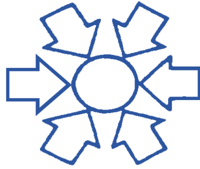

GSE Activity Report

Thursday, May 20, 2021

The Meaning of Mortgage Forbearance

Summary

Using its formidable trove of non-public data, the Federal Reserve Bank of New York has released a series of staff reports assessing the status of mortgage forbearance, concluding that forbearance has ameliorated the negative impact of the pandemic for borrowers (if not exactly for servicers and investors) but that serious-delinquency levels akin to the Great Recession still appear likely as forbearance ends.

Impact

The FRB-NY's mortgage analyses come via a four-report series, the first of which provides basic facts and stats on forbearance tracking those recently released by the CFPB. Like the CFPB, the New York Fed staff think those still in forbearance are likely to stay in forbearance for a good deal longer if they can, a prospect that will prove particularly problematic for the FHA which has an +11% forbearance rate versus an overall 4.2% one.

The paper also concludes that higher-income borrowers in higher-income areas did the best via forbearance, although lower-income borrowers needed the cash-flow relief the most. In general, forbearance for those who did not continue to pay their loans increased unpaid principal balances and did not offset growing delinquencies on non-mortgage debt, making it clear that distressed borrowers in most need of forbearance were able to keep their homes in consequence but not otherwise to secure a more stable financial future. This stands in sharp contrast to higher-income consumers, who paid down credit-card debt at record levels (with those in forbearance doing so at a steeper rate than those who did not elect it).

Outlook

The New York Fed also released a report forecasting what forbearance means to household creditworthiness and mortgage risk. In a cold-comfort conclusion, the data suggest that the post-COVID housing crisis won't approach the great financial crisis (GFC) in terms of severity due in part to the fact that many borrowers turned to forbearance to manage their mortgages exited forbearance by selling their house thanks to higher housing prices. In the GFC, prices of course tumbled, taking even relatively-low LTVs underwater.

However, severity benefits do not appear to offset delinquency risk. Many borrowers remain in forbearance and are also the lowest-income and lowest-score borrowers after current scoring distortions are taken into account. Now, borrowers with the lowest pre-pandemic scores have seen the highest score increases, a phenomenon the studies attribute to false-cure rates due to mandatory credit-reporting restrictions. Subprime mortgagors with initial scores below 620 saw a stunning 57-

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point jump on average over the past year versus an average score boost of 13 points for all mortgage borrowers.

Based on this, the study concludes that credit scores are no guide to credit risk for borrowers still in forbearance, most of whom are likely to face a "severe risk" of delinquency when forbearance ends. The study thus projects an overall serious-delinquency rate of 3.8%, up from the current 0.9% rate and the pre-COVID 1.3%. Given broader economic stress, a 6% overall serious-delinquency rate is more than possible – a rate about that of the Great Recession.

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