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Prepayment Model Update

What are the main changes?

- Faster Ginnie Mae speeds (relative to conventional speeds).
- Greater cashout refinancings (based on anecdotal evidence and fast late-1998/early-1999 low-coupon speeds) and faster initial seasoning (strong housing markets seem to have boosted homeowners' ability to trade up).
- Error-correction adjustments (short-term adjustments). The idea is to correct persistent errors, with a correction factor that decays over time (the underlying assumption is that the base model is accurate in the long run, but short-run deviations can occur for several months at a time).

Why are Ginnies, relative to conventionals, faster than in the past?

- The 50bp FHA mortgage insurance premium (MIP) effectively raises the weighted-average coupon by 50bp. Loans whose LTVs have dropped to below 80% can switch to conventional financing without any mortgage insurance fees. For high-LTV borrowers, the growth of high-LTV conventional lending may provide an alternative to FHA/VA financing.
- Buyouts/enhanced lender solicitation has increased Ginnie Mae refinancing efficiency.

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[9] See manifold MB724 (on Yield Book™ and Salomon Direct) for month-by-month prepayment speed projections by coupon and vintage.

- ➤ Depositary institutions (banks) need lower-income borrowers (who fit the typical Ginnie Mae borrower profile) to take out mortgages from them to satisfy Community Reinvestment Act requirements.
- ➤ For reasons not completely understood, 1993- to 1994-originated conventionals are prepaying relatively slowly.
- ➤ The strong housing market seems to have released more pent-up demand to move from Ginnie Mae borrowers.[10] Strong home price appreciation also weakens the assumability option.

How does the model boost Ginnie speeds?

- ➤ It raises the mobility rate (same as conventional), which is assumed to decay back to a lower rate over five years.
- ➤ It lowers costs to reflect increased refinancing risk owing to 50bp MIP fees and buyouts/lender solicitation.

What other changes have been made?

- ➤ More credit-driven refinancings for agency collateral. Given the agencies' move to purchase Alt-A and subprime loans, this change was made to explain some of the fast speeds on above-market-originated premiums.
- ➤ Shorter interest rate lags for refinancings in light of the fast January 2001 Fannie Mae and Ginnie Mae speeds.
- ➤ Because existing home sales are now reported based primarily on closings (so, turnover speeds more closely follow home sales), the number of business days in the monthly reporting period (calendar month for Ginnie Mae and Fannie Mae, the 16th to the following 15th for Freddie Mac) is now accounted for.
- ➤ Data Updates:
  1. Existing home sales
  2. Housing stock (used in estimation of overall turnover rate)
  3. Home price appreciation11
  4. Generic loan sizes
  5. Above-market spreads, refinancing percentages

Does the model account for future increasing refinancing efficiency?

The new model, as well as the production model, assumes some decline in refinancing costs in the future.

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[10] Perhaps Ginnie Mae borrowers are taking advantage of strong home price appreciation in combination with their high leverage loans to trade up.

[11] Through second quarter 2000. Although the third-quarter data has been released, the strong home price appreciation rates recorded then are not consistent with the expected slowdown in the housing markets. The model assumes recent rates of home appreciation carry forward to some extent, mean reverting to a long-run rate of 3% over a period of three years.