2023 Mortgage Industry Outlook: Opportunities, Challenges, and an Uncertain Future

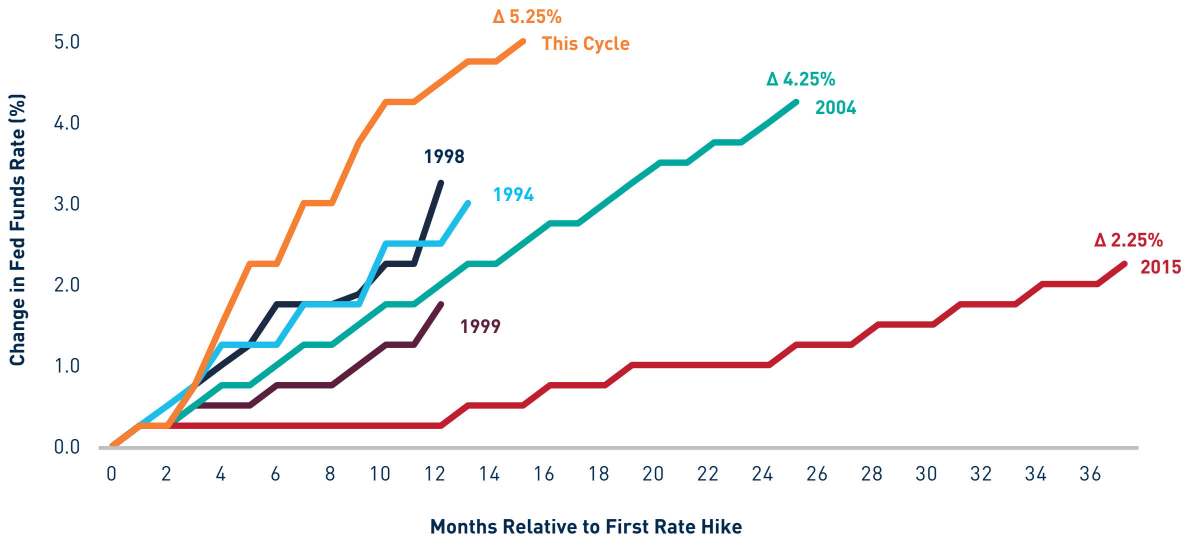
Mortgage originators and servicers are facing economic headwinds in 2023, but this unique time presents an opportunity to mitigate risks and improve operational efficiencies to position strategically for the future. In this paper, BRG experts analyze the challenges, changes, and possibilities for the industry.

Inflation, Rising Interest Rates, and a Looming Recession

The mortgage industry in 2023 is facing an uncertain future. Historically low interest rates created a spending boom starting in 2020, with heightened demand and minimal inventory driving up prices in a hot housing market. Yet as excess cash flooded the market, inflation rose, hitting 9.1 percent last fall.

Now a sharp course correction is underway. The Federal Reserve has raised interest rates at the fastest pace in forty years, with seven rate hikes in 2022 *(figure 1).* Federal Reserve Chair Jerome Powell indicated in December 2022 that these rates are likely to remain high for the foreseeable future[1]—potentially increasing further should wage growth remain above 2 percent.[2]

Figure 1. Federal Funds Rate Hikes Pace



Source: Bloomberg Finance L.P., Federal Funds Target Rate - Upper Bound FDTR:IND (May 2023).

1 Rachel Siegel, "Fed Raises Rates by Half a Percentage Point in Last 2022 Hike," Washington Post (December 14, 2022). https://www.washingtonpost.com/business/2022/12/14/fed-rate-hike-december/

2 Craig Torres and Catarina Saraiva, "Powell Puts US Pay Hikes at Heart of Fed's 2023 Inflation Fight," Bloomberg (December 18, 2022). https://www.bloomberg.com/news/articles/2022-12-18/fed-zooms-in-on-american-paychecks-as-it-takes-inflation-battle-into-2023

Though these moves are starting to cool inflation and lower consumer prices, they also have sparked fears of an economic downturn, given that rate hikes in 1987, 1999, and 2004 all resulted in recessions *(figure 2)*. Historically, interest rate–induced recessions have ranged in severity, from −0.1 to −3.8 percent changes in GDP and job losses of between one and seven million, with the 2008 financial crisis being an extreme example. Any such downturn in 2023 would have serious and wide-ranging implications for the mortgage industry.

Figure 2. Federal Funds Target Rate

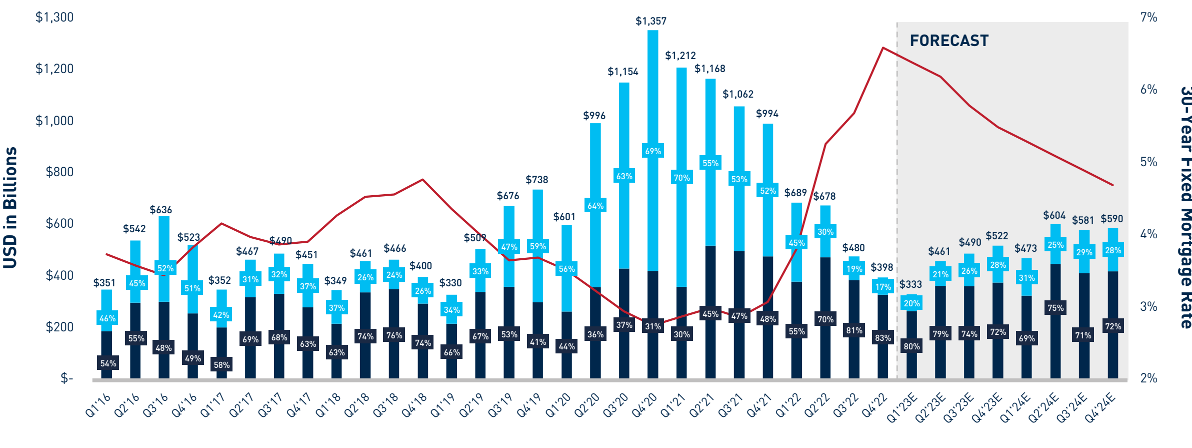
Source: Bloomberg Finance L.P., Federal Funds Target Rate - Upper Bound FDTR:IND (May 2023).

Even without a recession, many originators and servicers are already facing significant financial challenges resulting from these macroeconomic factors—all of which are likely to worsen this year.

The Housing Market Slump

In 2022, mortgage rates surged alongside rising interest rates, more than doubling to over 7 percent at inflation's peak. Consequently, as the actual price of properties sharply increased, the housing market saw demand plummet in 2022, and originations in 2023 are expected to drop 60 percent from 2021's high *(figure 3)*. Refinancing is also projected to fall from $2.7 trillion to $400 billion, as many homeowners are in lower fixed-rate mortgages.

Figure 3. Originations vs. 30-Year Fixed-Rate Mortgage

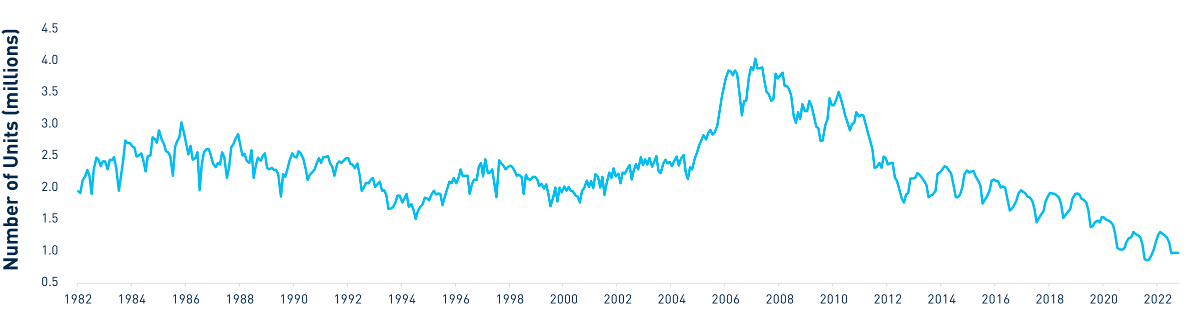


* 30-yr fixed-rate figures are average for the quarter
Source: Mortgage Bankers Association, "Forecasts and Commentary" (January 2023). https://www.mba.org/news-and-research/forecasts-and-commentary

Though a severe lack of inventory—the lowest in forty years—has kept demand from cratering, foreclosures following a recession may collapse artificially inflated property prices *(figure 4)*. US commercial mortgage-backed securities (CMBS) may be seeing the first signs of stress given the increase in commercial real estate delinquencies, increases in Cap rates, and continued impact of work-at-home policies from the COVID pandemic. Residential mortgage-backed securities (RMBS) performance will likely take more time to develop and likely has a high correlation with employment levels, which have been resilient despite Fed rate increases.

Certain specialized sectors are also facing unique challenges in this economic climate. Non-qualified mortgages (non-QMs), governed by strict regulations, may strain the liquidity of companies forced to buy out underperforming loans at a loss, while private equity firms engaged in single-family rentals (SFRs) are facing lower yields as rents decrease.

Figure 4. US Housing Inventory



* Composed of single-family, condos, and co-ops.
Source: National Association of Realtors (NAR), Total Housing Inventory in the United States: USATHI (April 2023).

Trouble Stirring in the Industry

Driven by the factors above, the mortgage industry has shown signs of financial distress, with total employment down 12 percent by the end of 2022 and continued layoffs in 2023. Freedom Mortgage, for example, laid off 50 percent of its workforce in 2022,[3] while Angel Oak underwent a 15 percent workforce reduction.[4] Mortgage originator Better.com also had several rounds of layoffs in 2022, which affected more than 35 percent of its employees.[5]

Additionally, for the first time since 2008, mortgage loan originator companies have been making headlines for bankruptcies. Reverse Mortgage Funding, America's fifth-largest reverse mortgage lender,[6] and First Guaranty Mortgage both filed for Chapter 11 bankruptcy in 2022.[7] Sprout Mortgage, which had heavily invested in non-QMs, simply shut down last summer.[8]

Fintech mortgage originators, which have captured significant market share since the Great Recession, face particularly acute risks. Their lack of servicing obligations, which can serve as a hedge against economic instability, and inexperience with housing market downturns make them more vulnerable than traditional and experienced mortgage companies with diversified revenue streams. Stock prices for Rocket Mortgage and LendingTree, for example, are down 50 and 80 percent, respectively, over the past year.

Meanwhile, mortgage originators that accelerated hiring during the pandemic, pushed volume with thin margins, and eliminated servicing will likely face layoffs or even bankruptcy without immediate action.

Recent Changes to Mortgage Fees Likely to Impact Homebuyers' Purchasing Power

On May 1, 2023, new mortgage financing policies implemented by the Biden administration and the Federal Housing Administration went into effect, adjusting the Loan-Level Price Adjustment (LLPA) matrix, hoping to promote equitable and sustainable access to homeownership.[9, 10]

Those with top credit scores will still pay less than a borrower with a lower credit score; however, those with a lower credit score will pay less than they would have prior to May 1. For example, a borrower with a credit score of 659 borrowing 75 percent of the home value will pay a fee of 1.5 percent of the total loan balance, compared to 2.75 percent previously. Alternatively, a borrower with a credit score of 740 or higher will pay as much as 0.375 percent, compared to 0.25 percent previously.

The impact on a monthly mortgage payment is expected to be minimal. However, the impact on a borrower's payment over the life of the mortgage could amount to thousands of dollars and will likely impact the purchasing power of many Americans.

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6 Bill Conroy and Chris Clow, "Inside the collapse of RMF, America's fifth-largest reverse mortgage lender," Reverse Mortgage Daily (December 8, 2022). https://reversemortgagedaily.com/articles/inside-the-collapse-of-rmf-americas-fifth-largest-reverse-mortgage-lender/

7 Daniel Gill, "First Guaranty Liquidation Approved After Deal With Ex-Workers," Bloomberg (November 1, 2022). https://news.bloomberglaw.com/bankruptcy-law/first-guaranty-liquidation-approved-after-deal-with-ex-workers

8 Chris Clark, "US lenders are starting to go bankrupt with new mortgages down 47% — could this one factor trigger the worst surge of failures since 2008?" Yahoo! (January 20, 2023). https://sports.yahoo.com/mortgages-down-55-us-lenders-100000026.html

9 The White House, "Fact Sheet: Biden-Harris Administration Announces Action to Save Homebuyers and Homeowners $800 per Year," press release (February 22, 2023). https://www.whitehouse.gov/briefing-room/statements-releases/2023/02/22/fact-sheet-biden-harris-administration-announces-action-to-save-homebuyers-and-homeowners-800-per-year/

10 Medora Lee, "Mortgage fees are changing for homebuyers next month. Here's what you should know.," USA Today (April 23, 2023). https://www.usatoday.com/story/money/personalfinance/2023/04/23/mortgage-fee-structure-change-may-2023/11713841002/

Using Technology to Mitigate Risks and Seize Opportunities

In today's uncertain economic climate, diversified service lines provide the best protection—particularly in higher-risk or niche sectors, like non-QM or reverse mortgages, which tend to see challenges first. While a strong origination and refinancing pipeline may have benefitted the industry during the pandemic, the consistency of mortgage servicing revenue will be an important part of keeping businesses healthy amid a downturn.

At the same time, servicing remains a significant cost driver, making this an opportune moment for innovation and technological disruption. The mortgage industry has lagged behind other sectors in adopting automation technology that can offer substantial efficiency improvements and cost savings, especially in a tight labor market.

For instance, when it comes to servicing, businesses can automate and digitize components of the transfer, processing, compliance, and mitigation operations to utilize employees more efficiently. Loan boarding and servicing transfers can benefit from a digitized process of ingesting and classifying documents, as well as capturing and confirming data on loan packages that have been received or provided to successor servicers. For more complex assessment functions, such as regulatory compliance or loss mitigation, data analytics and digital workforce tools can automate classification for high-risk loans or transactions. Bots can also reduce routine and repetitive "stare and compare" tasks related to payment processing, freeing up humans to do more sophisticated work.

More broadly, originators can use optical character recognition (OCR) and machine learning technology to detect fraud; data analytics and bot tools to automate elements of the quality control process; and sophisticated artificial intelligence (AI) chatbots to improve customer service efficiency.

Successfully integrating these technologies can have significant short- and long-term benefits for companies, with minimal costs and disruption. BRG recently worked with a top-five mortgage servicing company to automate processing and dispositioning of scanned bankruptcy checks. The solution empowered the client to automate processing for 93 percent of checks received and posting instructions for 80 percent of check allocations, resulting in a 50 percent reduction in team size and improved accuracy and processing speed. With these new efficiencies in place, the client is poised to recover implementation and digital worker subscription fees within sixteen months.

Mortgage companies that look to the year ahead, despite its uncertainty, as an opportunity to strengthen resilience, diversify service lines, and innovate through technology will be best positioned in the market—but they don't need to navigate these challenges alone. BRG's Financial Institutions Group experts can act as partners, leveraging their experience and insights to develop innovative business solutions for 2023 and beyond.

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