CAPCO

WHAT'S DIFFERENT BETWEEN THE ECONOMIC DOWNTURNS OF 2020 AND 2008 FOR MORTGAGE SERVICING?

TAKING STOCK AND PLANNING FOR 2021

Analyzing the similarities and differences between the 2008 and 2020 economic downturns can help mortgage servicers strategize and plan for what's to come in 2021. While there are distinctions between the downturns, lessons may be learned from the comparison which mortgage servicers can apply to the current economic environment. Mortgage servicers should take note and plan their strategies accordingly for the anticipated wave of loss mitigation precipitated by the end of COVID-19 forbearances.

LESSONS LEARNED IN 2008 THAT THE FEDERAL RESERVE APPLIED IN 2020

The COVID-19 pandemic and resulting economic restrictions shocked the economy, causing a 31.4% drop in gross domestic product during the April-June quarter of 2020.[1] Because of this, the Federal Reserve (Fed) initiated a variety of responses that surpassed the intensity, monetary value, and timeliness compared to the 2008 financial crisis.[2] Two key components of both the 2008 and 2020 responses were quantitative easing – a money-printing program used to purchase bonds to increase the money supply – and lowering interest rates.[3]

Quantitative Easing

During the 2008 financial crisis, the Fed did not start its quantitative easing program until three months after the collapse of Lehman Brothers in September of that year.[4] In contrast, the Fed started its 2020 quantitative easing program on March 15, 2020 – a matter of days after lockdowns and other economic restrictions began – with an immediate $80 billion buy and committment to purchase at least $700 billion in assets with no limit.[5] The Fed quickly expanded the program beyond the purchase of treasurys and mortgage-backed securities by purchasing blue-chip and junk bonds while aslo making Main Street loans.[6]

Lowering Interest Rates

After initially reducing the Federal Funds Rate by 50 basis points on March 16, 2020, the Fed took the drastic step of cutting the the rate to 0%.[7] These actions eased the impact of the pandemic and kept mortgage rates low. The Fed's ability to re-invigorate economic activity and growth by cutting rates was limited as the Federal Funds Rate at the start of 2020 (1.54%) was significantly lower than the start of 2008 (4.23%).[8] The attractiveness of low rates induced record mortgage origination volume of over $4 trillion in 2020.[9] Demand for housing continues to swell; mortgage originations are only held back from even further growth by a shortage of homes for sale. Loan originations were a boon for lenders and the overall economy in 2020.

Going forward, the Fed will be more limited in what it can do to boost the economy as it has significantly exhausted its ability to buy assets and cut interest rates. Any boosts to the economy will need to be addressed mainly through regulatory and/or legislative means.

1. https://apnews.com/article/dwight-eisenhower-gross-domestic-product-archive-economy-42b79397f8f796ce61486a98346142bd
2. https://www.bea.gov/index.php/news/glance
3. https://www.americanactionforum.org/insight/timeline-the-federal-reserve-responds-to-the-threat-of-coronavirus/
4. https://www.cnbc.com/2020/03/23/fed-is-helping-the-markets-more-than-it-did-during-the-financial-crisis.html
5. https://www.americanactionforum.org/insight/timeline-the-federal-reserve-responds-to-the-threat-of-coronavirus/
6. https://www.cnbc.com/2020/08/10/the-fed-bought-more-blue-chip-and-junk-bonds-and-has-started-making-main-street-loans.html#:~:text=In%20addition%2C%20the%20Fed%20stepped,pandemic%20and%20then%20were%20downgraded
7. https://www.americanactionforum.org/insight/timeline-the-federal-reserve-responds-to-the-threat-of-coronavirus/
8. https://www.macrotrends.net/2015/fed-funds-rate-historical-chart
9. https://www.housingwire.com/articles/rate-lock-data-suggests-record-4t-in-2020-mortgages/

KEY SIMILARITIES AND DISTINCTIONS BETWEEN THE ECONOMIC DOWNTURNS

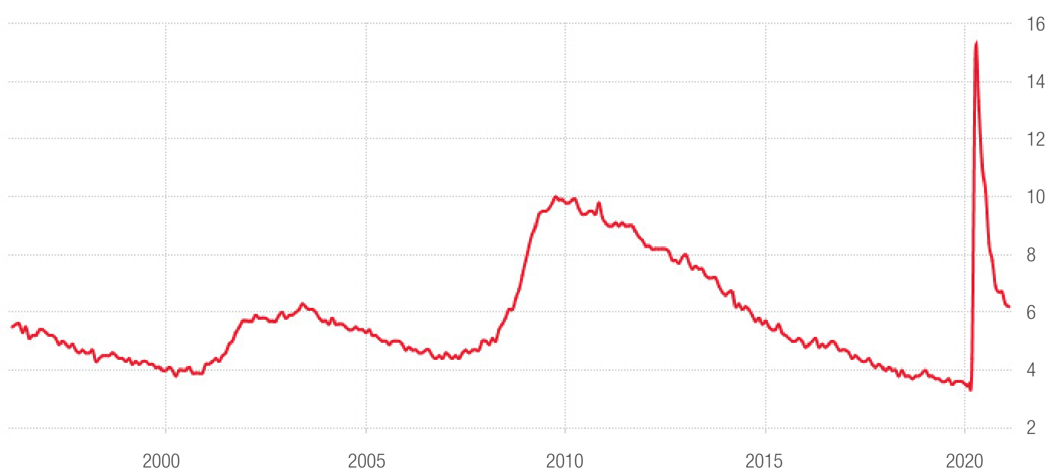
The causes of the economic downturns in 2008 and 2020 were completely different, which prevents servicers from simply dusting off and updating the policies and procedures used to get them out of the last crisis. The 2008 downturn stemmed from deregulation of the financial industry[10], while the 2020 downturn resulted from lockdowns and restritcions to combat the COVID-19 pandemic.[11] While both the 2008 and 2020 economic downturns resulted in borrowers struggling to pay their mortgages, the differences in the root causes of the economic downturns necessitate that mortgage servicers develop solutions uniquely designed to address the challenges borrowers face in 2021.

Unemployment and Delinquent Loan Increases

The economic downturns of 2008 and 2020 both experienced significant increases in unemployment,[12] which resulted in millions of seriously delinquent loans[13] as borrowers did not have the income to pay their mortgages (see Figures 1 and 2).

During the 2008 crisis, the seriously delinquent rate for conventional, FHA, and VA loans – and thus the average of all loans – moved relatively in tandem. In late 2009 and early 2010, the seriously delinquent rate for conventional loans, FHA, and the average of all loans peaked just shy of 10%. Contrastly, as a result of the recent crisis, a wide gap developed between the seriously delinquent rate for FHA loans (11.19%) and conventional loans (3.69%). This is further evidence that burden of the 2020 economic crisis has been felt much more by certain segments of borrowers who, while other segments have experienced little to no negative economic impact.

Figure 1: United States Unemployment Rate

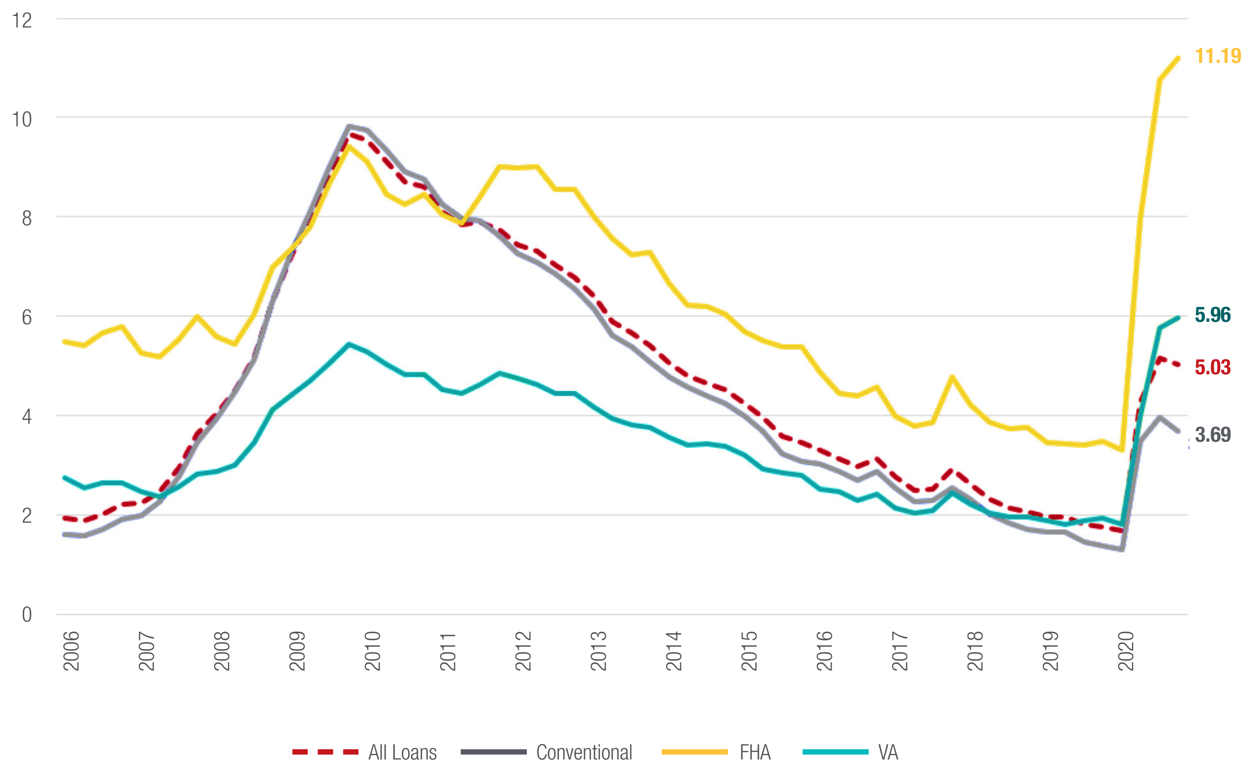


10. https://www.thebalance.com/what-caused-2008-global-financial-crisis-3306176#:~:text=The%20financial%20crisis%20was%20primarily,hedge%20fund%20trading%20with%20derivatives.&text=When%20the%20values%20of%20the,led%20to%20the%20Great%20Recession
11. https://www.thebalance.com/recession-2020-4846657
12. https://tradingeconomics.com/united-states/unemployment-rate (see Figure 1)
13. https://www.mba.org/news-research-and-resources/research-and-economics (see Figure 2)

Figure 2: Chart of the Week - February 12. 2021

Seriously Deliquent Rate by Loan Type for Q4 2020

(based on loan count, non-seasonally adjusted)



Source: MBA's National Delinquency Survey

Comparing the two graphs, it's clear that the increases in both the unemployment rates and the seriously delinquent rates varied in pace. In 2008, the pace was gradual and the full impact of the economic crisis was not felt until late 2009 or early 2010. In 2020, unemployment and seriously delinquent rates spiked from one month to the next, and the fallout was nearly immediate and more severe. Interestingly, the unemployment rate recovery from 2008 took years while a substantial recovery from 2020 occurred almost immediately. Figure 2 shows the classic V-shaped recovery involving a sharp rise in unemployment followed by a sharp decline as the economy quickly adjusted to working remotely.

The Impact of Remote Work

In an attempt to contain the coronavirus, the government enforced stay-at-home orders, social distancing, and business closures, halting a substantial amount of economic activity. Although some Americans were able to work remotely, 63% were not as their jobs require significant onsite presence.[14] This has created an economic disparaty that stands in stark contrast to the 2008 crisis, which was felt much more broadly.

14. Brynjolfsson et al. "COVID-19 and remote work." June 2020. https://www.nber.org/system/files/working_papers/w27344/w27344.pdf

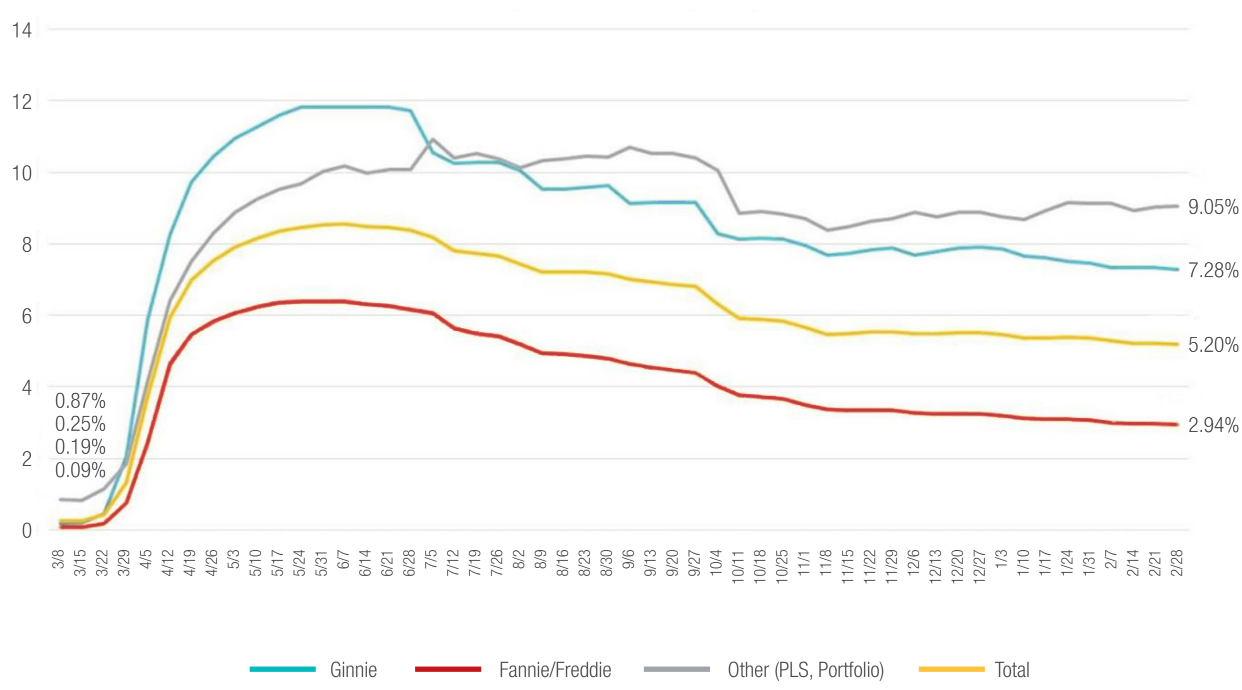
WHAT'S COMING?

THE EXPIRATION OF FORBEARANCE

In late March 2020, Congress passed the CARES Act to address the economic impact caused by the COVID-19 pandemic, which included providing borrowers with the ability to request a forbearance for up to six months and the option to extend said forbearance for an additional six months.

Two additional three-month extensions have been offered to borrowers, meaning their forbearances may last up to 18 months.[15] During the initial weeks after the enactment of the CARES Act, there was a wave of forbearances (see Figure 3).

Figure 3: Weekly Forbearance Requests as % of Servicing Volume (#)



15. https://www.consumerfinance.gov/coronavirus/mortgage-and-housing-assistance/mortgage-relief/

There are two key forbearance metrics that servicers should closely monitor:

1. The rate of new forbearance requests; and
2. The rate of exits from forbearances

Regarding the current state of forbearances, Mike Fratantoni, MBA senior vice president and chief economist stated: “While new forbearance requests dropped slightly, the rate of exits from forbearance was at the slowest pace since MBA began tracking exit data last summer. Overall, the forbearance numbers have been little changed over the past few months.”[16] As many borrowers struggle to recover from COVID-19 related economic hardships, forbearances will continue to be a necessary support for many borrowers.

Looking ahead, mortgage servicers should anticipate the wave of loss mitigation requests that will be coming during the second half of 2021. Recent extensions allow borrowers with federally-backed mortgages to request a forbearance or extend their current forbearance up to a maximum of 18 months.[17] The extensions have delayed the coming wave of loss mitigation requests, giving servicers more time to prepare for the inevitable. While there will be borrowers who exit forbearance, there are still millions of borrowers who will need to work with their servicers to find a solution as their forbearances end. As of March 14, 5.05% of borrowers are in a forbearance plan, equating to approximately 2.5 million homeowners.[18] When their forbearances end, these borrowers will have accumulated arrears, which mortgage servicers will have to address – mostly through loss mitigation.

16. https://newslink.mba.org/mba-newslinks/2021/january/mba-newslink-wednesday-jan-20-2021/mba-forbearance-call-volume-survey-headline-here/?utm_campaign=MBA%20NewsLink%20Wednesday%20Jan.%2020%202021&utm_medium=email&utm_source=Eloqua
17. https://www.consumerfinance.gov/coronavirus/mortgage-and-housing-assistance/mortgage-relief/
18. https://newslink.mba.org/mba-newslinks/2021/march/mba-newslink-tuesday-mar-23-2021/mba-share-of-loans-in-forbearance-falls-to-5-05/?utm_campaign=MBA%20NewsLink%20Tuesday%20Mar.%2023%202021&utm_medium=email&utm_source=Eloqua

OTHER FACTORS THAT COULD IMPACT SERVICER OPTIONS

Many Borrowers Did Not Seek Forbearance

Despite the increased availability of forbearance, many borrowers experiencing financial hardship did not request one.[19] According to a survey conducted by the National Finance Housing Resource Center, borrowers cited two main reasons for not seeking a forbearance: 1) the fear of making a lump sum payment at the end of the forbearance and 2) not knowing about the program.[20] The availability of jobs and the unemployment rate will continue to be important indicators of future mortgage delinquenies and forbearance rates.

Certain Job Sectors Continue to Experience Unemploymement

While some job sectors have recovered from the initial economic downturn, others are still experiencing high levels of unemployment. The US unemployment rate edged down to 6.2% in February 2021 – the lowest rate since April's record of 14.8%[21]. Certain industries, however, are experiencing significantly higher rates of unemployment: Leisure and Hospitality (13.5%)[22] and Construction (9.6%)[23]. This disparity in unemployment between job sectors heightens the need for mortgage servicers to have a more detailed understanding of the borrowers within their portfolio. Mortgage servicers will need to devise different strategies for different segments of borrowers and tailor solutions to each borrower's specific circumstances.

The "American Rescue Plan" of 2021

To address the ongoing economic crisis, the government recently enacted a $1.9 trillion COVID-19 relief bill called the American Rescue Plan Act of 2021 ("American Rescue Plan"). The American Rescue Plan – unlike the $3 trillion HEROES Act passed by the House Democrats in May 2020[24] – does not provide specific regulation governing mortgage servicers. Instead, the American Rescue Plan is focused on providing financial assistance to struggling homeowners, including:

1. Direct payments of $1,400.00 per qualified individual;
2. 2021Temporary federal unemployment benefits extension of $300.00 per week through September 6, 2021; and
3. Approximately $10 billion to provide direct assistance through state housing finance agencies to help homeowners with COVID-19 hardships.[25]

This financial assistance alone, however, will not be enough for many borrowers to exit forbearance and bring their mortgages current.

As the government continues to adjust its policies to address the continuing economic fallout, mortgage servicers will have to continually analyze their portfolio and update their 2021 forecasting.

19. https://www.wsj.com/articles/a-million-mortgage-borrowers-fall-through-covid-19-safety-net-11600335001
20. https://www.hsgcenter.org/wp-content/uploads/2020/07/Survey-results-Forbearance-and-Delinquency2.pdf
21. https://tradingeconomics.com/united-states/unemployment-rate
22. https://www.bls.gov/iag/tgs/iag70.htm
23. https://www.bls.gov/iag/tgs/iag23.htm
24. H.R. 6800 – The HEROES Act (https://www.congress.gov/bill/116th-congress/house-bill/6800)
25. https://img03.en25.com/Web/MortgageBankersAssociation/%7Bb2fd95af-3251-49ff-aa68-3d30f9f38291%7D_MBA_Summary_.pdf?utm_campaign=2021%20Stimulus%20Bill%20-%203.10.21&utm_medium=email&utm_source=Eloqua

6 KEY STEPS TO PREPARE FOR LOSS MITIGATION, POST-FORBEARANCE

As forbearances end later this year, a wave of loss mitigation requests from borrowers is coming. The recent forbearance extension may have delayed its arrival, but mortgage servicers should start preparing for it now. Loss mitigation policies and procedures should be reviewed and updated. Loss mitigation workflows should be enhanced, leveraging automation wherever possible. Servicing portfolios should be re-evaluated and forecasting updated to minimize risks. Multiple loss mitigation options should be developed which may be tailored to address the needs of each borrower's specific situation – a one-size fits all solution will not suffice.

In 2021, servicing organizations should consider these leading practices when evaluating their mortgage pipeline:

1. Review loss mitigation processes and improve workflows to increase efficiency;
2. Leverage automation to increase efficiencies and productivity;
3. Consider approaches to alleviate call center constraints (e.g., invest in digital technologies with self-service options or consider outsourcing of staff and/or servicing functions);
4. Review servicing volume and forecasting for 2021 given recent market developments;
5. Adjust risk and reporting systems to accommodate uncertainty in projections for 2021, and provide transparaency in individual loan default actions to ensure an equitable borrower outcome; and
6. Refresh reporting taking into Consideration key mortgage analytics such as loan modification, recovery rates, and curing success.

CONCLUSION

The COVID-19 pandemic will have a residual impact for many homeowners. Thus, approach 2021 with a proactive plan to equip your team with the strategies to handle the upcoming wave of loss mitigation and to adapt to changes in the marketplace. As a result, regardless of the economic environment ahead, you'll be ready for whatever comes.

AUTHORS

Zac Ross, Senior Consultant
Zac.Ross@capco.com

Eric Glaas, Principal Consultant
Eric.Glaas@capco.com

Charlie Vidal, Senior Consultant
Charlie.Vidal@capco.com

Kevin Jiang, Consultant
Kevin.Jiang@capco.com

FOR MORE INFORMATION:

Mike Peretz, Managing Principal
Michael.Peretz@capco.com

Justin Wellen, Managing Principal
Justin.Wellen@capco.com

Eric Glaas, Principal Consultant
Eric.Glaas@capco.com

Zac Ross, Senior Consultant
Zac.Ross@capco.com

ABOUT CAPCO

Capco is a global technology and management consultancy dedicated to the financial services industry. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward.

Through our collaborative and efficient approach, we help our clients successfully innovate, increase revenue, manage risk and regulatory change, reduce costs, and enhance controls. We specialize primarily in banking, capital markets, wealth and asset management and insurance. We also have an energy consulting practice in the US. We serve our clients from offices in leading financial centers across the Americas, Europe, and Asia Pacific.

To learn more, visit our web site at **www.capco.com**, or follow us on Twitter, Facebook, YouTube, LinkedIn and Instagram.

WORLDWIDE OFFICES

APAC
Bangalore
Bangkok
Gurgaon
Hong Kong
Kuala Lumpur
Mumbai
Pune
Singapore

EUROPE
Berlin
Bratislava
Brussels
Dusseldorf
Edinburgh
Frankfurt
Geneva
London
Munich
Paris
Vienna
Warsaw
Zurich

NORTH AMERICA
Charlotte
Chicago
Dallas
Hartford
Houston
New York
Orlando
Toronto
Tysons Corner
Washington, DC

SOUTH AMERICA
São Paulo

WWW.CAPCO.COM

CAPCO

JN_2940