BEYOND THE CREDIT SCORE:

The Secondary Mortgage Market

Housing Action Illinois

A stronger Illinois begins at home
Housing Action IL

- Housing Action Illinois is a statewide coalition formed to protect and expand the availability of quality, affordable housing throughout Illinois. Together we empower communities to thrive through three programs: Organizing, Policy Advocacy, and Training and Technical Assistance.

- Our members include housing counseling agencies, homeless service providers, developers of affordable housing and policymakers. These organizations serve low- and moderate-income households, helping to provide a place to call home, thereby strengthening the community at large.

- At Housing Action Illinois our supporters, participants and members agree that a stronger Illinois begins at home.

- HAI is a HUD Housing Counseling Intermediary with Affiliates in Illinois, Indiana and Missouri.
AGENDA

* Explain the purpose of the secondary mortgage market

* Explain the history of the market

* Show how secondary market rules impacted housing policy and neighborhoods

* Show how investor needs impact mortgages and underwriting

* Explain the role of the secondary market in the housing crash
The Secondary Mortgage Market
The Secondary Mortgage Market

The Secondary Mortgage Market is where banks sell mortgage loans to investors, which creates liquidity for the origination of new mortgages.
HISTORY OF THE MORTGAGE MARKET
Early Mortgages

- Mortgages offered by private companies, including insurers
- Required up to 50% down payment
- Often interest only or short-term loans with a balloon payment
- Limited the number of people who could buy homes
- Eventually, Building (Savings) and Loan Associations began offering mortgages
The Great Depression
Federal Home Loan Bank
Homeowners Loan Corporation
Homeowners Loan Corporation

- Congress created the Home Owners Loan Corporation to refinance existing home loans.
- Helped to prevent thousands of families from losing their homes to foreclosure.
Federal Housing Administration
Fannie Mae
Residential Security Maps

Home Ownership Loan Corporation hired appraisers to create maps to determine the quality of neighborhoods in 239 cities.

Neighborhood quality identified by color.
Residential Security Maps

- Green = Best
- Blue = Still Desirable
- Yellow = Definitely Declining
- Red = Hazardous
Chicago
Chicago
Note the description for the Washington Park neighborhood. If you were a lender in that era, would you want to lend there?

Eventually, the maps created by the Homeowners Loan Corporation and private firms were used by the entire mortgage industry to determine where to lend and how to price products.
In Chicago, this contributed to contract buying and other abuses that continue to impact many Chicago neighborhoods.
MANHATTAN, NEW YORK
MANHATTAN, NEW YORK

Credit: Mapping Inequality
New Orleans

(map of Greater New Orleans, Louisiana)
Philadelphia
Aurora, Illinois
Home Mortgage Disclosure Act Notice

The HMDA data about our residential mortgage lending are available for review. The data show geographic distribution of loans and applications; ethnicity, race, gender, and income of applicants and borrowers; and information about loan approvals and denials.

Inquire at this office regarding the locations where HMDA data may be inspected.
The Rise of the Secondary Market
Fannie Mae Goes Private
Ginnie Mae
Conforming Mortgages
Alt-A Mortgages
Sub Prime Mortgages
Mortgage Backed Securities
Mortgage Lending with Securitization

- Fannie Mae
- Freddie Mac
- MBS Issuer
- Mortgage Pool (MBS)
- Monthly Payments
- Investor
- Servicer
- Bank
- Mortgage Broker
- Homeowner
- Monthly Payments

*MBS = Mortgage Backed Security

Credit: Massachusetts Real Estate Law Blog
Collateralized Debt Obligations

Type of security often composed of the riskier portions of mortgage-backed securities.
Credit Default Swaps

A type of credit derivative allowing a purchaser of the swap to transfer loan default risk to a seller of the swap. The seller agrees to pay the purchaser if a default event occurs. The purchaser does not need to own the loan covered by the swap.
Credit Default Swaps

What is a Credit Default Swap?

A credit default swap is an agreement between two parties that works like a side bet on a football game. Swap sellers promise swap buyers a big payment if a company’s bonds or loans default. In return for the promise they get quarterly payments. Neither needs to hold the underlying debt when entering into a swap.

Credit Default Swap Seller
Promises to pay swap buyer a set amount if Widgets “R” Us defaults, often $10 million
- Receives annual payments from swap buyer in return for “insurance”
- Can include banks, insurance companies, hedge funds or others

Credit Default Swap Buyer
Promises quarterly payments to swap seller
- Receives promise of large payout if bond defaults
- Can include banks, insurance companies, hedge funds or others
- If Widget’s financial fortunes turn sour, the swap becomes more valuable. A swap holder can resell it and get high payments in return

Credit: Goldonomic
Credit Default Swaps

TODAY, I BET AGAINST THE BET I PLACED ON THE BET I MADE ON MY ORIGINAL BET.

ISN'T THAT ILLEGAL?!!

NOT IF IT'S CALLED A CREDIT DEFAULT SWAP.

Credit: The Cagle Post
Synthetic Credit Default Obligation

A CDO that holds credit default swaps that reference assets (rather than holding cash assets), allowing investors to make bets for or against those referenced assets.
Private Label Securitization
Private Label Securitization
All this financial creativity was a lot “like cheap sangria,” said Michael Mayo, a managing director and financial services analyst at Calyon Securities (USA) Inc. “A lot of cheap ingredients repackaged to sell at a premium,” he told the Commission. “It might taste good for a while, but then you get headaches later and you have no idea what’s really inside.”

Financial Crisis Inquiry Commission Report
Foreclosure Crisis
Starting in mid 2007, global financial markets began to experience serious liquidity challenges related mainly to rising concerns about U.S. mortgage credit quality. As home prices fell, recently originated subprime and non-traditional mortgage loans began to default at record rates. These developments led to growing concerns about the value of financial positions in mortgage-backed securities and related derivative instruments held by major financial institutions in the U.S. and around the world. The difficulty in determining the value of mortgage-related assets and, therefore, the balance-sheet strength of large banks and non-bank financial institutions ultimately led these institutions to become wary of lending to one another, even on a short-term basis. Prepared testimony of FDIC Chair Sheila Bair to FCIC, 9/2/2010
Foreclosure Crisis
The Present
The Present

FHA
Fannie and Freddie
Fintech = Financial Technology
Private Label Security
Credit Box Remains Tight in Conforming Market
Lenders using Portfolio Products to Serve Non-Conforming Buyers
The Present

Blackstone Group bought more than 1,300 single-family homes in Cook County in 2013, focusing its purchases in southwestern and western suburbs.

Blackstone 2013 Single-Family Home Purchases by Census Tract

- Blackstone purchased 10 or more homes and accounted for at least 10 percent of all houses sold in 2013.
- Blackstone bought fewer than 10 homes or accounted for less than 10 percent of all purchases.
- Blackstone made no purchases.

Source: Institute for Housing Studies, DePaul University
The Present
QUESTIONS?

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