

The impact of the coronavirus on mortgage refinancings

Laurie Goodman and Aaron Klein

Mortgages, whether purchase and refinance, require a long to-do list. If any of the steps in the chain cannot occur, the ability to get a mortgage is jeopardized. The unprecedented shutdowns caused by COVID-19 threaten to break multiple links in the mortgage chain. This article examines what is at risk for one segment of the housing world: mortgage refinancing.

At an aggregate level, an inability to refinance undermines the effectiveness of monetary policy. One of the main ways lower interest rates stimulate the economy is through refinancing. What is the purpose of the Fed lowering short term rates to zero and buying hundreds of billions of mortgages to lower mortgage interest rates if people cannot functionally access a mortgage?

Moreover, the demand for cash-out refinances is likely to rise substantially, given the combination of massive losses of income, low interest rates, and the increase in home equity over the past decade. Families look to their largest source of wealth, their home equity nest egg, to buffer massive and unforeseen economic shocks. The inability to refinance limits households ability to cope with this economic crisis. This is especially important when large portions of the economy are shut down and tens of millions of people are losing their jobs, home equity is one of the few places households can find money to make it through these tough times.

For any mortgage, including a refinance, to happen multiple steps behind the scenes must take place including title searches, appraisals, applicant employment and income verification, notarization, closings, and county recordation offices. Coronavirus poses new, unforeseen threats. For example, if a county clerk's recordation office requires filing a physical document for final recordation, and the office is closed, a mortgage cannot become official.

Coronavirus' impact will vary geographically as some areas and lenders will have systems that can work in this environment while others will not. Even if many refinancings sail through the process, others will be stuck in an "inability to process" pile that grows ever longer the longer the pandemic lasts. Here are five potential disruptions and potential policy solutions for each:

TITLE SEARCHES

A clear title is necessary for any real estate transaction, including a refinance. This title search is an examination of the public records to determine and confirm a property's legal ownership and to find out whether there are any competing liens on the property. This requires up to date information on the status of the property. With many county assessor's offices shut down, information cannot be updated. Approximately 2,000 of the 3,600 municipal jurisdictions that record titles allow the information up to the date of the shutdown to be searched online. For these areas, the risk exposure is from the

date of the title search to the date the new mortgage is recorded. It is important to realize there is always a gap; gap insurance is normally included as part of the title insurance policy. Most title insurance carriers have extended the gap from 60 to 90 days, requiring them to bear additional risk. And even 90 days may prove insufficient in the months ahead.

For the more than 1,500 jurisdictions that likely do not have electronic searches, the problem with how to search is more significant. These areas are likely to be more rural and sparsely populated than those with electronic searching capability, but still comprise close to 10% of potential mortgage refinancings. If these areas close their physical offices, and many already have, title searches cannot be completed and the borrower is unable to refinance. The bottom line: most title searches can be performed but many cannot.

One possible policy solution to this problem is to simply allow the prior title insurance policy to remain in force for refinances. This would apply to all refinancings, both rate/term and cash out, closed during the “coronavirus period.” The title company would bear a very small amount of additional risk on their lender insurance if the refinancing is a cash out. The logic is straightforward: If the property is not changing ownership hands, and there are attestations by the borrower that no new liens have been put in place, then there is little additional risk involved. This begs the separate question as to why refinances require new title insurance to begin with, but that is a separate question for a non-crisis period.

APPLICATION PROCESSING — VERIFICATION OF EMPLOYMENT

Refinances currently require verbal verification of employment, which can be very difficult to obtain in this environment when so many employers are closed or hard to reach on the phone. To their credit, Fannie Mae and Freddie Mac have provided additional flexibility to permit emails from the employer that identifies the name and title or the verifier and the borrower’s name and current employment status. The verification of employment can also be met by use of a current pay stub or bank statement. Moreover, the lender may obtain the verification of employment up to the time of loan delivery.

We view this as a very important step and one that lenders will want to emulate on all refinancings.

There is one additional item that lenders are asked to verify in the current environment: continuity of income. Fannie and Freddie are now asking their lenders to do due diligence to ensure that any disruption to borrowers’ employment or self-employment and/or income due to COVID-19 is not expected to impact their ability to repay the loan. This puts a burden on lenders, as it is not clear how a lender would verify this; and may result in self-employed borrowers having difficulty receiving a refinancing. Capping the risk to lenders through representation and warranty relief would help.

A better policy solution is to eliminate this requirement on same government sponsored enterprise (GSE) refinances (from Fannie to Fannie or Freddie to Freddie), as there is no additional risk for the GSEs. We also advocate eliminating this requirement on Fannie to Freddie and Freddie to Fannie refinances, as these organizations are under similar conservatorships.

APPRAISALS

It can be difficult to get a traditional appraisal in this environment. Borrowers are uncomfortable about letting appraisers in their homes, and appraisers are uncomfortable entering the homes. Fannie Mae and Freddie Mac traditionally offer an appraisal waiver for low LTV refinances under their automated underwriting systems. Fannie refers to this as a Property Inspector Waiver, Freddie refers to it as Automated Collateral Evaluation. Both GSEs appear to have expanded the LTV range for these waivers. In addition, they are permitting exterior only appraisals for Fannie-to-Fannie and Freddie-to-Freddie refinancings. All cash out refinances and refinances that are not Fannie-to-Fannie or Freddie-to-Freddie require a traditional appraisal, which all but guarantees they cannot be completed. This is particularly important in the COVID situation in which many families are facing substantial income losses and need to tap into their home equity. Congress recognized the need to reach into protected accounts in the recent CARE Act in which it temporarily eliminated the penalty for early withdrawals of retirement accounts like 401(k)s. Similar temporary modifications to allow people to tap into their home equity would be wise.

POTENTIAL POLICY SOLUTIONS

Expand the current waiver program to cover all GSE to GSE refinancings: both same GSE (Fannie to Fannie, Freddie to Freddie) and cross GSE (Fannie-to-Freddie and Freddie-to-Fannie). Waivers should apply to both cash out refinances as well as rate/term refinances.

Doesn't cash out refinance increase the risk to the GSEs? Yes, but the increase is marginal, as the max loan-to-value (LTV) on a cash out refinance is 80%. Moreover, allowing for more cash out refinancings will allow households to tap into the \$19.7 trillion of existing home equity to better weather this economic maelstrom, thereby resulting in fewer people falling behind on their mortgage, reducing forbearances. It is important to act quickly, as currently, any borrower can get forbearance by stating they have a hardship, however, once they enter into forbearance they are no longer eligible to refinance. Many borrowers may see a cash out refinance, with the opportunity to tap into wealth while locking in the lowest rates in several generations, as preferable to forbearance.

CLOSING

A large problem with closings is buyers and sellers unwilling to let a notary into their home to sign the closing papers. Many states do not allow e-notarizations, although this

is changing. For example, on March 20, New York State permitted notaries to sign virtually. Now approximately 23 states allow for virtual signings.

POLICY RECOMMENDATION

States should follow New York's lead allow for e-notarization. Congress could solve the problem more broadly by allowing e-notarization nationally, as Senators Mark Warner (D-VA) and Kevin Cramer (R-ND) have proposed in the SECURE Notarization Act. Moreover, using teleconferencing video systems (Zoom, Skype, BlueJeans) that record the proceedings is a wise method to capture the closing and allow for the borrower and seller to be "present" if they choose to be.

POST CLOSING

A final set of problems exist in jurisdictions, where final mortgages cannot be recorded electronically. State and local governments may need to adapt more quickly to electronic filings, suspend the requirement until offices open, and ultimately consider whether this is a critical aspect of local government, and if so, how to provide it in a manner consistent with social distancing and medical safety.

OVERALL POLICY RECOMMENDATIONS

During this stressful period, we urge the FHFA and the GSEs to prioritize their social purpose over profitability. There is a strong case for a widespread streamlined refinancing program. This part of the post-2008 financial crisis toolkit has all but disappeared. The Home Affordable Refinance Program (HARP) reduced payments for 3.4 million homeowners. While other parts of the loss mitigation toolkit are stronger than in the aftermath of the crisis the streamlined refinance program is a shadow of its former self. Fannie Mae's High LTV Refinance Option and Freddie Mac's Enhanced Relief Refinance Mortgage are very limited, restricting eligibility to loans with a 97 LTV or higher. Most of today's refinancers are ineligible for these limited programs. Eliminating the minimum LTV on this program would be an excellent first step, to the benefit of the both the borrower and the GSEs.

Restoring and expanding the streamlined refinance program which would allow both cross and same GSE refinancings with no documentation is a smart step to help homeowners deal with the current economic crisis and booster the economy's overall resilience to these challenging times. Addressing the new challenges COVID poses to people refinancing their mortgage, and tapping into their home equity, is critical to helping homeowners survive this recession. Policy makers have to be careful not to assume business as normal when pushing macro-levers, such as interest rates, and focus critical attention on the micro-levers to ensure people are able to access a working housing refinancing market.

Laurie Goodman is the Vice President of Housing Finance Policy at the Urban Institute, and serves on the Board of Directors of MFA Financial, Arch Capital Group

Ltd., and DBRS. She is also a consultant for Amherst Capital Management. The authors did not receive financial support from any firm or person for this article or from any firm or person with a financial or political interest in this article.