The Wall Street Journal November 26, 2021

"Mortgage Burnout Looms for Lenders"

****

Loan originators are likely to feel a hangover from the pandemic boom, so they need some new tricks.

It is getting to the hard part in the mortgage business.

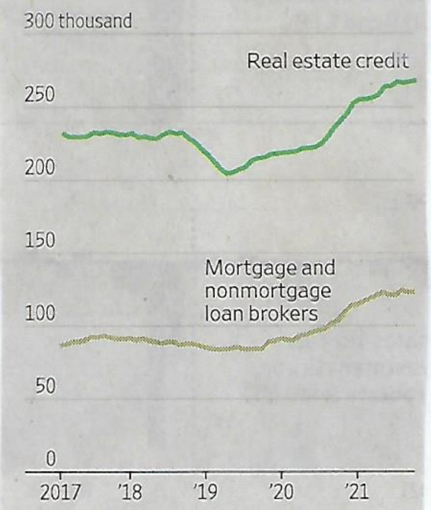
When mortgage lending volumes were buoyant during the pandemic, originators could offset competitive pressure on their margins, especially whenever rates ticked down and demand for refinancing grew. But volume in certain key segments is now getting harder to come by, even if rates remain low.

There is an effect in mortgages known as "burnout." As more people take advantage of low rates to refinance, that reduces the pool of people who would still benefit from doing so. At this stage of the cycle, any additional decline in rates doesn't always have the equivalent volume effect.

The Mortgage Bankers Association's index of refinance loan application volume is about a third lower than it was at the same time last year. That is partly driven by rates, which have jumped about 0.3 percentage points for 30-year fixed mortgages over that time, though they remain below their peak level for the year. But some measures of the portion of mortgage balances expected to be paid off early over the course of a year are slowing, too.

Among borrowers that could improve their interest rates by a percentage point or more by refinancing, the portion was north of 50% at the peak of the pandemic for mortgage-backed securities of 30-year Fannie Mae- and Freddie Mac-guaranteed mortgages, according to Walt Schmidt, mortgage strategist at FHN Financial. Now it's closer to 40%. That is still well above the roughly 30% rate before the pandemic. But where that number settles will be a key variable for how refinance volumes move, depending also on where interest rates are. One factor may be a "moderating use of appraisal waivers," which jumped during the pandemic, says Mr. Schmidt. These waivers, en-

U.S. employment in mortgage lending by industry, monthly



Note: Not seasonally adjusted
Sources: Piper Sandler; U.S. Bureau of Labor Statistics

abling a borrower to skip a property inspection, made refinancing faster and easier for many people.

In theory originators can make up for less demand through pricing, trying to earn a bit more on each mortgage sold. But the industry still appears to have a lot of capacity for originating, built up to handle the pandemic surge. The number of people working in the U.S. in real-estate credit as of September was tracking about 25% higher than two years prior, according to government employment figures studied by analysts at Piper Sandler. The number of mortgage and other loan brokers was almost 50% higher.

The result is competitive pricing pressure, which can translate into narrowing margins earned by originators when selling mortgages into the market. While there was an uptick in the median "gain on sale" margin tracked by Piper Sandler in the third quarter from the second, that was driven in part by the one-off end of a pandemic fee imposed by Fannie Mae and Freddie Mac.

There are some offsets. One is to keep expanding in purchases. In that part of the market, volumes could be boosted further if home prices dip or if more homes are constructed, or by demographic trends like more people moving out or starting families as the pandemic wanes.

There are also products like cash-out refinancing. Rocket Cos. told analysts in November that it set volume records for both purchase mortgages and cash-out refis in the third quarter. The company noted that some customers who are looking to buy, then finding a long wait for inventory, may shift toward using cash-outs to fund renovations.

Eventually, capacity in the industry will likely shrink, enabling the surviving players to bolster their pricing. But that can take years to shake out. So investors for now are going to have to consider which originators' growth stories still sound good at lower volume.

—*Telis Demos*