Home Lending Isn’t Dead

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Ever since interest rates spiked higher in May 2013, there has been a great deal of conjecture about the market for home lending. What had been healthy demand for refinance loans fell markedly when rates increased. After several years of historically low interest rates, a downturn in refinancing had to be expected. Did the turn in rates, however, signal the end for home lending? Hardly.

Consider what happened after interest rates jumped last year. Within a matter of weeks, major players in the refinance market announced significant staff reductions. Generally, these were among the largest and most aggressive financial institutions in the market.[1] Dependent upon transaction volume and income from selling the funded loans, they quickly adapted to new market conditions.

Home purchases remain an important source of mortgage loan demand for most institutions. According to the Mortgage Bankers Association, home purchases are continuing – though at levels slightly lower than last year's.[2] While consumers remain sensitive to rates in the short term, there has always been a market for new purchase mortgage loans – even a generation ago, when average rates exceeded 10 percent for all of 1990.[3] Consumers continue to need home loans as they move, expand their families, adjust to empty nests and retire. These needs can be postponed temporarily, but history shows that consumers adjust to new interest rate environments.

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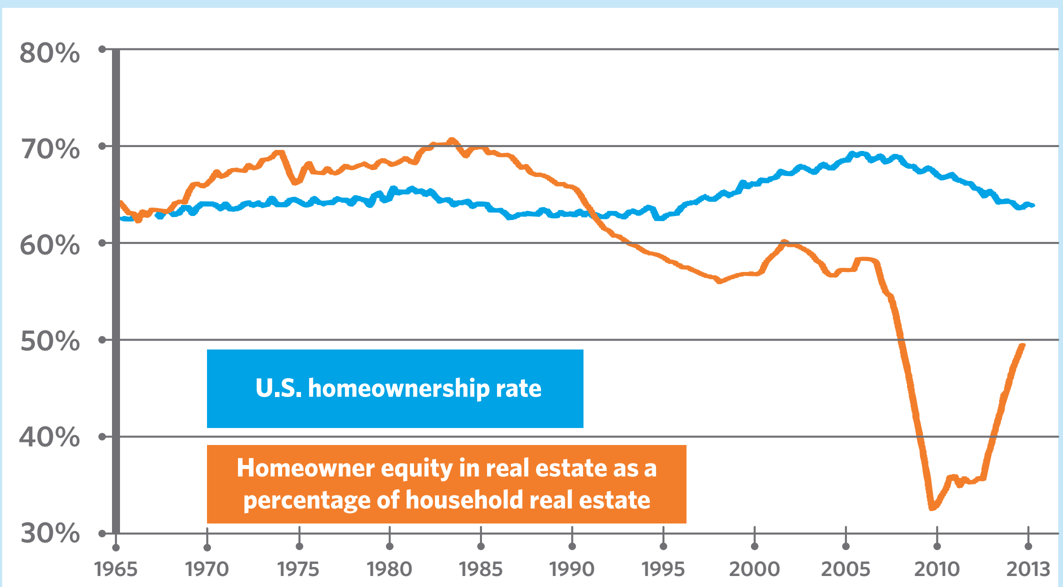
[1] HSH.com, *How Will Mortgage Lender Layoffs Impact You?*, November 11, 2013
[2] CalculatedRiskBlog.com, *MBA: Mortgage Refinance Activity Increases as Mortgage Rates Decline*, May 21, 2014
[3] Freddie Mac, *Mortgage Rates Survey*, July 17, 2014

New Emphasis on Home Equity

Add home equity loans to the mix and the picture gets much rosier. As the residential real estate market recovered during the past year, home equity made a comeback.

Homeowner equity had fallen dramatically during the housing crash, reaching a low of 36.5 percent in 2009. It was not until 2013 that homeowner equity climbed back above the 50 percent mark.[4] Equity continues to rise; it was nearly 54 percent as of the first quarter of 2014.[5]

Homeowners who previously had no or minimal home equity suddenly have a new source of available credit.



Source: Federal Reserve Bank of St. Louis, June 2014

"Home equity loans are a good option for financial institutions because they are highly secured," said Mara Friedman, senior market strategist for Harland Clarke. "Since the loans are usually kept in portfolio rather than sold — as is the case with most 15- and 30-year fixed rate mortgages — banks and credit unions can book large balance loans that help even out their balance sheets."

[4] Bankrate.com, *Home Equity Loans, HELOCs Available Again*, June 17, 2014

[5] Research.StLouisFed.org, *Owners' Equity in Real Estate as a Percentage of Household Real Estate*, August 2, 2014

Home Prices on the Rise

The S&P Case-Schiller 20-City Home Price Index increased by 9.3 percent for the year ended May 2014.[6] An upward trend in home prices provides more homeowner equity, thereby supporting opportunities in equity-based lending.

Consumers have done plenty of loan shopping recently. Despite the decline in home loan refinancing over the past year, more consumers are shopping for home loans (new purchase loans + plus refinance loans + home equity loans) this year.

Percentage of HHs Applying for Home Loans	July 2013	June 2014
Home Loan Shoppers (purchase + refi + HE)	2.67%	2.93%
Home Equity Qualified Applicants (FICO 680+ and LTV<70%)	0.37%	0.45%
New Home Buyers (No existing mortgage)	0.48%	0.55%

Source: Datamyx 2014

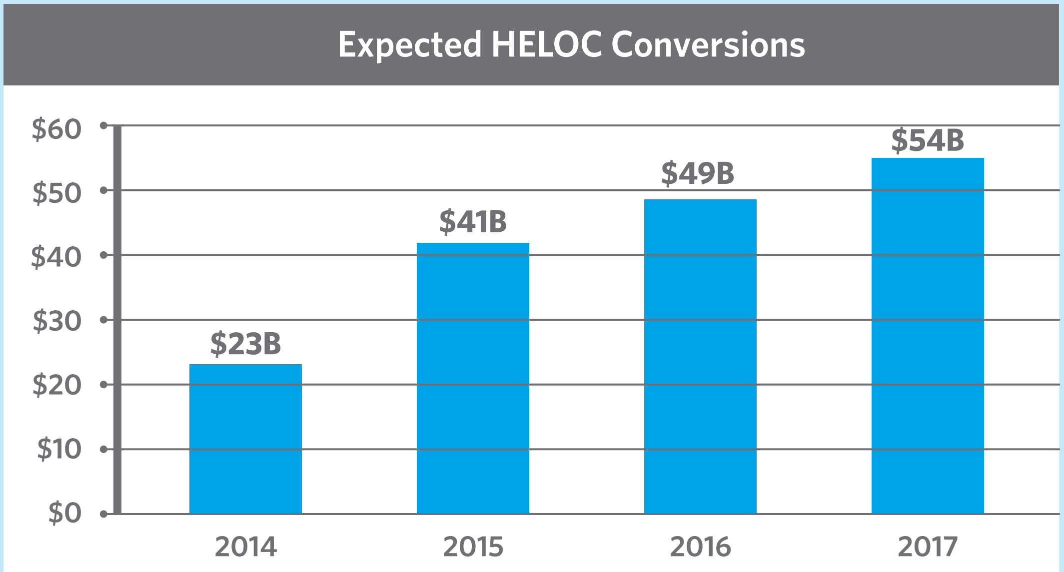
As expected, the percentage of consumers looking for new homes versus refinancing loans has increased. In addition, the percentage of loan shoppers that are Home Equity Qualified (defined as FICO 680+ and LTV<70%) similarly increased during the past year.

HELOC Refinances Will Boom

HELOC lending gained popularity in 2004, so the earliest HELOC borrowers recently experienced ten-year conversion dates. Conversion dates typically call for HELOCs to convert to home equity loans (HELOANS). Borrowers who balk at conversion can either repay draws against their lines of credit or refinance their HELOCs.

[6] Federal Reserve Bank of St. Louis, *S&P Case-Schiller 20-City Home Price Index*, August 2, 2014

The Office of the Comptroller (OCC) estimates $23 billion in bank HELOCs will convert this year. The number of conversions is expected to increase significantly between now and 2017, when they peak. So, for the next few years, HELOC refinance opportunities will abound.



Source: Office of the Comptroller

Newly installed Fed Chairperson, Janet Yellen, has shown a commitment to maintaining the current rate environment over the course of the year. Lower rates will continue to prop housing demand and ensure that the refinance market does not dry up. Total mortgage originations for 2015 are projected to be 15 percent greater than in 2014.[7] Add to that the contributions of increasing equity as home values continue to rebound, and lenders should see an increase in higher quality home loan applications.

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[7] Mortgage Bankers Association, *Mortgage Finance Forecast*, April 8, 2014

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