

Mortgage Finance Commentary: December 2009

The most important factor driving recent declines in real estate market activity and increases in delinquencies and foreclosures has been the ongoing job losses and rising unemployment rates stemming from the most severe recession the country has experienced in a generation. The central question in any forecast for the housing and mortgage markets is the outlook for the job market: when will companies begin hiring again?

Property values will not recover until the overhang of unsold inventory returns to normal levels, reducing the excess supply. This excess supply will remain unless and until homebuyers return to the market in force. Even though affordability remains near record levels, there has not been any strong indication that the demand for homes is recovering. However, it is important to remember that affordability is a three-legged stool. Mortgage rates, home prices, and household incomes all impact affordability. Today, mortgage rates remain near record lows, and with the continued decline in home prices, for those with resources, it is a buyers' market like we haven't seen in years. Obviously, the problem is that there are not enough potential homebuyers who have the income and downpayment, and who feel confident both that the housing market will recover, and that their job situation is secure, to boost demand despite the improvements in affordability.

November's jobs report was relatively positive, showing a decline in the unemployment rate to 10.0 percent from 10.2 percent in October. Payroll employment declined by only 11 thousand in November, and job losses were revised lower by 160 thousand for the prior two months. Employment does seem to be stabilizing, but the hiring we see is happening at the low end, particularly temp hiring for relatively low skilled positions.

Going forward, it is important to remember is that in most recent recessions the unemployment rate has typically had two peaks. The first peak occurred near the nadir of employment, when the pace of layoffs finally slowed. The second, higher peak, occurred several months later, as conditions began to improve. This improvement led discouraged workers and others to reenter the labor force, pushing up the unemployment rate further until they secured a position.

2010 will likely be another tough year for the industry, as the unemployment rate peaks, but remains high, leading to continued high levels of delinquencies and foreclosures. Home sales should begin to pick up modestly, and home prices should begin to stabilize, leading to some growth in purchase originations. However, rising rates will significantly curtail refi originations.

Housing and Mortgage Data Update

- Construction spending remains extremely weak, particularly for multifamily buildings. Single family starts decreased to 470,000 in October from 511,000 in September. Single family starts remain more than 70 percent below their peak at the height of the boom. Multifamily starts fell to a record low of 48,000 units in October from 72,000 in September, and now more than 85 percent below their peak level.

- Home sales continue to recover. Existing homes sales increased by 10.1 percent in October to 6.1 million at a seasonally adjusted annual rate. New home sales increased by 6.2 percent to 430,000 in October.
- Inventories of unsold homes have declined appreciably in recent months. The months supply of existing homes for sale decreased from 8 months in September to 7 months in October. For new homes, the months supply decreased from 7.4 months in September to 6.7 months in October. There were 239,000 new homes on the market in October, down from a peak above 570,000 in July 2006.
- Home prices continue to be impacted by the substantial overhang of excess supply in the market. FHFA's purchase only index was unchanged at the national level from August to September. MBA forecasts that home prices will increase about 1 percent in 2010 after reaching a trough in 2009.
- According to MBA's Weekly Application Survey, 30-year fixed mortgage rates steadily declined through November, falling 18 basis points relative to the month prior and ending November at 4.79 percent. 15-year mortgage rates reached a new record low for the survey of 4.27 percent. The share of borrowers choosing the 15-year has increased over the course of 2009 as a result of the widened spread between 15- and 30-year loans. MBA forecasts that 30-year mortgage rates will increase through 2010 to end the year at 5.7 percent.
- On a seasonally adjusted basis, purchase applications declined almost 20 percent from October to November. Refi apps increased by about 1 percent over that time.
- MBA projects that mortgage originations will decrease from almost \$2.0 trillion in 2009 to about \$1.5 trillion in 2010. MBA forecasts that purchase originations will increase from \$718 billion in 2009 to \$804 billion in 2010, while refinance originations are projected to fall from \$1.246 trillion to \$693 billion.
- The Federal Reserve and U.S. Treasury mortgage purchase programs continue to dominate the secondary market. In November, Federal Reserve purchases of agency MBS accounted for about 80 percent of new MBS issuance from Fannie Mae and Freddie Mac.