2017 Mortgage Market Outlook: Executive Overview Report

January 2017

Source	2016 Estimate			2017 Forecast			2017
	Purchase ($B)	Refinance ($B)	Total ($B)	Purchase ($B)	Refinance ($B)	Total ($B)	Purch/Refi Ratio
iEmergent	$947	$903	$1,850	$1,025	$532	$1,557	66%/34%
Fannie Mae	$1,013	$890	$1,903	$1,053	$520	$1,573	67%/33%
MBA	$990	$901	$1,891	$1,092	$479	$1,571	70%/30%
Freddie Mac	$1,060	$940	$2,000	$1,084	$421	$1,505	72%/28%

Note: All forecasts are as of December 2016

For the 2017 housing market, the outlook is generally positive. The long recovery from the elevated delinquency and foreclosure rates of the Housing Bust is nearly complete, and home values nationally have returned to their pre-Boom peak. For the 2017 mortgage industry, a sharply shifting change is in order as refinance volumes fall significantly and purchase becomes a much bigger part of the market.

Forecasters, including Fannie Mae, Freddie Mac, iEmergent and the MBA, anticipate that total mortgage opportunity in 2017 will decrease from 2016, because of a drop in refinance activity, but the purchase market will again see healthy growth.

Comparing the outlooks from these forecasts, we note that they are about as closely aligned as they have been for years. This is largely due to the fact the disruptive forces in the mortgage market for the last decade – elevated delinquency & foreclosure rates, number of households underwater on loans, volume of homes at distressed prices – are dissipating. But there are fundamental differences in forecast methodology here. Most mortgage forecasts are generated at the national level. At iEmergent, we work from the bottom up. Our methodology for forecasting purchase opportunity begins at the census tract level with quantifying the homebuyer pool – or *the number of households that are ready, willing and able to buy a home*. The size of that pool is determined by demographic shifts (i.e. household growth) and by the relationship between the financial health of US households (demand) and housing-market issues (supply).
In addition, driving both the demand and supply-sides of the equation are macroeconomic trends, regulatory and legislative actions in lending, and – as always – the individual behaviors of households across the nation.

This market-based approach gives our clients the critical information necessary to make successful tactical and strategic decisions in managing their businesses.

Mortgage Market Overview

- With rising interest rates, refinance volume will dip considerably in 2017.
- With good economic conditions, purchase volume will continue to grow, but increased uncertainty and inventory-induced sales constraints may limit the up-side potential.
- In total, the 2017 mortgage originations market will decline by 13 to 19%.
- The ARM share of originations will rise as interest rates rise.
- Credit availability has arguably been too tight and should further loosen in 2017.
- Existing homeowners will continue to reap the benefits of home price gains and will tap into their growing home equity through increased home equity borrowing. However, this home equity lending opportunity is concentrated mostly in the largest mortgage markets.

This year's purchase market will continue its robust growth path, but the refinance opportunity will shrink significantly. Purchase volume will be double what it was in 2010-11 during the depths of the Housing Bust, and about at the levels experienced in 2001-02. For the refi segment, we expect to see the lowest refi share of originations since 2000.

Thus, despite the growing purchase market segment, overall originations will decline from 13% to 19% in 2017.

Mortgage Originations (1st Lien) for 1-4 Family Homes

Refi
Purchase
Refi % (R axis)

Origination Volume, $ Billions
4,500
4,000
3,500
3,000
2,500
2,000
1,500
1,000
500
0

Refi % of Purchase & Refi Originations
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%

532
1,025

1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016e 2017f

Source: Historical data from HMDA. 2016 estimate from iEmergent (using high refi estimate). 2017 forecast from iEmergent (using mid-point refi estimate).

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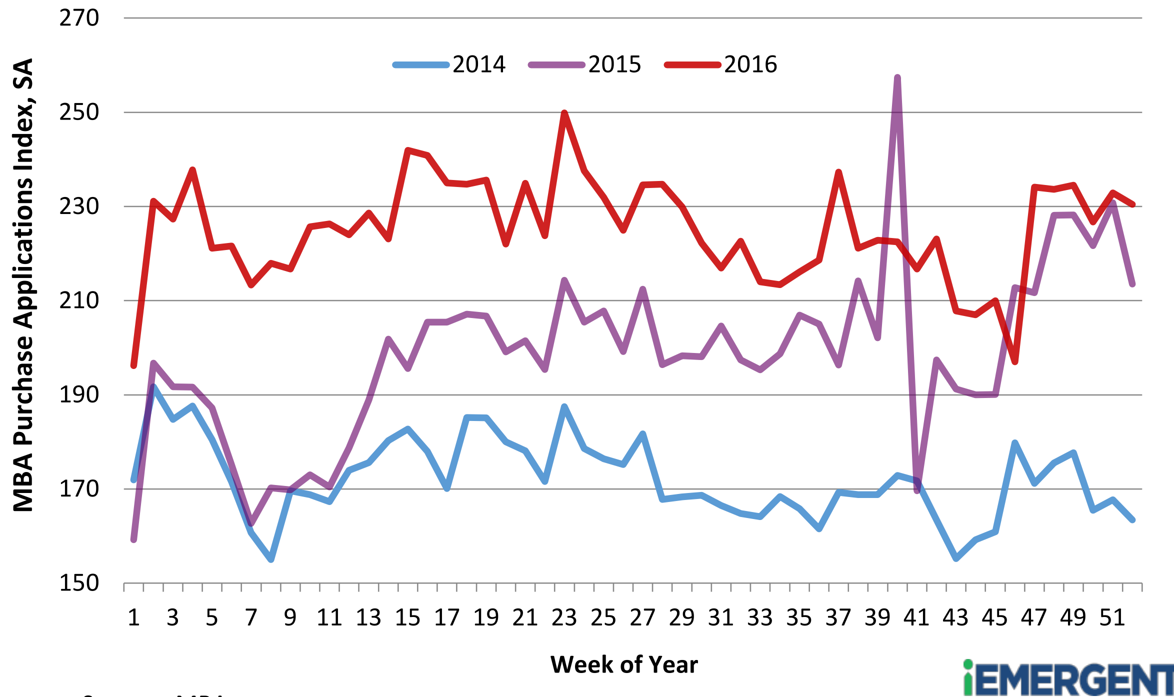
The *MBA's Purchase Applications Index* reflects considerable volatility week to week, but it is a leading indicator of eventual counts of loans originated. Looking at the index from a year-over-year perspective, as shown below, highlights the fact that 2016 purchase applications were considerably ahead of 2015's applications early in the year. However, the purchase market lost some steam in November-December, partly as a result of the post-election interest rate spike. Applications from that time period typically fund during the first quarter of the following year, so expect little year-over-year change in purchase counts in Q1/2017.

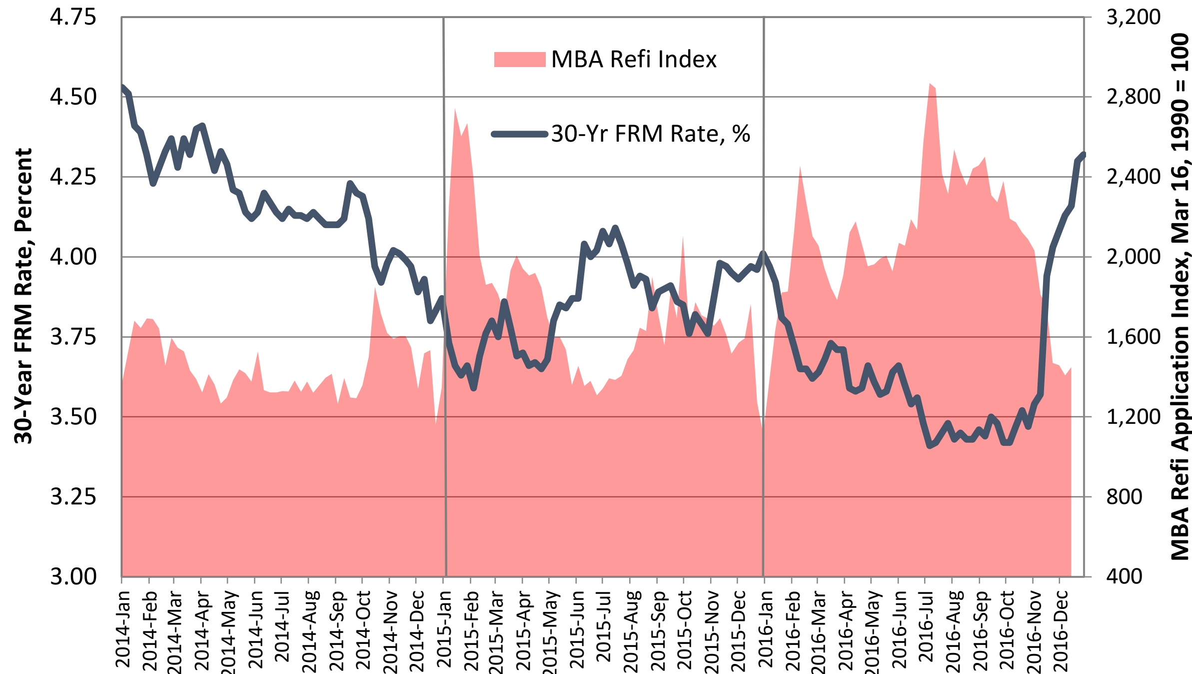


Source: MBA

Refinance volume depends almost entirely on mortgage interest rates, which in turn are dependent on bond rates (specifically, 10-yr Treasury rates) that are notoriously hard to predict. For that reason, we always present our refi forecast as a range.

Last year, industry experts (including us) said rates had nowhere to go but up, yet with global recession worries that began in January-February and the unexpected Brexit vote in July, bond rates and thus fixed mortgage interest rates kept tumbling down. That ushered in a surge of refinance activity that resulted in another refi boom year.

Since the election, mortgage rates have soared and refi application volume has plunged. As we head into 2017, there is little to suggest that mortgage rates will return to the sub-3.5% range that prevailed for the second half of 2016. The reality is, rates would have to fall below 3.25% for an extended period to see another significant refi surge. Thus, we expect refinance volume to decline significantly in 2017.



Source: FreddieMac, MBA

As the attached Black Knight analysis shows, the post-election rate spike reduced the pool of homeowners who could profitably refinance their homes by more than half (from 8.3 million to 4 million). Further interest rate rises will shrink that pool even more.

Traditional Refinance Candidates

Refinance Candidates (left axis) | FHLMC 30-Year Fixed Rate (right axis)

Left axis: Volume in Millions (0M, 2M, 4M, 6M, 8M, 10M) — Right axis: FHLMC 30-Year Fixed Rate Mortgage (3.25%, 3.50%, 3.75%, 4.00%, 4.25%)

Month	Refinance Candidates (M)
2014-07	3.8
2014-08	4.6
2014-09	3.8
2014-10	4.6
2014-11	5.1
2014-12	5.7
2015-01	6.4
2015-02	6.3
2015-03	5.4
2015-04	6.1
2015-05	5.3
2015-06	4.7
2015-07	4.0
2015-08	5.4
2015-09	5.4
2015-10	5.9
2015-11	5.2
2015-12	5.2
2016-01	5.7
2016-02	6.6
2016-03	6.5
2016-04	7.4
2016-05	7.4
2016-06	7.4
2016-07	8.7
2016-08	8.6
2016-09	8.4
2016-10	8.3
TODAY*	4.0

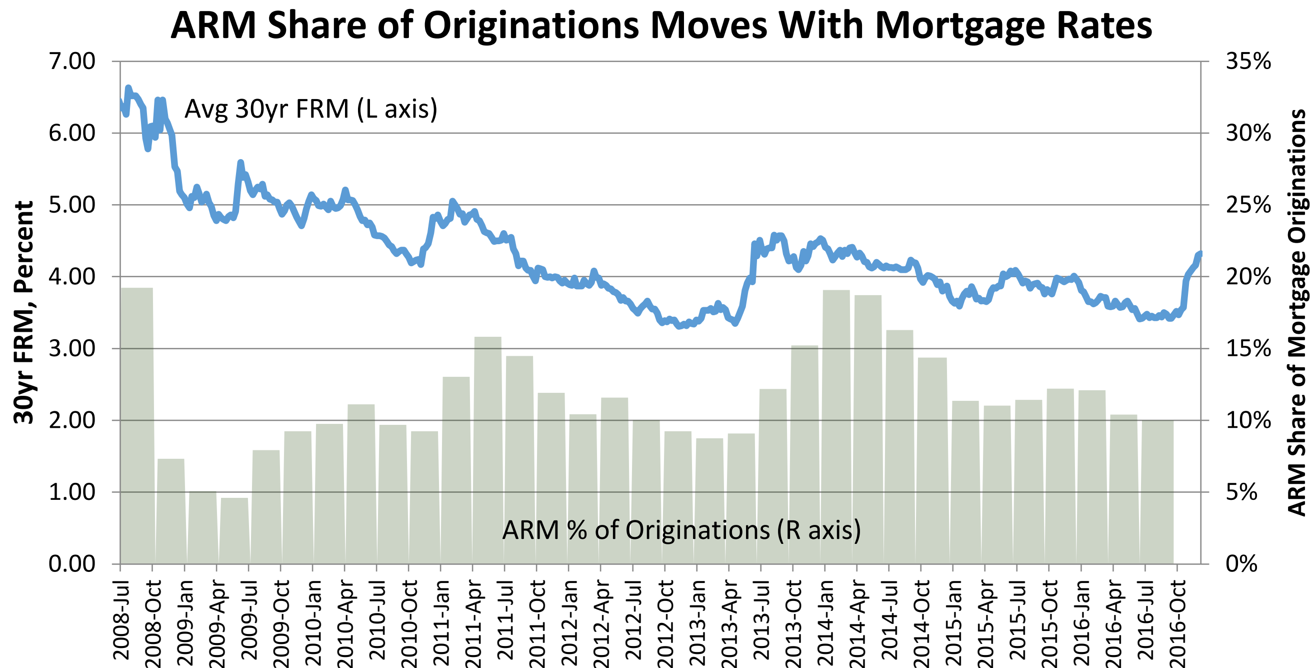
***Refinance Candidates** are borrowers that are current on their 30-year mortgage with <=80% current LTVs, credit scores >= 720, and current interest rates on their mortgage >= 75 BPS above the 30-year fixed rate at the time as reported in the FHLMC rate survey*
TODAY *is based on FHLMC 30-year rate as of November 23th 2016 of 4.03%*

Source: Black Knight Financial Services *Mortgage Monitor.*

Rising interest rates will have much less of an impact on **purchase** market volume. But what they *will* affect is the share of adjustable rate mortgages (ARMs) originated.

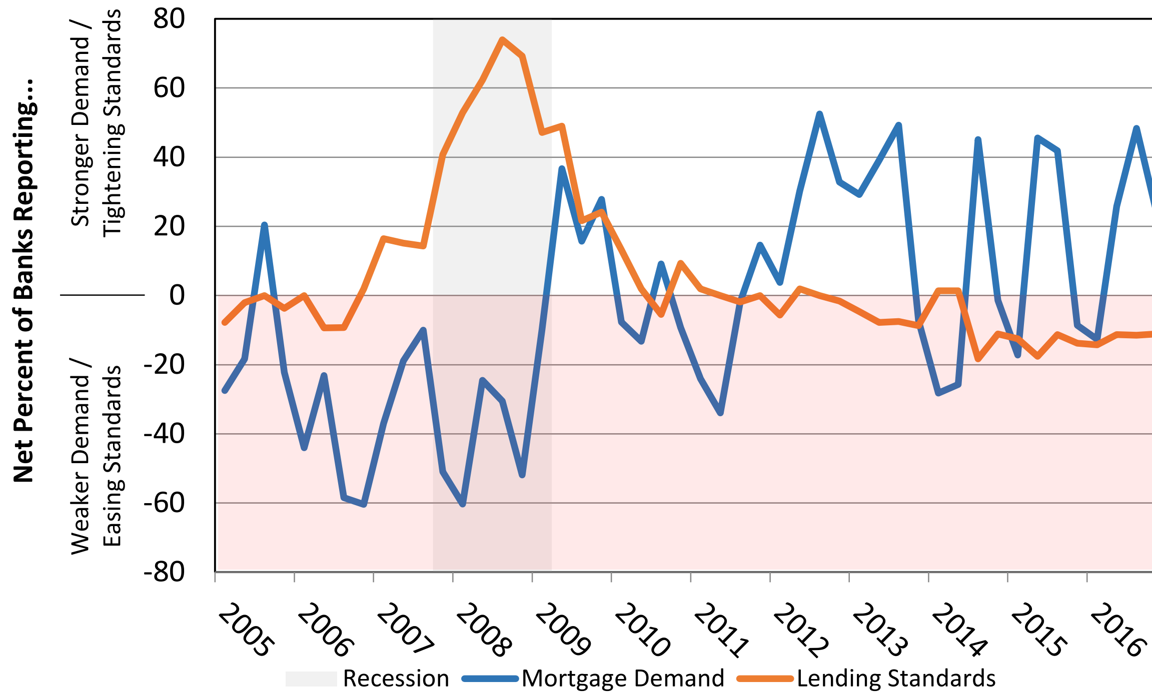
> *For a young family planning to buy the perfect starter home last October, the monthly mortgage payment on a 3.5% fixed rate mortgage was just barely achievable on their income. But now, fixed rates are up to 4.25% and may head higher. They can't afford payments on that! And Baby #2 is due in March! What are they going to do?!*

Some may settle for a cheaper home, but what many of them will do is choose an ARM mortgage. ARM mortgages will typically quote 60-90 bps lower than FRMs for starting note rates. Our family can currently get a 3.5% 5/1 ARM with the same points and fees. Their mortgage rate will be fixed for the first five years. After that, the rate will adjust and may go up, so there's an interest rate risk there, but at least they have a fixed payment for several years. Indeed, past history has shown that when mortgage rates rise, the ARM share of mortgages also rises, because of those lower initial note rates.



Source: FHLMC, Inside Mortgage Finance

With the generally robust demand for mortgage financing, credit availability is increasing as well. According to the Federal Reserve's quarterly Senior Loan Officer Survey, more banks have been easing lending standards than tightening for the last 10 consecutive quarters.



Source: Federal Reserve Senior Loan Officer Survey, Oct 2016

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Following a deep recession caused in no small part by defaulting mortgages, lenders became extremely conservative with lending standards, and as a result, many able borrowers have been denied credit over the last eight years.

The chart below shows average loan default performance by year of origination. The 1999-2003 period was a period of reasonable lending standards and acceptable default rates. Then came the years when lending standards became recklessly loose and resulted in ruinous default rates. But since 2008, standards have been so tight that default rates have been at historic lows, with the most recent period, 2011-2015, even lower still.

For 2017, a year when mortgage origination volumes will most likely decline, we expect the credit box to open up somewhat as lenders compete in a smaller market.

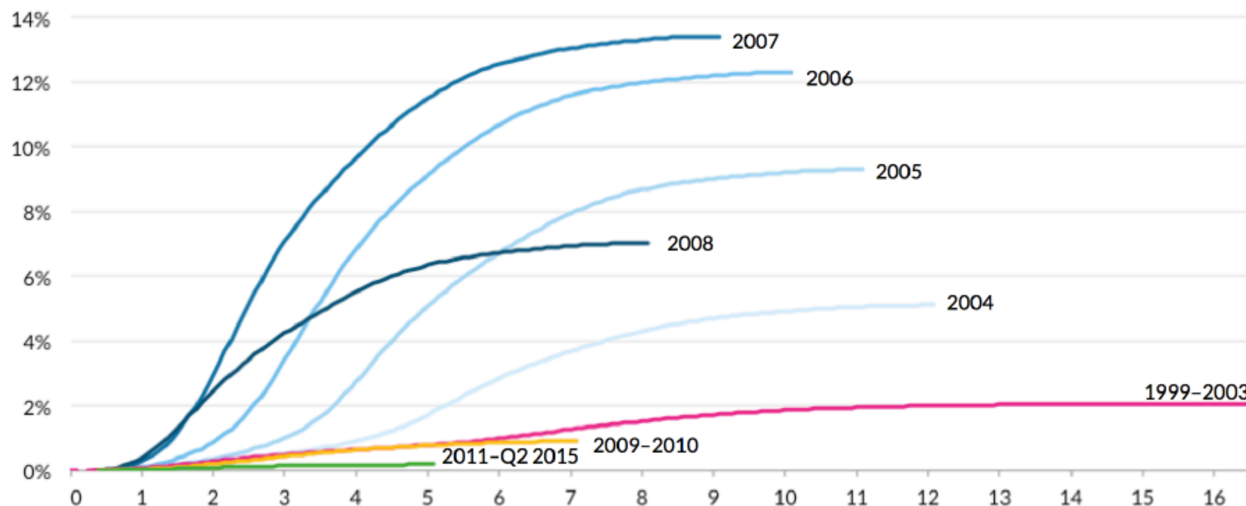


Chart from: Laura Goodman, "Squeaky-Clean Loans Lead to Near-Zero Borrower Defaults – And That is Not a Good Thing," Urban Institute, Aug 31, 2016.

Since home values started appreciating again in 2012, homeowners' equity has soared. In the five years from 2011 to 2016, tappable equity of households with mortgages has more than doubled from $2.2 trillion to nearly $4.7 trillion. This doesn't even count the couple hundred billion homeowners have already taken out through cash-out refinancing (about $90 billion in the four quarters ending in Q3/2016, according to Black Knight estimates). However, with interest rates on the rise, that tactic will be less appealing in 2017. Instead, we expect to see a revival in home equity lending, primarily through lines of credit (HELOCs) but also with closed-end second mortgages.

Tappable Equity of U.S. Mortgage Holders

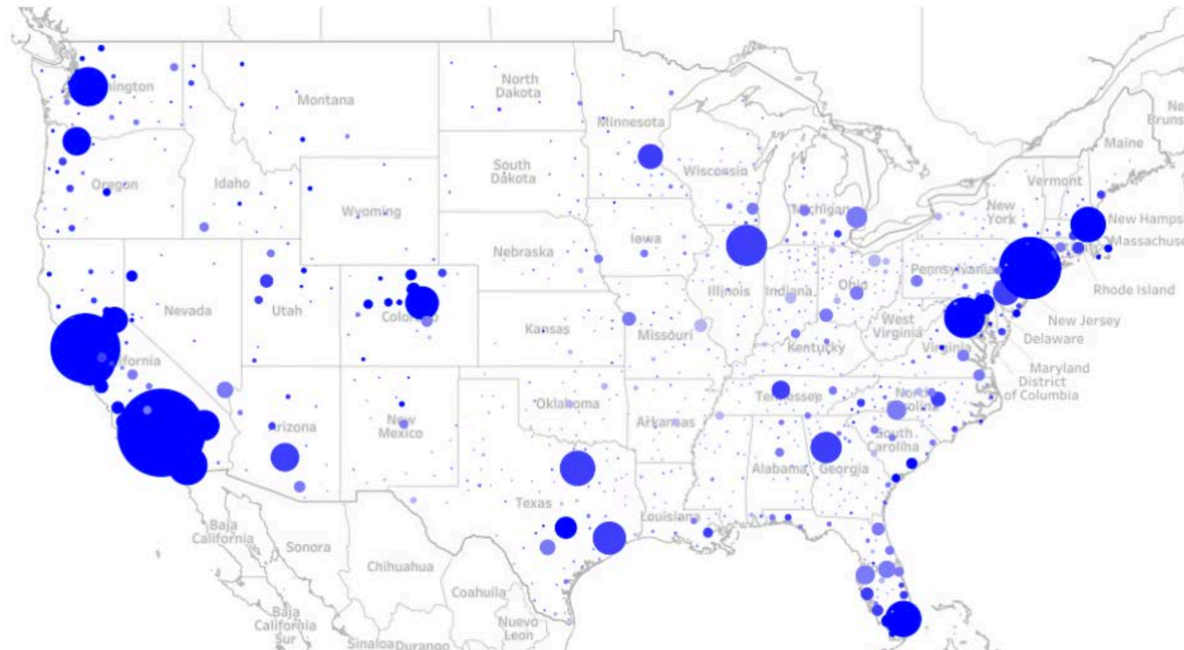
Tappable Equity of Mortgage Holders in $Billions

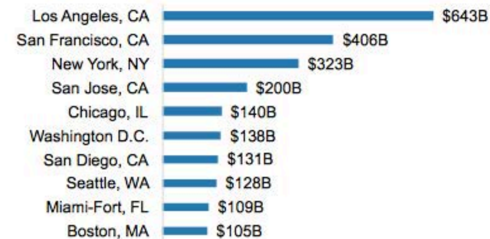
Period	Tappable Equity
2004-12	$4,285
2005-12	$4,914
2006-12	$4,627
2007-12	$3,755
2008-12	$2,830
2009-12	$2,603
2010-12	$2,370
2011-12	$2,234
2012-12	$2,557
2013-12	$3,123
2014-12	$3,557
2015-12	$4,122
2016-09	$4,638

Tappable Equity: *Equity available on all residential properties with an existing mortgage before reaching a current CLTV of 80%*

Source: Black Knight Financial Services *Mortgage Monitor.*

That home equity lending opportunity is especially concentrated in the major metropolitan markets. The top 10 mortgage markets contain about half of that un-tapped home equity potential, and the state of California alone accounts for $1.7 trillion, nearly 40% of that volume.





Source: Black Knight Financial Services *Mortgage Monitor.*

OUR COMPANY

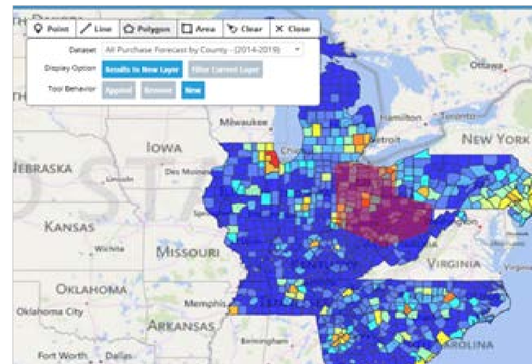
iEmergent is a forecasting and advisory firm for the lending industry. Since 2000, we have been focused on delivering a forward-looking approach to helping organizations navigate the industry's changing landscape. After nearly 20 years as an executive at two national lenders, our founder leveraged his background in mathematics and predictive modeling to develop a groundbreaking method for forecasting mortgage opportunity. In addition to our forecasts, we provide strategic advisory services to lenders of all sizes and types, as well as mortgage insurance, title, and investment companies. Viewed as industry leaders, we have been featured in Mortgage Banking magazine, HousingWire, National Mortgage News, Origination News, Inman News, and the Credit Union Journal.

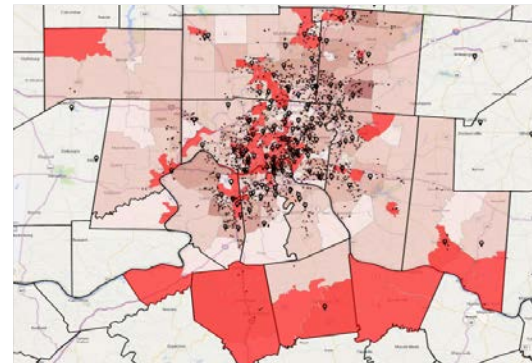
OUR PRODUCTS

iEmergent provides accurate, forward-looking data that quantifies what's next in mortgage markets across the nation. As housing and lending sputter and stutter toward recovery, our forecasts drill down into states, metro areas, counties, and neighborhoods to quantify where and how mortgage opportunity will grow, slow, or stay the same.

Most clients access our data through Mortgage MarketSmart, a web application with dynamic maps. This powerful visualization tool brings HMDA and detailed forecast data to life, helping organizations easily make decisions about high-level strategic opportunities and tactical, market-level challenges:

- Expand and grow responsibly
- Improve sales strategies at all levels
- Optimize resources, brand, and locations
- Recruit, hire, train, and retain sales resources
- Minimize distribution risk and meet CRA/Fair Lending regulations





FORECAST SEGMENTS

Market Geography

- State
- MSA
- County
- Census Tract

Market Segments

- Occupancy Types
- Custom Loan Sizes
- Conventional Loan Type
- FHA,VA, FSA Loan Types
- Jumbo, Conforming
- Borrower Income Levels
- Borrower Race/Ethnicity
- First Time Homebuyer
- CRA Eligible
- New Construction Sales
- Custom Loan Sizes
- Refinance Ranges

For more information about Mortgage MarketSmart, our forecasts, or advisory services, call Fenn Meents at 515-327-0070 (x101).