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VIEWPOINTS

Get Ready for the Refi Bubble to Burst

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Let's start with a little history of past refinance booms, using data from the Mortgage Bankers Association:

In a refinance wave between the first quarter of 1998 and the second quarter of 1999, quarterly refinance volume nationally averaged $203 billion a quarter, peaking at $303 billion in 1999 before it started dropping.

Once rates moved up in mid-1999, refinance volume on a national basis plunged, averaging only $50 billion for the next year and a quarter and bottoming out at $48 billion. Going from the high of $303 billion a quarter to a low of $48 billion was an 84% decline.

If we look simply at averages, refinance volume dropped from a six-quarter average of $203 billion to a five-quarter average of $50 billion, a 75% decline.

Let's go back to the refinance wave of 1992-93. Between the first quarter of 1992 and the first quarter of 1994, national refinance volume averaged $120 billion a quarter, peaking at $175 billion near the end. In the next five quarters, it averaged only $23 billion, hitting a low of $13 billion.

There was a nine-month period in 1994 when it averaged only $15 billion a quarter. Going from a high of $175 billion to a low of $14 billion was a 93% drop.

That's not a typo. It was 93%.

Let's now look at averages. Volume averaged $120 billion a quarter during the 1992-93 refinance wave and $23 billion a quarter over the next year and a quarter, an 80% drop.

The MBA Economics Department forecast through 2014 shows the refinance market dropping from $388 billion in last year's fourth quarter to $83 billion in the fourth quarter of 2014, a 79% drop.

If you want to do your own research, the MBA puts out a table showing total volume by purchase versus refinance for every quarter since 1990. It's interesting, but it can also be scary.

Every refinance wave is slightly different, but due to repeated rate drops and extended periods of low rates, we now have a much tighter coupon stack. We no longer have the range of coupons that would continue to feed refinances even as rates go up.

That is, there just are not that many mortgages left at the 5% to 6% or 7% range.

Instead, we have a case where for a relatively small drop in rates, a large percentage of the market suddenly has a refinance incentive. However, for a small increase in rates, the refinance incentive starts to vanish.

One industry expert put it best when he told us, "In the old days it was a dimmer switch that ended refinance booms. Now it will be an on/off switch."

Making it worse is that declining volume always leads to smaller margins as lenders cut prices to keep their volume up.

We strongly suggest that all mortgage lenders prepare themselves for a minimum decline in refinance activity of 75% and make sure their capital plan, liquidity plan and budget all reflect this.

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