Mortgage Orb
Required Content for Real Estate Finance Professionals

Is There Any Viability Left In The Jumbo Mortgage Market?

IN FROM THE ORB > REQUIRED READING
BY PHIL HALL ON TUESDAY 19 JANUARY 2010

COMMENTS: 0

REQUIRED READING: **When it comes to jumbo mortgages, Jim Deitch is marching to the proverbial different drum.**

"We are originating jumbo product," says Deitch, CEO of American Home Bank in Mountville, Pa. "It is about 10 to 15 percent of our production."

But Deitch's bank is the exception to the rule. Among the multiple sectors within the mortgage banking industry, the jumbo mortgage market has been particularly hard-hit. The evaporation of secondary marketing opportunities for these oversized nonconforming loans, coupled with severe problems facing the housing markets, has resulted in a product whose popularity has been on the decline since the industry began to stumble. The National Association of Realtors (NAR) estimates that the national share of home sales above $750,000 is approximately 2.3% for 2009, down from 4.4% in 2007.

While many industry experts believe the jumbo market will not show any significant signs of near-future improvement, some believe that the product still has viability - provided that originators are willing to play by new rules.

Admittedly, today's jumbo market is in a fairly sad state of activity.

"It looks like a ghost town," rues Bill Bradway, managing director of Boston-based Bradway Research. "There is a very low level of activity. Institutional investors don't want the product. Banks, in general, are leery of putting it on their books due to the severity of delinquency that exploded in prime and jumbo."

"The jumbo market flatlined about one-and-a-half to two years ago," adds Chris George, president of CMG Mortgage, based in San Ramone, Calif. "A few established lenders are holding jumbos on their balance sheet - but there is a limited amount of capacity."

And, it appears, there is a limited amount of patience regarding that prospect.

"Lenders do not typically want to hold 30-year fixed-rate loans on their balance sheets," says Michael Fratantoni, vice president for single-family research and policy development at the Mortgage Bankers Association.

Bradway adds that the chaos in the housing markets extended into jumbo territory, which doesn’t help the product's attractiveness.

"Home values have cratered," he says. "Say you have a $1 million mortgage underwritten with a relatively conservative 70 percent loan-to-value. If the borrower goes into default and forecloses, you are coming out at less than $1 million."

Off the books

However, there are originators who can sell their jumbos - mostly to larger banks that can accommodate the loans on their balance sheets.

"We sell everything we originate," says Jean Badciong, chief operating officer at Inlanta Mortgage, Waukesha, Wis. "We've been selling to some of the bigger banks. It is typical for us not to keep loans in our portfolio."

Yet, not every originator is this aggressive in selling loans. "The originators who do not have the balance sheet and are unwilling to broker their loans do not have the ability to make these mortgages," observes Adam Glasner, executive vice president of capital markets at GMAC Financial Services, Fort Washington, Pa.

But, at the moment, this is the only option available to jumbo mortgage originators.

"There is no secondary market for jumbos," says Don Romano, former president of Shelter Rock Mortgage Corp. in Lake Success, N.Y. "The lenders who are originating jumbos are cherry-picking and holding them in portfolio until the private-label market returns."

For Romano, the return of the private-label market is already too late. Earlier this year, he was forced to shut down his 17-year-old company due, in large part, to the collapse of this sector.

"Jumbos were 40 percent of our business," says Romano, who is now a mortgage originator with Bank of America. "After the markets contracted, they went down to 10 percent."

With the disappearance of the private-label market, jumbos were literally without a secondary market home. Richard **Rydstrom**, chairman of the Coalition for Mortgage Industry Solutions, puts the blame on the federal government.

"Uncertainty related to government regulations and the ability of government to change the rules is causing massive indecision," he says. "The new proposed regulatory system and consumer finance protection agency, and state and federal preemption rules remain a great concern."

Rydstrom adds that government-sponsored enterprise (GSE) loan limits remain a cause of concern and uncertainty.

"Remember that Congress temporarily increased the conforming loan limits from $417,000 to $625,500 - $729,750 in high-cost areas - in the Economic Stimulus Act of 2008," he continues. "This allowed the GSEs to purchase higher loan limit loans keeping interest rates down and enhancing liquidity. Investors, however, would not purchase bundles of loans with more than 10 percent of the loans over $417,000. Since most pools exceed the 10 percent cap, lenders were again stuck with higher cost alternatives. When the increases expired on December 31, 2008, illiquidity rose again as loans above the Housing and Economic Recovery Act limits became more expensive and harder to obtain."

Rydstrom adds that the American Recovery and Reinvestment Act of 2009 raised the loan limits again for one year, which he feels is illogical. "These loan limits must be permanently raised," he says. "Uncertainty breeds indecisiveness and illiquidity."

If there is any indication that anyone in Washington is willing to step in, it hasn’t been made obvious.

"I don't see them sweeping in to help," says Tom Millon, president and CEO of Capital Markets Cooperative, Ponte Vedra Beach, Fla. "The bigger issue regarding Fannie and Freddie is what will happen when the Fed uses up its purchasing power? That's the dominant issue - jumbos are pretty far down the list in terms of priority. But if private markets don’t start operating soon, it will be ugly for high-priced houses. It is going to force someone’s hand."

Next chapter

Is there any help on the way? Millon believes that jumbos could have some appeal.

"If you look at who could come in - private equity, public equity markets, hedge funds looking for a trade - those entities have fairly decent appetite for risk," he continues. "Understand that good jumbo loans are being underwritten to tighter standards."

Glasner notes that the early signs of economic improvement can only point in the product’s favor. "We are starting to see home values are showing signs of stability," he says, adding that this would be an opportunity for originators to take a new look at the product.

But Bradway insists that the product will not have a wider appeal, as long as the housing markets remain depressed.

"Investors will stay away until they sense collateral pricing has bottomed out and is beginning to restore itself," he says. "There are still important parts of the national market - Florida, California, Arizona, Las Vegas - where higher-end properties are still looking for a bottom."

However, jumbo mortgages are still being originated. As previously mentioned, American Home Bank does not see the product as a liability. Deitch notes that the product has advantages that make it a worthwhile addition to his bank's product line.

"It offers attractive yields, compared to commercial loans and investments," he explains. "Jumbos qualify as 50 percent risk based assets for risk-based capital purposes; the 50 percent risk class increased the return on risk-based capital over commercial loans that are 100 percent risk-based. It also has conservative underwriting criteria and a good expected loan performance."

Deitch believes that more lenders will begin to look anew at jumbos. "There will be some additional depositories entering the jumbo market to replace loan runoff and to take advantage of attractive yields available in the jumbo market," he adds. "In addition, jumbo mortgage underwriting criteria has gotten very prudent, and combined with the 50 percent risk weight for depositories' risk-based capital computation, the return on equity is attractive if the depository has the balance sheet capacity to hold the loans."

"Banks now have jumbo money available for their best customers," observes Fratantoni. "The customers would have very high credit scores and a 25 to 30 percent down payment on an owner-occupied property. But there are almost no jumbo loans for investors or second-home properties."

CMG Mortgage's George believes that in the absence of a private-label market or GSE intervention, banks could work together to relaunch the sector.

"Between the third and fourth quarter in 2010, we will see larger banks picking up jumbos, and a market will develop in which banks trade ARMs [with one another]," he predicts. "The bank would then say, 'If we can trade them, why not get nonbank investors to take them?'"

However, Bradway questions whether more banks will proceed into this sector. "Banks need to have a comfort level," he says. "And clients need to have additional assets pledged to take on the loans. At the moment, it is still a pick and choose market."