MBA Forecast Commentary

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Purchase Activity Showing Signs of Picking Up

MBA Economic and Mortgage Finance Commentary: April 24, 2018

Our overall forecast was little changed over the month; we still expect the economy to grow at a steady pace over the next two years, boosted by tax reform and riding a wave of strong employment and stock market. Rates rose over the past month on all the positive economic news, but also as investors faced a little less geopolitical uncertainty. Fed communication has been mostly hawkish, with most recent speeches and communication implying an intent to maintain a rising fed funds rate and continued balance sheet normalization. With favorable demographics providing housing demand, we estimate purchase mortgage originations to increase 5 percent in 2018 and another 6 percent in 2019, even as housing inventory remains tight and affordability issues creep into the market for prospective buyers. Refinance activity continues to be weak, but we saw increasing cash out activity at the end of 2017 as rate/term refinancing decreased as rates increased.

The job market, an important driver of housing market health, remains strong. Despite some monthly volatility, average monthly payroll growth in the first quarter was just over 200,000 jobs, following an average of 220,000 jobs in the fourth quarter. We expect job growth to slow as the economy has surpassed full employment, and as companies have reported increasing difficulty filling open positions, and as labor force participation remains flat. The unemployment rate remained low at 4.1 percent and has held that level for around two quarters. We expect that the unemployment rate will continue to decrease slowly, reaching a low of 3.7 percent in the third quarter of 2018, and staying at that level through 2019 before increasing slightly in 2020. With the economy at full employment, monthly job growth will slow to around 150,000 jobs for the rest of 2018 before decreasing further to 100,000 jobs per month in 2019.

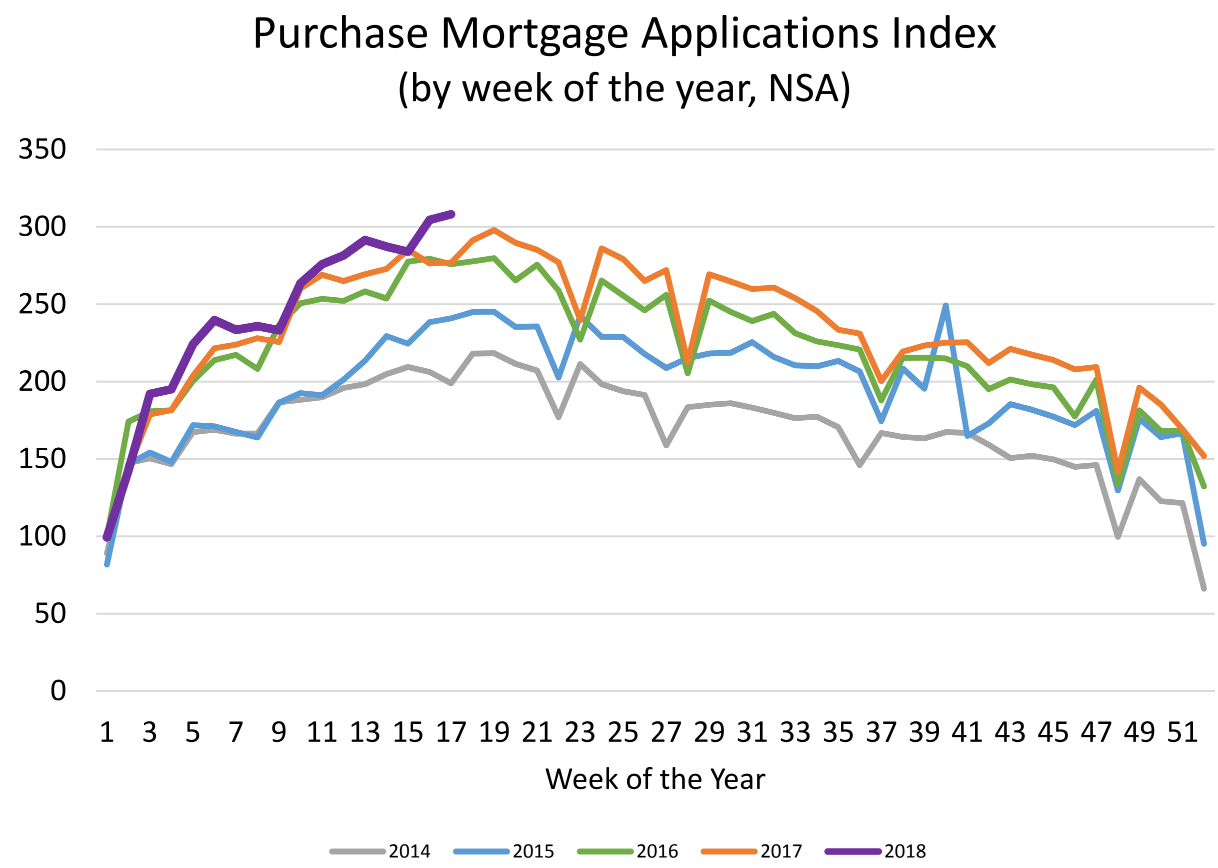
While demographic, economic and employment conditions are supportive of housing market growth, housing supply constraints continue to hold back the pace of home sales. Low levels of inventory, particularly, for lower priced homes, have made the market for buyers competitive and continue to exert upward pressure on home prices, creating some affordability issues. However, we have seen an improvement in year over year growth in home purchase applications. As seen in figure 1, growth has picked up in purchase applications after some slower weeks around the Easter and Passover holidays, as well as some late winter weather in parts of the country.

We forecast that 30-year mortgage rates will 5 percent by late 2018 or early 2019, pushed up by firming inflation, growing deficits, and the strong economy. Stronger wage growth is likely to overcome this headwind of increasing mortgage rates, but the inventory issue remains the biggest drag to purchase market growth. We expect about 5 percent growth in purchase origination volume this year as some growth will take place and home price growth abates slightly. However, refinance volume will be down close to 30 percent from 2017 as the 30 year fixed rate mortgage continues to increase.

Another challenging area for the mortgage industry has been lenders' cost to originate loans, especially as we move into a purchase dominated market. As highlighted in a recent chart of the week (figure 2), independent mortgage bankers' total loan production expenses – commissions, compensation, occupancy, equipment, and other production expenses and corporate allocations – increased to $8,475 per loan in the fourth quarter of 2017, from $8,060 in the third quarter of 2017. This is based on data from MBA's Quarter Performance report. This marks the second highest level reported since the inception of our study in the third quarter of 2008, with the study-high at $8,887 per loan in the first quarter of 2017.

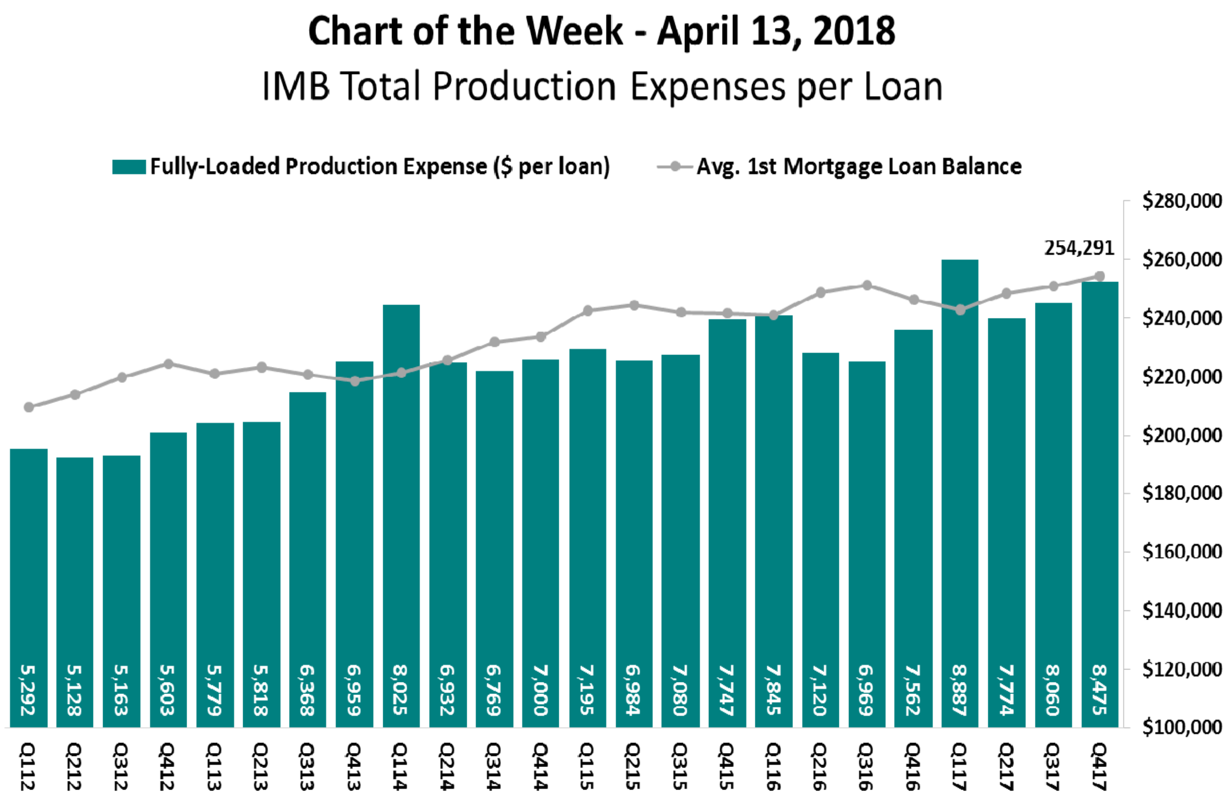
The higher production costs in the fourth quarter of 2017 were likely driven by several factors. During this quarter, average production volume by count per company averaged 2,059 loans in the fourth quarter of 2017, down from 2,341 loans in the third quarter of 2017. Fixed sales, fulfillment, support and corporate costs were spread over fewer loans, increasing per-loan costs. In addition, loan balances continued to rise, affecting variable sales compensation costs. The average loan balance for first mortgages reached a study high of $254,291 in the fourth quarter of 2017, up from $251,109 in the third quarter of 2017. Since sales compensation is usually a percentage of the average loan balance for a loan, sales personnel costs per loan generally rise with increasing loan balances. Other factors influencing production costs may include rising compliance-related costs, technology spending, and non-sales labor costs for specific skillsets such as underwriting.

Figure 1.



Source: MBA Weekly Applications Survey

Figure 2.



Source: MBA Quarterly Performance Report