgage Bankers Association and servicer representatives ran to Congress and the U.S. Federal Reserve asking for help.

If servicers can't pay back-end investors, it would implode servicing companies, upend the entire mortgage-financing market, and hammer pension portfolios, banks and myriad investment houses. The upshot: A rescue plan was adopted in mid-April.

Servicers will have to cover the first four months of the payments that "pass through" to investors; after that, Fannie and Freddie will pay investors what they're counting on.

Can you see where this is going…?

The mortgage market is once again relying on the giant GSEs (government-sponsored enterprises) – **YES, I mean taxpayers, ultimately** – to bail out borrowers and lenders.

But this time around, the damage will be worse, last longer, and hit the housing market, mortgage-backed-securities investments, and the economy in ways that are different and potentially worse than the historically horrific 2008 financial crisis.

How so you ask?

Jobs, jobs, jobs.

When the Buying Ends…

Since the pandemic gripped America, more than 33.5 million workers have filed for unemployment benefits. The rolling four-week average now exceeds 4.1 million claims per week.

In the month of April alone, the Bureau of Labor Statistics (BLS) says that 20.5 million non-farm payroll jobs were lost.

The unemployment rate has soared from 3.5% in early February to 14.7%.

But even the BLS admits the 14.7% number understates the real unemployment rate.

Because unemployment is calculated via a survey BLS conducts over a week (in April it was from April 12 through April 18), it's really a "snapshot" that requires the incorporation of seasonal and other extrapolations.

For one thing, BLS said only 70% of surveyed households responded – far less than the typical 83%. BLS also commented on its own survey results with skepticism, saying the estimated 9 million people (that number is an extrapolation) answering they were employed but "absent" over that week is unusual. In a survey commentary, the BLS said the unusual number, about 7.5 million more than typical, indicates those people should probably have been recorded as unemployed.

If they had been, the U.S. unemployment rate would be 19.7%.

The "U6" measure of unemployment – which includes workers who say they're discouraged and not looking for work and workers working part-time who want to be employed full time – stands at 22.8%. That number's also being questioned.

A lot more jobs have now been lost in eight weeks than were created over the prior decade.

Unemployment at 20% is double what it was during the depths of the 2007-2009 Great Recession.

And it would approach the 24.9% rate recorded in 1933, the low point of employment during the Great Depression.

We might get there before workers start to get rehired.

Against this bleak employment backdrop, housing prices have only held up nationally because there's little inventory for sale, experts say.

But they expect that to change.

Housing inventory – the number of homes available for sale – has been low for a while. As of February, inventory was down nearly 10% on a year-over-year basis, dropping from a supply of 3.6 months to a supply of 3.1 months.

During the last full week in March, the number of for-sale homes being taken off the market jumped nearly 150% year over year, says real estate brokerage Redfin.

So far, the drop in homes for sale has been supporting price levels. And "home sales will decline significantly," says Tendayi Kapfidze, LendingTree's chief economist.

When forbearance runs out, homes for sale will flood the market in the hardest-hit areas, depress prices, and impact securities and lenders tied to more troubled mortgagors.

The central bank's decision to [buy a nearly unlimited supply](https://www.wsj.com/articles/federal-reserve-announces-major-expansion-of-market-supports-11584964844?mod=article_inline) of government-backed mortgages has helped calm skittish markets. But the market for loans in which the government doesn't shoulder the risk is coming undone.

Investors are abandoning that market, starving lenders that extend mortgages to borrowers who don't qualify for conventional loans. Those lenders are halting operations and bracing for a sharp rise in missed mortgage payments during the pandemic.

One lender, **Angel Oak Cos**., laid off 70% of its staff and put originations [on hold for two weeks](https://angeloakms.com/?mod=article_inline) because it said it couldn't properly evaluate applicants' credit risk.

**Citadel Servicing Corp.**and**Sprout Mortgage** have [put some originations on hold](https://www.sproutmortgage.com/?mod=article_inline).

Borrowers are already struggling to line up financing that was readily available just weeks ago. As housing prices crash in several parts of the country, problems in these slices of the mortgage market could persist until well after the U.S. economy emerges from lockdowns.

The market for mortgages not backed by the government nearly disappeared after the housing market imploded in 2008.

The Great Unraveling Has Begun

Non-bank lenders, who can originate as much as 60% of U.S. mortgages, rely on lines of credit from banks and non-bank finance companies to fund their loans. These "warehouse lenders," as they're known, recoup loan money when they sell the mortgages they make to investors. But warehouse lenders often pull back as risks rise, and now they are raising lending standards, as most bank lenders have done, and aren't looking to make loans in some areas.

The sinking economy and uncertain outlook for housing has battered investors who loaded up on mortgages that lack government guarantees. Fund managers who oversee huge investment pools of mortgage-related instruments and products have faced withdrawals, forcing them to sell assets to raise cash and reducing the pool of buyers for these loans.

Mortgage real estate investment trusts – publicly traded companies that typically use leverage to boost returns – had been a growing presence in the market for mortgage-backed securities. Now, many of their banks are asking them to put up additional collateral for their loans in margin calls.

As non-agency mortgage lenders pull back, more loans will be channeled through the government-sponsored enterprises Fannie and Freddie – the same ones that bankrupted themselves in 2008.

Too bad they're already loaded up with nonperforming mortgages, technically in forbearance.

When home values underlying MBS, both government-guaranteed and private, start to falter and fall, the same negative feedback loop that tore up homeowners, MBS investors, banks, finance companies, and investment houses in 2008 will revisit the economy and further slow the country's recovery.

But not to worry. Just like in 2008, there are lots of ways to make money from what's just starting to unfold.

I'll be back next week with those plays.

And in the meantime, be sure to check out my colleague Michael Robinson's latest presentation…

You see, working from home, telemedicine, and even online grocery shopping are trends that've been here for years without causing any problems… until February.

The 88 most populous cities across the United States are now seeing their Internet speeds tumble by 44% (and this could just be the start).

That's why the FCC had to step in – and its $10 billion initiative could translate to a huge payout because of it. [**Click here to check out our research**](https://pro.moneymappressinfo.com/m/1546782)…