The Arizona Loan Baron

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A Message from The Arizona Loan Baron:

"BOTTOM bottom line: ... not at all uncommon to see mortgage rates get stuck in the mud even as Treasury yields surge to all-time lows..."

The Day Ahead: Don't Expect Mortgage Rates to be Thrilled

Good morning. 10yr yields are in the 1.2's. All-time lows.

We follow MBS and the 10yr Treasury yield (and other rates, when relevant) here. The focus is on the 10yr for THESE REASONS.

Today will be "interesting" then, because mortgage rates aren't going to do what the 10yr is suggesting. I've broken this down before in excruciating detail HERE. <---- That's the definitive link on this topic, but I'm going to break it down in different, mostly smaller words.

When you get a mortgage, a lender writes a check on your behalf in exchange for you agreeing to pay them back over time. Why would the lender do that? Because they're counting on you paying back more than you borrowed.

That's simple right? If they loaned you $250k to buy a house, and you make at least one payment, they'll get their $250k back plus whatever interest you paid in the first month. Shouldn't they be happy?

No, not at all. They'd actually be pretty pissed off. Your new loan is a thing of value that can generate money for an investor. As such, they're willing to pay more than the principal amount of the loan for the right to collect interest. So your $250k loan may have cost $260k to purchase/fund. If you're familiar with the concept of lender-paid closing costs, that's where that money comes from. Bottom line, in the above scenario, the lender needs to collect $10k in interest before they break even.

If the lender were buying US Treasuries, they wouldn't have to worry about the US government deciding to pay the loan back too quickly. Treasuries don't even have that option. They also don't have as much interest-earning potential for investors. The mortgage investor is taking more risk for more reward. The risk is that you pay your loan off too quickly and they don't make money on interest.

When rates fall super duper fast, those risks increase quickly. The investors who buy mortgages know this, so those premiums begin to decline. $260k

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 6.0	99.80	+0.34
MBS GNMA 6.0	100.73	+0.25
10 YR Treasury	4.5780	-0.0565
30 YR Treasury	4.7248	-0.0266

Pricing as of: 5/2 2:23PM EST

Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.42%	+0.01	0.00
15 Yr. Fixed	6.85%	+0.01	0.00
30 Yr. FHA	6.88%	0.00	0.00
30 Yr. Jumbo	7.60%	0.00	0.00
5/1 ARM	7.48%	-0.02	0.00
Freddie Mac			
30 Yr. Fixed	7.22%	-0.22	0.00
15 Yr. Fixed	6.47%	-0.29	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	7.24%	+0.11	0.66
15 Yr. Fixed	6.75%	+0.11	0.64
30 Yr. FHA	7.01%	+0.11	0.94
30 Yr. Jumbo	7.45%	+0.05	0.56
5/1 ARM	6.64%	+0.12	0.87

Rates as of: 5/2

becomes $258k, etc.

What we're dealing with here are the building blocks of lending. Whether we're talking about a Treasury bond or a mortgage, both are loans. Both have a price for the investor/lender and a rate of return. Price and rate are the two key inputs that decide the cost of any given loan. A higher price paid by the investor is the same thing as the investor accepting a lower rate of return and vice versa.

So when we talk about "premiums beginning to decline," we're talking about investors paying LOWER prices for any given rate of return. And as the previous paragraph discussed, when an investor is paying a lower price, it's the same thing as you paying a higher rate. In short: super fast drop in rates = investors worried you'll refinance too soon for them to break even = investors pay less of a premium for your loan so they can break even sooner, and lower prices = higher rates for you.

If you've been reading this and think your head is about to explode due to a logic bomb you think I missed, don't worry... I didn't miss it. I realize what I wrote above could be reduced to the assertion that "rapidly falling rates = higher rates." Here's how that works:

Just throw the word "relatively" in front of "higher rates." For the investor who buys loans/bonds (whether it be mortgages or Treasuries), everything is relative. When the rates are falling across the board (i.e. Treasury yields of all kinds declining in concert with mortgage rates), it means investors are paying higher prices for those loans across the board. The refi risk scenario discussed above means the investor isn't increasing their price offering for mortgages in proportion to the price increases for something like US Treasuries (which, again, don't carry that "refi risk").

Looked at another way, if the overall "rate of return" for the bond/loan investor is declining, the simple act of keeping mortgage rates 'unchanged' is the same as raising mortgage rates when the overall rate of return in the bond/loan market is holding steady. It's all relative.

BOTTOM bottom line: the mortgage investor has to worry about you paying your loan off too quickly, so it's not at all uncommon to see mortgage rates get stuck in the mud even as Treasury yields surge to all-time lows. Given enough time and market stability, mortgage rates eventually follow, but without enough time, sometimes they'll just wait here and reconnect with Treasuries when rates head back up.

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The Arizona Loan Baron

The Arizona Loan Baron is at your service!

I would appreciate the opportunity to share with you my extensive mortgage lending experience. My client focused approach has allowed me to build long lasting relationships and partnerships throughout Arizona. I know this market. I live here and work here. Please allow me the opportunity to be your mortgage lending partner.

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