

ASK THE ECONOMIST

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Recently, the Trump administration has proposed large-scale budget cuts to HUD. How should we measure the impact of these cuts?

HUD’s mission is to ensure fair and equal housing access and community development opportunities for all Americans. The White House’s budget cuts of over \$6 billion to HUD are thus controversial, and any process to measure their impact needs to be as objective as possible if it is to gain traction. I thus propose a transparent data-driven approach.

First, we should use administrative and publicly available data to estimate the pre-cut costs and benefits of each of the affected programs. Second, we should study post-cut substitution effects: Will state and local governments be able to position themselves to meet specific community needs or will the reductions lead to a vacuum? Will private

investment take over some programs, and is this even desirable? Once we understand these two elements, HUD will need to evaluate them, prioritize, and take tough decisions.

I also urge continued re-evaluation—especially as the economic environment evolves. This way, HUD should be able to efficiently provide opportunities for as many individuals as possible under the new constrained reality.

How do HUD programs promote homeownership for Americans? What do you predict for the future of HUD?

Since the Great Recession, FHA has played a critical countercyclical role to stabilize the mortgage market. This is true not only for single-family but also for multifamily and health care insurance programs that experienced a fourfold increase in volume

from 2008 to 2011. As the economy continues to recover, I expect to see FHA’s market share diminish as nongovernment entities re-enter the market. However, this process will be different than any other we have witnessed because it crucially depends on the future status of the GSEs.

What HUD will look like in the coming decades also depends on how it accommodates the aging baby boomer cohorts. By 2030 almost 20 percent of the U.S. population will be over the age of 65, compared to 12 percent in 2000. HUD currently provides mortgage insurance for residential care facilities and hospitals; its reverse Home Equity Conversion Mortgage enables seniors to “age-in-place.” Other HUD programs, such as the Section 202 voucher program, provide vital assistance for the elderly. I anticipate that these programs will play an increasing role in the economy, assuming HUD has the budget to execute them. Moreover, I believe that HUD will need to be flexible and provide new programs to the elderly that, if left to the private market, would be lacking.

Currently, the future of the GSEs is also being questioned. What do you foresee for the enterprises moving forward? Recently, leading industry experts have weighed in with multiple proposals that detail principles and recommendations for GSE reform and even provide roadmaps to minimize housing

finance disruptions during the transition. Since these proposals are like one another in many respects, I believe that it will not take too great a leap of faith to reach a general consensus for a plan of action.

Meanwhile, foundations for GSE reform are moving ahead. The GSEs are taking strides to become guarantor companies, the Common Securitization Platform that integrates the GSEs' various and antiquated securitization systems is now scheduled to arrive in 2019, and the GSEs now have meaningful credit-risk transfer programs. These three pieces, together with a federal insurance fund to cover catastrophic risk, will likely constitute the basis for the new market structure.

In recent testimony, Treasury Secretary Mnuchin said GSE reform remains a priority, and that he would share ideas in the second half of 2017. It thus appears that as soon as there is a political will to move ahead with reform, it can happen. Only time will tell.

In July, Fannie Mae will raise its DTI requirements. What impact will this have for borrowers? By raising the DTI ceiling to 50 percent and loosening the credit box, Fannie Mae is likely making a play to attract more student loan-laden millennials to homeownership. I am not worried by this move—Fannie's research team, where I used to work, claims that the additional default risk is minor.

With that said, will this move have a widespread impact? The consensus is that lender credit overlays—driven by the existing housing finance system's structure—are the main reasons for tight credit.

The good news is that structural changes are happening. The GSEs have made major progress in tackling reps and warrants risk and steady progress in coming to grips with litigation (False Claims Act) risk. However, the industry is still in need of a structural upheaval in servicing where costs are high and uncertain, and progress has been slow.

Per the MBA, the cost of servicing a nonperforming loan quintupled to almost \$2,400 between 2008 and 2015. I therefore believe that without addressing servicing compensation and costs, lenders and servicers will continue to restrict the credit box beyond investor guidelines, and loosening DTI ceilings will only have limited effect.

What are the biggest challenges currently facing mortgage servicers? In addition to the compliance and fee structure challenges I touched on above, two challenging areas include the rising interest-rate environment and the increasing role of nonbank servicers who serviced a quarter of all mortgages in 2015.

Rising interest rates are a mixed blessing for mortgage servicers. After a long period of low-interest rates and a slow and uneven recovery, uncertainty about the value of servicing remains as rates rise. Slower prepay speeds should lead to rising MSR valuations, but rising rates could cause additional delinquencies in fragile markets leading to additional servicing costs and reduced valuations.

I believe the rapidly increasing share of nonbank servicing—a trend that continues as Citigroup plans to exit servicing—is a challenge to the industry because of what could happen in the next economic downturn. While nonbanks appear to be more proficient at managing the rising costs of servicing, a 2016 GAO report noted that they do not have, as a group, the same regulatory scrutiny as banking institutions. I worry that if CFPB's budget is severely cut in FY 2018, we may remain far from achieving a prudent level of compliance. I am also worried about nonbanks' lower capital requirements. These risk factors could lead to major problems in the next economic downturn.

What aspects of servicer scorecards drive their success? One of the projects I am most proud of being part of in the last decade was the analytical design of Fannie's STAR servicer scorecard. While all scorecards have controversial and imperfect aspects, I believe that the enhanced use of data to provide servicer oversight has led to major improvements in loan performance. STAR was an example of smart regulation—using objective data science to drive desired outcomes.

Data-driven scorecards often fail, however, because they are overly complex and opaque black boxes. The STAR scorecard's success was due to leveraging readily available servicing data and adopting a straightforward and transparent analytical methodology, which I believe Fannie was shrewd to disseminate through the internet. STAR shows that transparency and simplicity are critical for scorecard success.

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