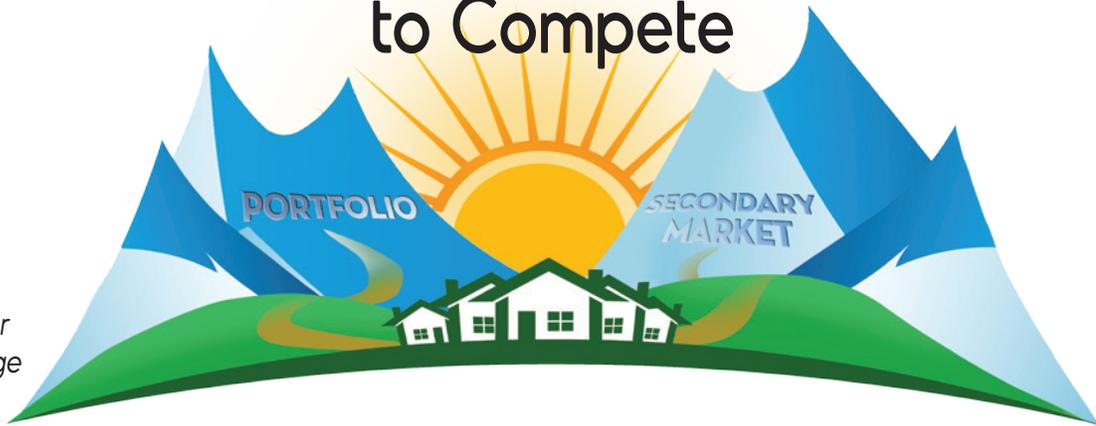


Leverage Portfolio Loans and the Secondary Market to Compete



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Behold the power of credit union mortgage portfolios. Holding loans in portfolio gives credit unions an enormous advantage at a time when fast-rising home prices are creating demand for non-conforming loans to meet a variety of needs, ranging from jumbo loan amounts to solutions for self-employed borrowers and overcoming affordability hurdles in high-cost markets.

In terms of mortgages, credit unions have increased market share from 1.9% in 2007 to 8% as of March 2019, according to the Credit Union National Association (CUNA).¹

Credit unions originated \$26 billion in first mortgages in the first three months of this year, up sharply from \$17.5 billion in the same period of 2014, Callahan & Associates reported.²

Those numbers are especially impressive when you factor in the rapid rise of Internet-based lenders (or “fintechs”) that have been capturing Millennial home buyers in recent years with appeals like Rocket Mortgage’s “Push Button, Get Mortgage” ads.

With those unique sales pitches and automated efficiency, fintechs have claimed about 8% of the mortgage market, up from 2% in 2010, the National Bureau of Economic Research stated in a recent report.³

GROWING MEMBERSHIP AND MORTGAGES

One of the credit union’s many strengths is an increasing base of members. Figures from CUInsight.com show annual credit union membership grew 4.5% to 116.2 million at the end of 2018 (and overall membership is up 31% since 2008).⁴

As member-owned institutions, credit unions typically have a low tolerance for risk, and careful underwriting of loans means members are less likely to default than bank borrowers.

As nonprofits, credit unions can often charge lower interest rates and fees than large banks. One of the reasons is that credit unions with mortgage portfolios earn interest income month-by-month on each loan over the long term. Many banks opt to sell most of their newly originated loans for an immediate profit.

Holding mortgages in portfolio (rather than selling them to GSEs and private investors) also gives credit unions the ability to tailor mortgages to meet member needs. In some cases, credit unions create unique loan products to suit the local market. This flexibility can also mean taking a second look at a loan when a member with a solid income and payment history comes up a bit short on a debt-to-income limit or credit score guideline.

The Federal Housing Finance Agency recently raised the baseline limit on the size of mortgages that can be sold to Fannie Mae and Freddie Mac to \$484,350. Homebuyers seeking a bigger mortgage, known as a “jumbo loan,” often turn to credit unions for mortgages that will be held in portfolio or sold to investors other than Fannie Mae and Freddie Mac.

CREATIVE LOCAL SOLUTIONS

Jumbo loans are just one of the products that lead homebuyers to credit unions. For many self-employed borrowers with fluctuating incomes, a credit union with knowledge of the local economy can be easier to deal with than a national bank.

Similarly, a large bank might decline the mortgage application of a recent college graduate based on debt-to-income

requirements, even when that person just earned an advanced degree and has landed a job with a strong salary.

With the flexibility a portfolio provides, credit unions nationwide have created lending programs that offer degreed professionals low down payments and more flexible requirements. These programs have been designed for professions ranging from doctors and nurses to teachers, service members and law enforcement personnel.

In areas with high real estate prices, credit unions are helping members overcome affordability hurdles.

According to a *Credit Union Times* article published in March, buyers of multi-story homes have obtained mortgage loans from credit unions that approved the rental income from an apartment on one of the home's levels as qualifying income.⁵

In another case, a California credit union created a special loan program to enable the renovation of what had been a commercial loft into a residential building with separate living spaces for four borrowers with four separate mortgages.

EXPLORE NEW OPPORTUNITIES

Some credit unions are also helping members by offering small-balance mortgages. A recent article in *The Wall Street Journal* spotlighted banks turning away loans in the \$20,000-to-\$70,000 range.⁶ ATTOM Data Solutions found there's been a 38% reduction in mortgage originations in the under-\$70,000 category since 2009. Over the same period, originations of \$150,000-plus mortgages increased by 65%.

The WSJ article states smaller loan amounts aren't profitable enough for many banks since those low-balance mortgages cost nearly as much to originate as much larger loans. In addition, banks believe high-balance borrowers are more likely to consider other bank products, including credit cards and investment services.

Alissa Sykes, Senior Vice President and Chief Growth Officer at Sun-



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mark Federal Credit Union in Latham, New York, said low-balance mortgages aren't a focus, but the credit union does offer mortgages down to \$50,000.

"We believe it's a service to our membership," Sykes said. "Our most important message to our members is that we have mortgage programs that fit almost everyone's needs. We want to provide more than a mortgage—we are about the entire relationship."

THE EVOLVING SECONDARY MARKET

To balance risk, credit unions sell a portion of the loans they originate to the secondary market, including Fannie Mae and Freddie Mac. In 2018, credit unions sold \$50 billion in mortgage loans to the secondary market, up sharply from \$4.5 billion in 1997, CUNA reports.

As a result, advocates for credit unions are closely watching discussions in Washington, D.C., about possible changes to the GSEs, including proposals for the GSEs to buy fewer loans in favor of private investors taking on more risk.

In a letter to the House Financial Services Committee late last year, CUNA officials said 35% of credit unions access the secondary market to manage long-term interest rate risk. The CUNA letter emphasized the importance of a reliable secondary market, stating, "Access to a liquid secondary market with relatively low transaction costs is vital for the health of credit union mortgage lending."

THE FINTECH CHALLENGE

Credit unions face a growing challenge from fintechs—lenders who specialize in originating loans through a largely automated, digital process. Not only do these online lenders have appeal for younger borrowers, but their processes are so efficient that online lenders are closing mortgages about 20% faster than brick-and-mortar credit unions and banks, according to the National Bureau of Economic Research.⁷

Some experts warn that the growing

efficiency of fintechs could cut further into the profits earned from loan originations. The Mortgage Bankers Association calculated that the average profit independent mortgage bankers earned on a single loan dropped to \$367 in 2018, a decline from \$711 in 2017.⁸

Despite these challenges, credit unions also have a huge opportunity right in their own backyards.

Currently, only 2.5% of members have a mortgage with their credit unions. While fintechs and traditional lenders may lure some members away, it's relatively inexpensive for credit unions to market mortgage programs directly to their members, which could help fuel additional growth in years to come. ▲

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