Our Perspectives:
Commentary on the economy & regulatory policies affecting financial companies

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Some Challenges and Opportunities for the Mortgage Industry in 2014*

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The year 2014 is shaping up as one that will present major changes in the mortgage finance environment. Lenders and other participants will face a number of challenges, or viewed another way, find many opportunities in which through their own efforts and ingenuity they will distinguish themselves from others and create many opportunities for themselves. Here are a few.

1. CFPB and Data. CFPB will continue to be data driven, and with an increasing number of complaints in their archives, will be driven toward supervision and enforcement activity by an analysis of these complaints. They have received 230,000 so far and thousands more are arriving monthly.

2. Errors in new systems. Lenders will be utilizing new computer and work process systems without opportunities to test them sufficiently in real time with real customers, and with that will come inevitable problems, many small and some larger. Such problems may create a second wave of stories about such systems, likening them to robo signing.

3. Consumer confusion with new notices. Consumers will be receiving more notices and more new notices pursuant to the new rules, whether they are current of in default. This has the potential for major customer confusion.

4. Scope and complexity of new rules will lead to violations. Regulators and the various enforcement agencies at the state, local and federal level will be vigilant to capture violations of the new mortgage rules, whether during the period of "flexibility" promised by the regulators or afterwards. A list of the new rules provides some indication of the scope

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of compliance problems: (1) Ability to Repay and Qualified mortgage; (2) High-cost mortgages; (3) Mortgage Servicing; (4) Appraisals and appraisal disclosures; and (5) Loan originator compensation. We expect the TILA/RESPA integration rules and forms will be published very soon, perhaps before this is published. Still to come will be the Mortgage credit risk retention and QRM. The policy of supervision through litigation will gain momentum.

5. Many borrowers will have difficulty accessing credit. It is highly unlikely that there will be a larger number of consumers that will be able to get mortgage credit after the mortgage rules go into effect in January, and there may be fewer. Consumers, consumer groups, government officials, and the media may not understand that result.

6. Political pressure will intensify. Pressure to expand lending will ratchet up from politicians as the election nears, and, in particular, pressure to make credit available to those further down the credit quality and income rungs of the economy.

7. Disparate impact based discrimination cases will continue. With the Mount Holly case likely to be settled, disparate impact will remain an active theory for assessing violations of Fair Lending, and an agency or a private litigant may test the applicability of that theory based on a firm's dominant use of QM loans as the basis of their mortgage lending.

8. Regulators may utilize combination of HMDA and disparate. New HMDA data requirements and new tools designed by CFPB to be used to analyze HMDA data, when used in conjunction with disparate impact analysis, may create more examples of discriminatory lending practices.

9. Cash Purchases. Cash purchases will likely slow down or stop as obvious profitable acquisition targets vanish.

10. Increase in rentals. Younger upscale consumers seem to be moving toward a more urban center lifestyle that includes renting cars, bicycles and other necessities, including shelter, rather than buying it. Shelter rental may also be the option of choice for those unable to meet the credit quality standards in the new mortgage rules. How to finance the increased rental properties and what new rules will be developed to regulate that financing are, as of yet, undetermined.

11. Mortgage rental bonds. Mortgage rental bonds will become more popular, and following on their increase will be the attendant discoveries of

tenant rights and the high likelihood of the development of one or more movements to provide greater tenant protections and to provide access to rental properties to some groups unable to gain access through the normal market processes.

12. Fed newcomers, QE3 reduction, transition changes at GSEs may effect secondary market performance. The secondary market for mortgages will face challenges if the Fed begins to back down from QE3, and if certain transition changes are made in the operations of the GSEs. The degree of those challenges and the appropriate response may turn out to be frustratingly unpredictable because of the existence of a new Chairman, potentially, a large number of new governors, and, potentially, a new Director of FHFA.

13. Security of mortgage collateral. While mortgage lending will remain secured, the degree of security may be less than a decade ago as the pressure to modify nonperforming loans increases (including principal forgiveness), a quasi-partnership is created between government and defaulting mortgagors, the payment priorities of mortgagors change, and no solution has yet been found to the problems of either lengthy foreclosures or buyback demand policies of buyers of loans.

14. Pressure on smaller mortgage lenders. Many smaller lenders will withdraw from mortgage lending because the cost of establishing and maintaining a compliance group in their firm, as well as the risk of litigation or regulatory penalties because of compliance errors, will eliminate the ability to make that a viable business.

15. Consolidation in banking industry. Consolidation will continue in the banking system as smaller institutions are unable to find sufficiently sophisticated management to succeed the senior managers currently in place as their firms are faced with both severe competition from national and large regional competitors utilizing new consumer technology and expanding regulatory compliance requirements. Those consolidations will be felt most intensely in rural areas. A new "Too Small To Survive" level among banks will begin to be set by the market place, probably at something around the $10B level.

16. Capital rules. New capital rules will force companies to make difficult internal capital allocation decisions.

17. Macro unsettling forces in the economy. Markets and the economy generally will be unsettled by (a) Congressional and Administration efforts

to win the 2014 elections; (b) a decline in trust between and among the developed countries; (c) the tight focus of the media on the debates and dissension in the government as the deficit, budget, appropriations and related issues fester for months; and (d) the commencement of the tenure of a new chairman and perhaps as many as four new governors of the Board of Governors of the Federal Reserve System.

18. Congressional decision on government backstop for mortgages. A decision on the existing GSEs and how to operate a secondary mortgage market will be addressed, although perhaps not finalized, including what role the government will assume. While it may not settle all questions, it may provide some guidance for the final solution of the issue.

19. Cyber activity. Not only will the realization of the need for more and better security be apparent, but so also will the fact that younger consumers are looking more to nontraditional communication avenues for purchase and sale events (see, for example, Cryptolocker success, growth of online sales kiosks in retail stores, and use of Twitter for source material for mainstream media).

20. Traditional stuff. Will sale of mineral rights to fracking companies lead to cancellation of mortgages; will statute of frauds protect against oral assurances in foreclosure cases; will increases in minimum wages upset budget or sales plans; will the butterfly effect of problems in Rio around the Olympics, see through skyscrapers in China, and corruption and discontent in the crescent running from Algeria thorough Delhi cause economic rain clouds here; will Too Big To Fail discourse spill over into Big Enough to Be a Problem or We Love Glass-Steagal issues; etc.?

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