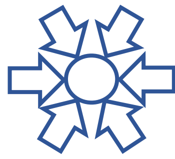

GSE Activity Report

Monday, August 22, 2022

Forbear to Forget

Summary

A new Federal Reserve Bank of Cleveland study validates forbearance as a mortgage-market buffer, reinforcing the likelihood that policymakers and servicers will turn quickly to it if current mortgage-market conditions turn ugly under the combined stress of higher rates and slow to no growth. If bank regulators also reinstate regulatory forbearance on forborne loans, the regulatory-capital cost of higher-risk loans gets a nice counter-cyclical boost, perhaps encouraging banks to tread softly back into at least some of this sector if parallel calculations under the all-powerful stress capital buffer prove propitious.

Analysis

This study focuses on loans in Ginnie Mae securities based on loan-level data from eMBS, a comprehensive database of MBS. It finds that CARES Act forbearance was largely taken up by borrowers in need. There is little evidence that borrowers used forbearance strategically to game the system judged by the extent to which a borrower waits until after purchase of a new home to request forbearance, requests for forbearance after refinancing, or forbearance for the maximum allowed time. To examine the performance of these strategies empirically, the study compares rates of entry into forbearance for federally backed purchase mortgages by first-time and repeat homebuyers, looks at forbearance entry rates of recently refinanced mortgages, and analyzes the rate at which borrowers in forbearance depart.

Key evidence highlighted in support of the study's findings include that loans entering into forbearance in July of 2020 and 2021 were less likely to enter forbearance compared to other months – for example, twenty percent of borrowers who entered forbearance had exited by their third month, while only half of the mortgages that entered forbearance were still in forbearance six months later. The probability of entering forbearance remained below one percent right after the loans are originated and remained low six months later, while forbearance uptake was higher for borrowers already in their homes.

Outlook

The study recommends that policymakers consider how forbearance could be used in economic downturns despite rising pandemic-era housing prices that may correlate with anomalous borrower forbearance behavior because households that enter forbearance in economic downturns in which house prices decline may do so with the express intent to avoid payments or loan modification. The study nonetheless concludes that consistent use of forbearance during recessions and to address idiosyncratic shocks to households could be effective, a finding corroborated in a 2020 Federal Reserve Bank of New York study of 2008 mortgage protections even though this paper is not cited by the Cleveland analysis.

Federal Financial Analytics, Inc.
2101 L Street, N.W., Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail : info@fedfin.com www.fedfin.com

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