Credit Union Mortgage Lending in a Volatile Market

Over the past few days, extreme volatility in the world’s credit markets has made it difficult to sell any security with even the slightest credit risk. This is because investors are repricing risk following a slew of losses on securities backed by subprime mortgages. With oceans of excess liquidity sloshing around the world’s credit markets during the past few years, risk premiums on all types of investments were driven to very low levels. Investors essentially skipped normal prudence and due diligence and treated many potentially high-risk securities as low risk investments. In one small sector of the credit markets, subprime mortgage-backed securities, that proved to be a very unwise strategy. As a result, investors have almost halted buying many other securities that might have unknown risks until they can figure if these are good, safe investments, or the next subprime debacle. In other words, in this world, it’s not “buy, then check” but rather, “don’t buy until absolutely sure.”

Mortgage lenders who originate loans for sale to the secondary market are finding it hard to sell any but prime, conforming loans. They are therefore having to substantially increase interest rates on all other mortgage loans. This includes not only Subprime and Alt-A loans (both of which are almost impossible to sell) but also prime loans that exceed the Freddie Mac and Fannie Mae conforming limit of $417,000. The result: even very well qualified borrowers are finding it very difficult to secure a non-conforming mortgage loan from the many mortgage lenders that fund loans by sale to the secondary market.

Lenders like credit unions who originate mortgages for their own portfolios are not directly affected by the vagaries of the secondary market. Since a credit union is intimately familiar with its own underwriting standards, there is no reason to believe that today’s mortgage loans are any more risky than those originated last quarter or last year. The only caveat to this is the greater risk to collateral values caused by the shortage of mortgage credit from other lenders. For loans with reasonable loan-to-value ratios, that should not be too significant a concern.

Therefore, a credit union with sufficient room on its balance sheet to increase its mortgage loan portfolio is in a very strong position to both help its members and gain market share in the first mortgage market. This will be especially true for credit unions that operate in those parts of the country where jumbo mortgages are prevalent. Homebuyers and Realtors will be looking for reliable lenders.

Any credit union wishing to take advantage of this opportunity should be very careful to conduct the appropriate ALM and liquidity analysis. Current market conditions do not suggest that a credit union should substantially increase a previously well considered mortgage portfolio limit. However, if a credit union currently has in portfolio less than its mortgage policy limits, the next few weeks or months are likely to provide strong demand for loans. Because of the possible risks to collateral values, credit unions may want to slightly widen spreads on non-conforming loans over conforming loans, even if they plan to hold them in portfolio. Also, it would be unwise to add a huge volume of these loans all at once. They are likely to stay on the balance sheet for quite a long time. Remember, even really good deals should only be done in moderation.

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