Mortgage Pricing Insights

JULY 2020

CONTENT OVERVIEW

INTRODUCTION

MORTGAGE PRICING INSIGHTS REPORT SUMMARY

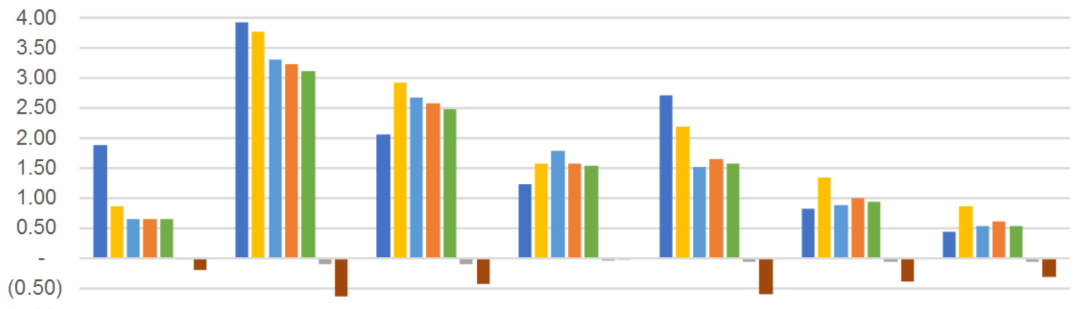
Optimal Blue and Andrew Davidson & Co., Inc. (AD&Co), a leading provider of risk analytics and consulting for residential lending and MBS, have partnered to deliver the Mortgage Pricing Insights report. Released monthly, this report leverages proprietary data and analytics produced by both firms to provide a comprehensive view into mortgage finance across the primary and secondary markets. Each robust report includes updates to critical mortgage metrics like rates, yields, volumes, and prepayments, and also highlights the most relevant trends in the mortgage industry. For access to the data and analytics displayed herein, please contact Optimal Blue and/or AD&Co through the contact information provided on page 14.

JUNE MARKET OBSERVATIONS

- With exceptions, mortgage markets have stabilized significantly since the peak of the pandemic. The 10-year Treasury rate was virtually unchanged in June, while mortgage rates fell by about 10 bps. Mortgage spreads to Treasury and secondary market spreads improved by about the same small margin. However, these spread levels remain historically wide.
- The mortgage rate spread to the 10-year is now 248 bps, down from 258 bps in May, though up from 205 bps at the beginning of 2020. The spread between primary mortgage rates and secondary mortgage rates is now 154 bps and was down 4 bps on the month but remains higher than the 123-bps level in January. MBS OAS spreads fell 7 bps during the month but remain 11 bps wider than January 2020 levels.
- The AD&Co mortgage forecast herein sees only a modest drop in the spreads and primary mortgage rates over the next three months to a year.
- Credit, as measured by FICO, LTV, and DTI, and non-government mortgage volume remains challenged. The jumbo share of the market, down roughly 50% on the year, improved slightly this month. Forbearance concerns, increased delinquencies, and a lack of secondary market fluidity still manifest in this segment.
- Rate lock volume was at near record levels in June, growing 32% since May and 107% year-over-year. Purchase volume has rebounded as the typically strong Spring buying market was delayed due to social distancing requirements. Refinance volumes showed no signs of slowing as rates continue down into unprecedented territory. While conforming loans maintained their dominant share of production, non-agency originations edged higher in a sign that secondary market liquidity may be slowly returning.
- The best efforts to mandatory delivery spreads remain elevated, a signal that we are in recovery mode with ongoing uncertainty. These spreads, combined with higher volume and margins, contribute to a major improvement in gains for most lenders.

MORTGAGE RATES

MORTGAGE RATE SUMMARY

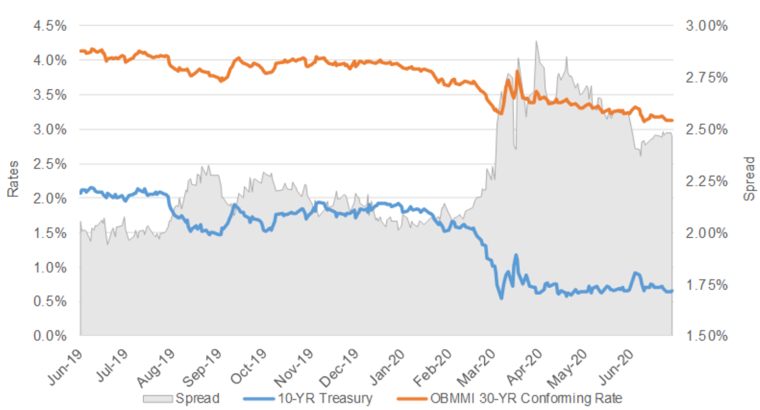


	10-Yr Treasury	OB 30-Yr Conf Index	OB Index Spread to Treasury	Primary Secondary Spread	MBS Yield	MBS Spread to Treasury	MBS OAS
Begin 2020	1.88	3.93	2.05	1.23	2.70	0.82	0.43
20-Mar	0.85	3.76	2.91	1.57	2.19	1.34	0.86
30-Apr	0.64	3.31	2.67	1.79	1.52	0.88	0.53
31-May	0.65	3.23	2.58	1.58	1.65	1.00	0.61
26-Jun	0.64	3.12	2.48	1.54	1.58	0.94	0.54
1-Mon Chg	(0.01)	(0.11)	(0.10)	(0.04)	(0.07)	(0.06)	(0.07)
3-Mon Chg	(0.21)	(0.64)	(0.43)	(0.03)	(0.61)	(0.40)	(0.32)

Source: Optimal Blue Mortgage Market Indices™ (OBMMI ™) — optimalblue.com/obmmi
AD&Co Analytics — ad-co.com

MORTGAGE RATE SPREAD TO TREASURIES

The 10-year Treasury yield rose to 0.91% in early June—its high-water mark since late March—before retreating to close the month at 0.66%, roughly where it started. Optimal Blue's 30-year conforming rate fell to 3.12%. The mortgage rate spread to the 10-year dipped to a post-COVID low of 237 bps. It rose steadily thereafter, but still finished the month 10 bps lower at 246 bps as mortgage rates continued their decline.



SPREAD TO TREASURY

Open: 258 bps
Close: 246 bps
Average: 246 bps
Min: 237 bps
Max: 258 bps

Source: Optimal Blue Mortgage Market Indices™ (OBMMI™) — optimalblue.com/obmmi
U.S. Department of the Treasury — treasury.gov

MORTGAGE RATES – Cont'd.

PRIMARY TO SECONDARY YIELD SPREAD

The mortgage rate spread to MBS fell 4 bps on the month to 154 bps, well below the 191-bps peak in mid-March, but it remains historically wide. Originators report high profits per loan, but risk is elevated in several areas. Financing costs, hedging costs, and delivery uncertainty due to forbearance are all up; servicing values are down, and loan processing capacity is constrained by the pandemic.

PRIMARY SECONDARY SPREAD

Open: 158 bps

Close: 154 bps

7-year Average: 129 bps

7-year Min: 108 bps

7-year Max: 191 bps

Source: Optimal Blue Mortgage Market Indices™ (OBMMI™) — optimalblue.com/obmmi
Bloomberg L.P. — bloomberg.com

PRIMARY MORTGAGE RATES VIA OBMMI™

Mortgage rates continued their descent into unchartered territory in June, notching new all-time lows. Jumbo rates remain high relative to federally connected loans due to a lack of secondary market liquidity for non-agency products.

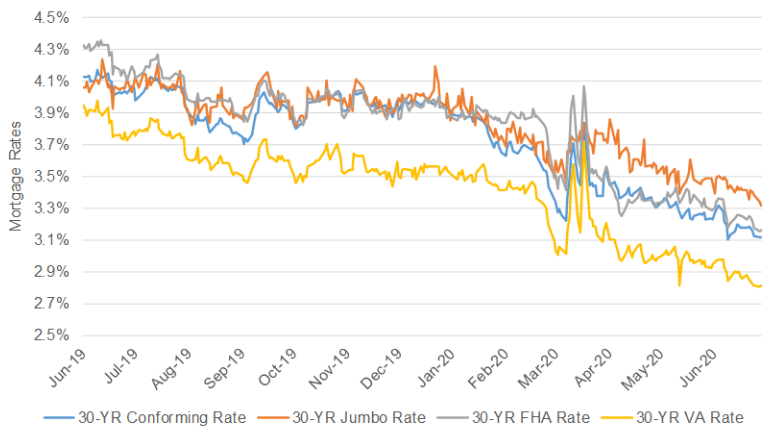
MONTHLY RATE AVERAGES (MoM)

30-YR. Conf.: 3.19% (-10 bps)

30-YR. Jumbo: 3.43% (-7 bps)

30-YR. FHA: 3.25% (-11 bps)

30-YR. VA: 2.89% (-9 bps)

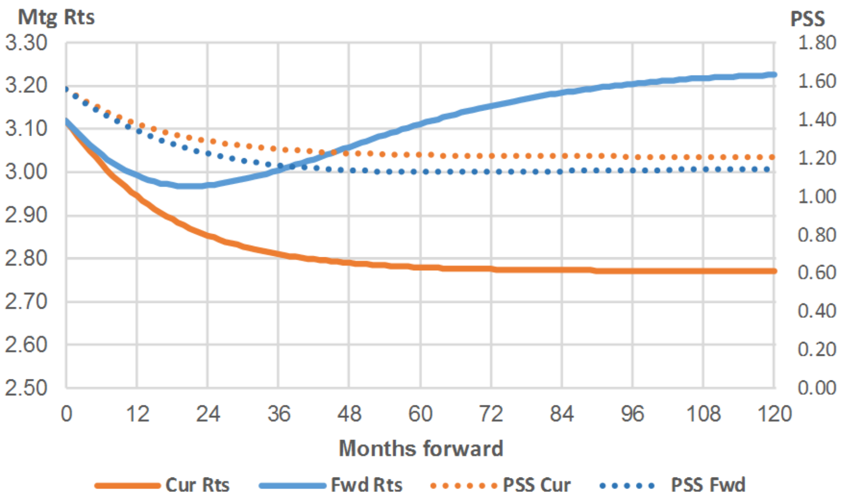


Source: Optimal Blue Mortgage Market Indices™ (OBMMI ™) — optimalblue.com/obmmi

MORTGAGE RATES – Cont'd.

MORTGAGE RATE FORECAST

AD&Co forecasts PSS and primary mortgage rates will be somewhat range bound at yields implied by both the current and forward yield curves, with the added potential for rates to gradually decline to 2.80%.



RATE FORECAST (PSS)

3 months: 3.07% (150 bps)

6 months: 3.02% (145 bps)

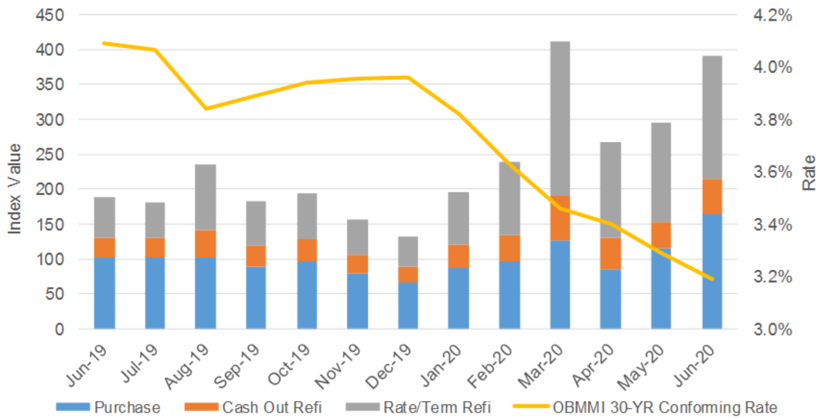
12 months: 2.94% (138 bps)

Source: AD&Co Analytics — ad-co.com

PRIMARY MARKET

LOAN ORIGINATION VOLUMES

Rate lock volumes surged in June, driven by record low rates and relaxed COVID restrictions. Purchase volumes were up 42% from May and 59% YoY, as many buyers previously forced to delay were able to reach purchase agreements on new homes. Refinancing originations show no signs of slowing as borrowers take advantage of the current rates to reduce payments or take cash out.



VOLUME CHANGES

MoM, YoY

Purchase: +42%, +59%

C/O Refi: +32%, +86%

R/T Refi: +24%, +200%

Total: +32%, +107%

Source: Optimal Blue Mortgage Market Indices™ (OBMMI™) — optimalblue.com/obmmi
Optimal Blue Market Analytics — optimalblue.com/market-analytics

ORIGINATIONS BY PRODUCT

Conforming loans maintained a dominant market share in June; however, the market for non-conforming products, particularly jumbo loans, is showing signs of recovery after bottoming in April. This is a good sign that secondary market liquidity may be returning for non-agency products. FHA share ticked up slightly at the expense of VA production.

PRODUCT SHARE (MoM)

Conforming: 72.2% (-66 bps)

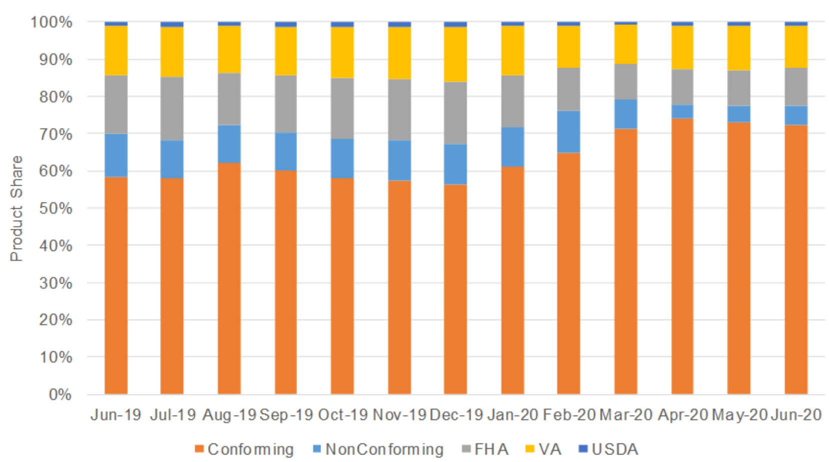
Non-Conforming: 5.2% (+78 bps)

FHA: 10.3% (+52 bps)

VA: 11.2% (-61 bps)

USDA: 1.1% (-4 bps)

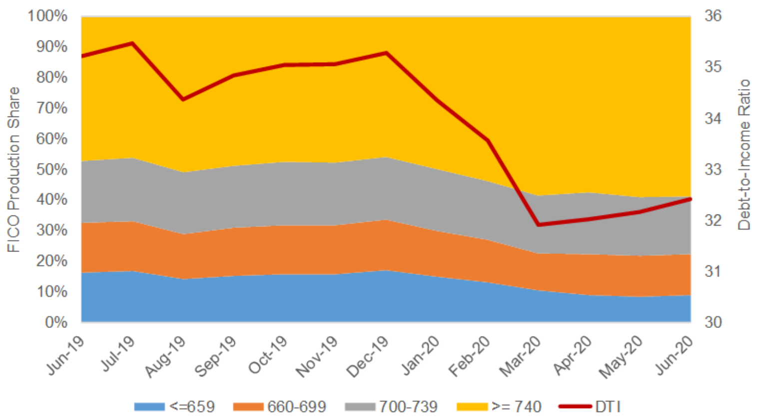
Source: Optimal Blue Market Analytics — optimalblue.com/market-analytics



PRIMARY MARKET – Cont'd.

ORIGINATIONS BY BORROWER CREDIT

Share of new originations by borrower credit was mostly unchanged in June. Lender overlays meant to minimize fallout risk from forbearance risk have hindered the mortgage financing efforts of borrowers with lower credit scores. With no shortage of refi volume coming from low-risk borrowers, lenders are likely to maintain these higher standards. DTI has slowly returned from its March lows but still indicates a tight lending environment.



FICO BAND SHARE (MoM)

<=659: 8.7% (+0.4%)

660-699: 13.4% (+0.2%)

700-739: 18.9% (-0.3%)

>=740: 59.0% (-0.3%)

Source: Optimal Blue Market Analytics — optimalblue.com/market-analytics

LENDER PIPELINE PULL-THROUGH

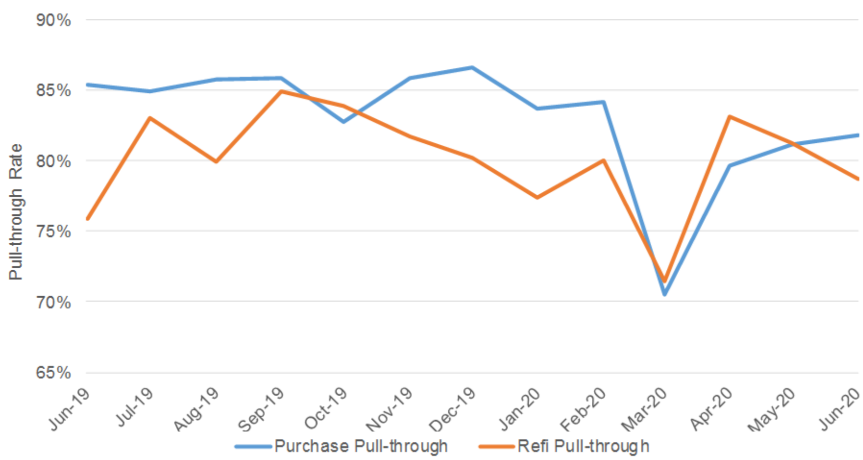
Originator pull-through rates have stabilized after a tumultuous March that saw significant fallout in response to the onset of COVID-19. Since then, pull-through for both purchase and refinance loans has maintained near 80%.

PULL-THROUGH (MoM)

Purchase: 81.8% (+0.66%)

Refi: 78.7% (-2.57%)

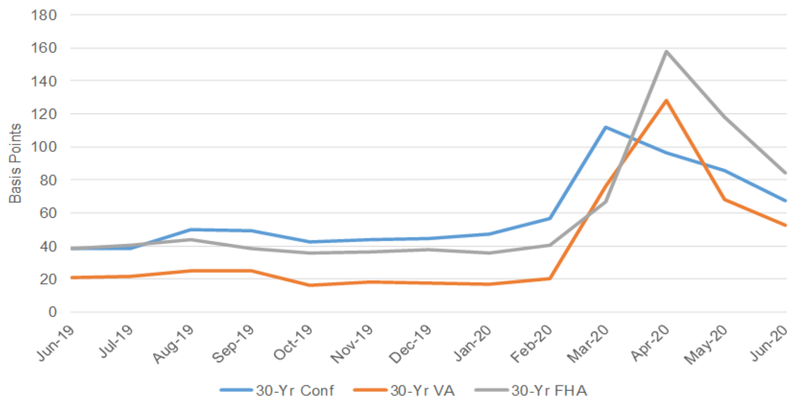
Source: Optimal Blue Hedge Analytics — optimalblue.com/hedge-analytics



PRIMARY MARKET – Cont'd.

BEST-EFFORTS VS. MANDATORY SPREAD

The spreads between best-efforts and mandatory delivery remained elevated but continued their downward trajectory in June. The contracting spreads signal lower pipeline hedging costs for lenders as stability returns to the market.



BEST-EFFORTS VS. MANDATORY SPREAD (MoM)

30-YR. Conf.: 68 bps (-18 bps)

30-YR. VA: 52 bps (-16 bps)

30-YR. FHA: 84 bps (-34 bps)

Source: Optimal Blue Hedge Analytics — optimalblue.com/hedge-analytics

WHOLE LOAN VS. MBS PRICING

Investor/aggregator pricing versus MBS is still down 1.5-2.5 points since the onset of COVID but is improving. Cash window and conforming loan pricing picked up over ½ a point in June, as government loan pricing moved sideways. Fed purchasing has driven the price of MBS upward, but whole loan pricing did not follow suit, as market volatility and forbearance concerns instigated wider margins for aggregators.

SPREAD CHANGES (MoM)

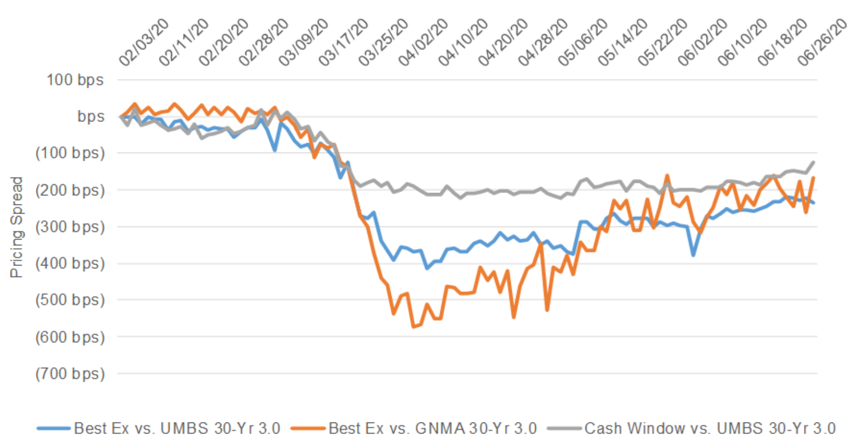
Best Ex vs. UMBS: +59 bps

Best Ex vs. GNMA: -4 bps

Cash Window vs. UMBS: +59 bps

Spreads indexed to zero on February 3, 2020.

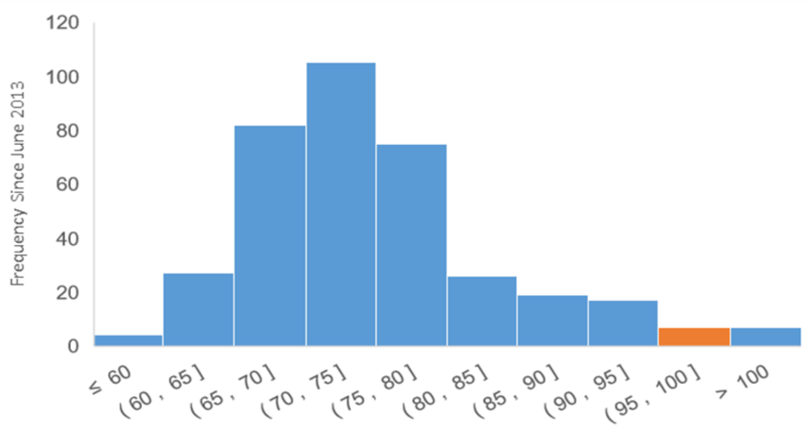
Source: Optimal Blue Hedge Analytics — optimalblue.com/hedge-analytics



SECONDARY MARKET

MBS NOMINAL SPREADS TO THE 10-YR. TREASURY

Nominal MBS spread to Treasury is 94 bps, 45 bps tighter than in mid-March after the Fed began to buy MBS in size. The nominal MBS spread to Treasury remains wide relative to the long-term historical average of 75 bps.



MBS NOMINAL SPREAD

Current: 94 bps

Last Month: 100 bps

7-year Average: 75 bps

7-year Minimum: 57 bps

7-year Maximum: 141 bps

Source: AD&Co Analytics — ad-co.com

NOMINAL SPREAD & OAS HISTORY

Nominal MBS spreads tightened slightly last month but remain well below the recent stressed level of 141 bps seen in mid-March. MBS OAS contracted 11 bps during the month and is now at 54 bps, close to the 12-month average of 51 bps. The MBS OAS remains modestly higher than the pre-pandemic OAS levels observed in early 2020.

MONTHLY SPREADS

NOMINAL, OAS

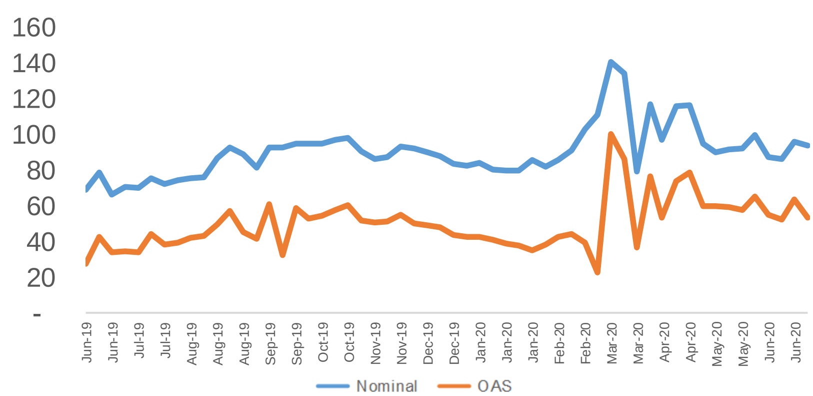
Last Month: 100, 65

Current: 93, 54

Average: 90, 50

Minumum: 66, 23

Maximum: 141, 101

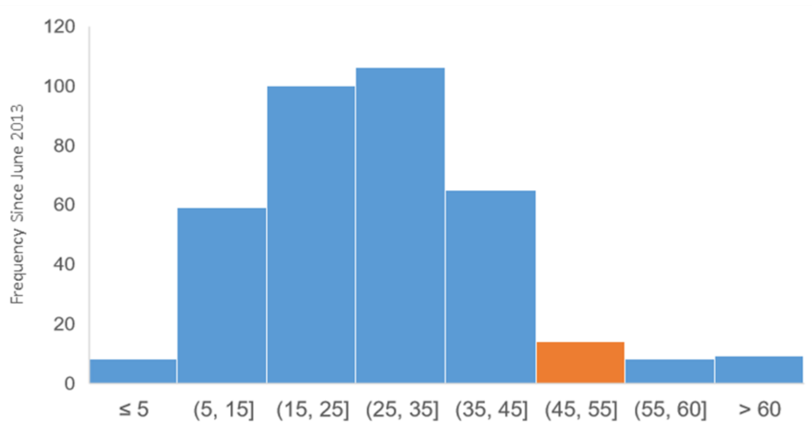


Source: AD&Co Analytics — ad-co.com

SECONDARY MARKET – Cont'd

MBS CC OAS TO SWAPS

MBS OAS tightened by 11 bps since the end of May to 54 but remain historically wide. The long-term average OAS is 54 bps. The current wide MBS OAS reflects the risk of adverse prepayment speeds.



MBS OAS

Current: 54 bps

Last Month: 65 bps

7-year Average: 28 bps

7-year Minimum: 2 bps

7-year Maximum: 101 bps

Source: AD&Co Analytics — ad-co.com

30-YR. MBS EMPIRICAL DURATIONS

Empirical durations show that investors are willing to pay for additional mortgage coupons. The more current coupon prices MBS empirical durations got significantly shorter during June, while higher premium coupon MBS empirical durations got marginally longer.

CHANGE

G2 2.5: -1.95

G2 3.0: -.03

G2 3.5: -.37

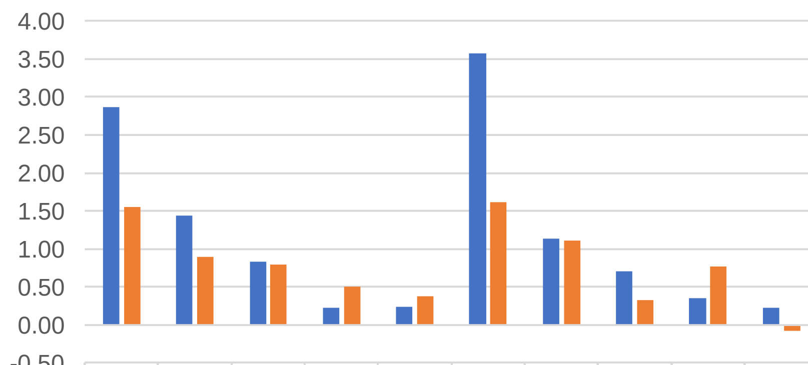
G2 4.0: +.42

FNUMBS 2.5: -1.31

FNU 3.0: -.54

FNU 3.5: -.04

FNU 4.0: +.28



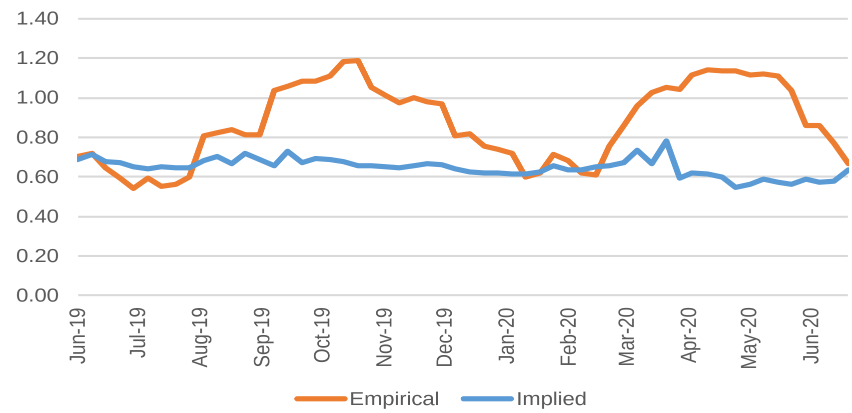
	2.50	3.00	3.50	4.00	4.50	2.50	3.00	3.50	4.00	4.50
	FNUMBS 30YR					G2 30 YR				
29-May	2.86	1.44	0.83	0.22	0.24	3.57	1.14	0.7	0.35	0.22
26-Jun	1.55	0.9	0.79	0.5	0.38	1.62	1.11	0.33	0.77	-0.08

Source: AD&Co Analytics — ad-co.com

SECONDARY MARKET – Cont'd

EMPIRICAL VS. IMPLIED VOLATILITY

Empirical volatility is based on weekly changes in a 60-day moving average for a 10-year swap rate, annualized. Implied volatility used in MBS OAS calculations has recently been well below realized volatility. The difference between the two-time series has narrowed over the last month indicating convergence between expected and actual volatility. Implied volatility rose slightly during June but is near the 12- month average.



VOLATILITY

EMPIRICAL, IMPLIED

Last Month: 1.04, .56

Current: .67, .63

Average: .87, .65

Minimum: .54, .55

Maximum: 1.19, 78

Source: AD&Co Analytics — ad-co.com

CORPORATE CREDIT MARKET HIGH-YIELD SPREADS

Corporate credit spreads were tighter 10 bps on the month to 644 bps and 443 bps lower than their peak in March. However, they remain 288 bps wider on the year. Mortgage rates, funding costs, and corporate credit spreads increased similarly, but have moved marginally lower over the last month.

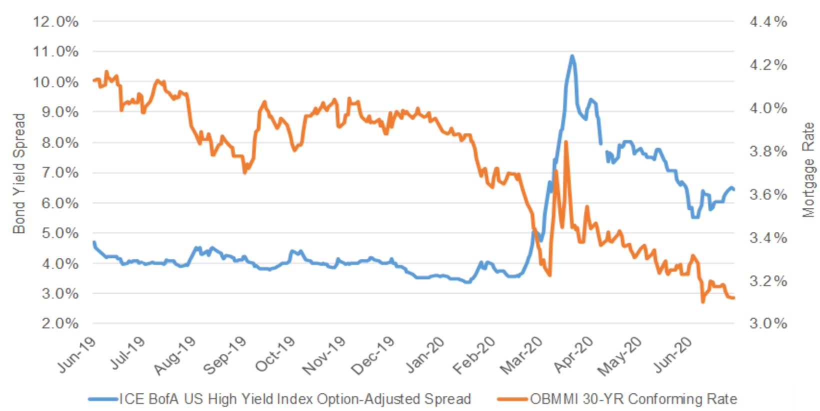
CORPORATE HIGH-YIELD SPREADS

March 20: 1087 bps

May 31: 654 bps

June 30: 644 bps

Source: Optimal Blue Mortgage Market Indices™ (OBMMI™) — optimalblue.com/obmmi
Federal Reserve Economic Data (FRED) | Federal Reserve Bank of St. Louis — fred.stlouisfed.org



SECONDARY MARKET – Cont'd

GSE CONFORMING MORTGAGE CREDIT CONDITIONS

Market implied GFees are derived from CRT prices using three factors: (A) expected loss, (B) price of unexpected risk, and (C) technical spread. During the early months of the pandemic in the spring, implied GFees were driven by technical spread, which increased significantly due to CRT forced liquidations, while the fundamental loss expectation component increased 2 to 3 times. Since their peak at the end of March in the upper 60 bps, implied GFees have now fallen 30 bps into the low 30 bps area indicating improved expectations from conforming GSE credit. Implied GFees remain above their pre-pandemic levels by 7 to 10 bps.

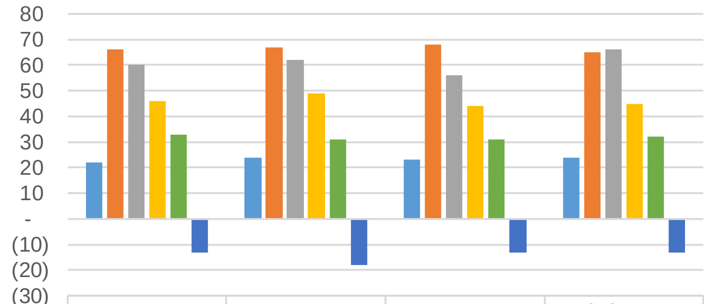
CHANGE FROM FEBRUARY TO JUNE

CAS: +11

STACR: +7

60-80 LTV: +8

HLTV: +8



	CAS	STACR	60-80 LTV	High LTV
2/28/2020	22	24	23	24
3/31/2020	66	67	68	65
4/30/2020	60	62	56	66
5/29/2020	46	49	44	45
6/30/2020	33	31	31	32
1M Chg	(13)	(18)	(13)	(13)

Source: AD&Co Analytics — ad-co.com

SOURCES & REFERENCES

ABOUT OPTIMAL BLUE

Optimal Blue's Marketplace Platform connects the industry's largest network of originators, investors, and providers. Nearly $2 Trillion of transactions are processed across the platform each year, facilitating a broad set of secondary market interactions like pricing, locking, hedging, and trading of mortgage loans. For more information, please visit www.optimalblue.com.

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ABOUT ANDREW DAVIDSON & CO., INC.

Andrew Davidson & Co., Inc. (AD&Co) was founded in 1992 by Andrew Davidson, an international leader in the development of financial research and analytics, mortgage-backed securities product development, valuation and hedging, housing policy and GSE reform, and credit-risk transfer transactions. Since its inception, the company has provided institutional fixed-income investors and risk managers with high quality models, applications, consulting services, research, and thought leadership, aimed at yielding advanced, quantitative solutions to asset management issues. AD&Co's clients include some of the world's largest and most successful financial institutions and investment managers. For more information, please visit www.ad-co.com.

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