Are lenders listening to GSEs?

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Because many of us have experienced multiple, often-volatile real estate cycles, I'll start this brief essay with my *"conclusion"*, relating to what Lenders, Realtors and title insurance companies are experiencing:

1. Fannie Mae and Freddie Mac deserve credit for authorizing an "*Alternative to title Insurance",* thereby significantly lowering Borrower closing costs.
2. The GSEs-compliant Attorney Opinion Letter provides for the benefits of increased transaction volume, margin spread and market share to their "Seller" Lenders.
3. *The real question is, are the Lenders listening to the GSEs by implementing the safe, reliable and low-cost alternative authorized by the GSEs?*
4. Lenders would be well advised to seek Consumer Choice-Alternatives to the title insurance monopoly that generated revenue of $26 Billion in 2021 and paid only 3% in claims. 75% of SFR searches and examinations reflect "clean" title, rendering title insurance costly and unnecessary.
5. Incredibly, rather than protecting market share by reducing Borrower costs, lenders, Realtors and the title insurance monopoly are employing decades old solutions to a 2022 problem!

Following is my overview of real estate market factors contributing to yet another painful cycle. As might be expected, the cycle is similar to other cycles that were destructive to many fine companies and their employees; and in many respects are both complex and simple. Lets review market basics to begin.

<u>BORROWERS:</u> Consumer loan origination desires are really quite simple: Low rates for qualification and payment purposes. Consumers desire choice and alternatives. Borrowers have little interest in the next greatest, newest technology...benefitting giant corporations.

Consumers desire an alternative to high closing costs, such as title insurance, which are traditionally excessive and unnecessary.

Case Schiller National Home Price Index reports that home prices today are 43% higher than pre-pandemic 2019. Such pricing drives up loan qualification, pricing and closing costs, such as title insurance. Consumers and lenders should recognize that the cost of title insurance is not correlated to risk.

<u>LENDERS:</u> When demand and interest rates increase, pricing and costs go up. When supply and interest rates go down, home prices and costs go down.

In cycles of decades past, lenders typically are reacting today as they always have: Making up for the shortfall in traditional loan products by offering new products such as 40 year mortgages, loan hybrids, increased broker commissions, temporarily-locked loans commitments, HECLS, ARMS, Reverse Mortgages, increased conforming-loan levels, higher loan fees; and *employee layoffs.*

Note, that none of the old school lender solutions benefit the Borrower with lower origination or closing costs. In fact, closing costs have increased 30% in recent years (to a large degree based on the over-heating of home pricing. And, lenders have feasted on the low interest rate driven volume

In mid-September 2022 most direct and wholesale lenders suffered losses in transaction volume, revenue and net earnings in the range of 50-60%, as a result of mortgage interest rates essentially recently doubling from 2.5% to 6%. Major lenders have reported billions of dollars in reduced transaction volume, related revenue and tens of thousands of layoffs.

<u>FEDERAL RESERVE:</u> Also known as the Central Bank, the Federal Reserve's "Fed Funds" establish interest rates, which drives the nation's money supply…dictating interest rates either up or down. Prior to 2021 the Fed Fund rate was essentially zero…which provided for extraordinarily low mortgage interest rates. The Fed Fund rate is generally tied to the Prime Rate.

These rates, when higher, tighten money supply to restrain inflation, resulting in higher mortgage interest rates. 30 year fixed mortgage rates are often tied to the 10-year yield on Treasury bonds.

Liquidity into the nation's banking system is to a large degree the result of the Central Bank purchasing Mortgage Backed Securities. A conflict exists when the buyers of Mortgage Backed Securities require a higher-based interest rate-based Return on Investment (ROI), yet for political purposes the rates have been near zero. Mortgage Backed Securities may experience loan payoffs or refinancing, given low mortgage origination rates. This reduces the investor's yield. As a result, the secondary market may require increased (inflationary) rates to achieve yields.

<u>BOND MARKET:</u> While mortgages are generally perceived to be tied to 10-year Treasuries, they are actually directly related to the bond market. Banks and investment firms buy and sell Mortgage Backed Securities as investment products, with yields attracting buyers. Mortgage Backed Securities generally earn a "risk adjusted" higher yield than 10-year Treasury Bonds.

<u>RESIDENTIAL HOMES:</u> Government Sponsored Enterprises, Fannie Mae and Freddie Mac forecast that homes suffer a 5% reduction in sales for every 1% increase in interest rate. Goldman Sachs predicts a reduction in home

value of 22% in 2022, a realistic consideration when compared to the extraordinary 2021 appreciation in home value, often exceeding 10% per month during the days a 2.5 interest rates. Black Knight projects that in 2022 and 2023 home pricing will reduce approximately 1% per month, a loss of value and/or equity not experienced since 2011.

In 2020 trillions in federal stimulus dollars triggered today's inflation. Soaring home prices forced the Federal Reserve to raise interest rates in an attempt to control inflation, which has predictably eroding purchasing power.

MORTGAGE RATES: Debt-to-Income Ratios, Loan-to-Value (LTV) and credit history generally dictate lender loan rates. Lenders generally desire a DTI of 43%; and an LTV of 80% or less. A lower DTI, LTV and satisfactory credit score can be expected to result in a lower interest rate. Superior qualifying factors will lower origination and closing costs. As a point of comparison, conforming 30 year fixed loans were 2.5% in August 2021 and 6% in September 2022.

REALTORS: Layoffs and more layoffs in 2022; interspersed with the telling of unrealistic expectations that "rates will be coming down soon". Overly optimistic statements must be offset by local market research from reliable sources.

TITLE INSURANCE: An abundance of new products, services and technology…that benefit the title company, not the consumer. Title insurance is a 4 corporate conglomerate monopoly that generated $26 Billion in revenue in 2021 and, embarrassingly, paid out only 3% in claims. The industry is essentially unchanged in 100 years, and is based on the overhead of headcount and brick & mortar.

The claim of lower prices is often quoting for the wrong product for the pending transaction. For example, quoting a "re-fi" rate for a "purchase" transaction is a form of bait & switch. And, the title monopoly's dark side is its diversification strategy: Executing 90% of real estate foreclosure. In other words, evicting their cash paying customers from their homes. RESPA was legislated into law to prevent the common title insurance practice of illegal briberies and kickbacks.

BUILDERS: Naturally builders are esteemed for their ability to add inventory into the real estate market, thereby theoretically driving retail pricing down. However, in recent quarters, builders have found themselves facing elevated material and construction costs…which have delayed new homes coming into the market, while at the same time, together with increased interest rates, resulting in upward pressure on home price.

The National Association of Home Builders/Wells Fargo (NAHB/WFB) Housing Market Index has declined 8 straight months, as a result of higher material and building costs. The result is higher cost, diminished demand and the inadvertent positioning as a competitor of all home-purchase inventory, not just newly constructed home purchase opportunities.

RENTAL HOMES: Rental homes are being swept up by institutional investors resulting in two negative results: First, the investment community, because of their capital dominance can require higher rental prices; and two, the rental property is removed as new inventory to the real estate market, which additional inventory would have driven down home purchase prices, Real Estate Broker & Data firm RedFin reported recently that many primary geographic markets are seeing rental increase of 24-48%.

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