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NATHAN HOWARD/ BLOOMBERG NEWS Mortgage rates recently fell below 6% for the first time in years.

Trump's Push to Make Homes More Affordable Needs the Banks to Play Ball

Lenders have many reasons to resist jumping back into mortgages

Will big banks be offering more mortgages to struggling first-time home buyers? Don't bet the house on it yet. - Note

Things are looking a little less grim for Americans straining to afford a home, with mortgage rates falling below 6% for the first time in years. At the same time, the top banking regulator at the Federal Reserve, the Trump appointee Michelle Bowman, recently said the central bank is considering whether some targeted changes to capital rules could lower the costs for banks to make and service mortgage loans. - Note

The goal is to stem a long-running trend since the aftermath of the 2008-09 financial crisis, when stricter capital requirements made it costlier for many banks to hold mortgages. Since then, a growing share of mortgage lending and servicing has gone through nonbank entities like Rocket, with the loans ultimately going into the securitization market. Reducing capital requirements can help a bank make more loans with existing equity capital resources. - Note

In theory, bringing banks back into parts of the market where they have dialed back could introduce more competition, and in turn better pricing for home borrowers. The Fed also said that borrowers were more likely to receive forbearance during Covid-19 when a bank was servicing their mortgages as opposed to a nonbank.

But to unlock a flood of new lending, especially for first-time buyers trying to make a suitable down payment, would probably require much more than changes at the margins of capital rules.

Analysts at Morgan Stanley wrote in a recent note that although less-stringent mortgage capital requirements could help banks "defend market share," they also said they "don't expect a meaningful pivot back into mortgage by banks in the near term."

The balance in enabling more mortgage lending is to do so without encouraging banks to take more risks. One doesn't have to think too hard to remember a time that home lending caused big problems. Big banks also likely re--member the tens of billions of dol --lars of government fines they paid related to mortgage servicing after the 2008-09 financial

crisis. In recent years, banks have represented a smaller share of government-backed mortgages for lower-income borrowers.

So a question the Fed is considering is whether to calibrate capital requirements for a mortgage to its loan-to-value ratio. In plain terms, this would mean that it could become cheaper to carry a mortgage if the borrower made a big down payment, helping to derisk the loan.

But mortgages with larger down payments are, in many cases, not what struggling first-time home buyers are seeking. Some banks already give priority to often wealthier customers seeking “jumbo” loans that don’t fit Fannie Mae and Freddie Mac guarantees. These borrowers can afford to make higher down payments, and might be less likely to miss payments over time. They can also bring other business, like sizable deposits, investment accounts or lots of card spending, which justify aggressive pricing on mortgages.

Yet banks might still be wary of being too generous on rates to chase even well-heeled customers. Memories of the experience of First Republic should still be fresh. That bank was known for offering attractive mortgages to wealthy customers. Those low-yielding assets then plunged in value when rates rose, while the accompanying deposits fled, contributing to the bank’s collapse.

Meanwhile, the emergence of technology-driven nonbank lenders has started to change key parts of the mortgage business radically. These firms are primarily in the business of making and then selling mortgages, earning a gain on each sale. They often aggressively seek to refinance customers at lower rates, because doing so represents another transaction. That might help explain why mortgages have recently been prepaid at a surprisingly fast pace, even after rather modest decreases in mortgage rates.

By contrast, for a bank thinking about holding loans or servicing rights, this dynamic adds risk. You might lose the stream of payments unless you are willing to refinance that customer at a lower rate when rates fall. Having to make big investments in technology to match the servicing capabilities of nonbank peers would be an additional hurdle.

Instead, one driver of the standard 30-year, fixed-rate mortgage’s move to an average national rate below 6% has been a tighter gap between the yields on mortgage bonds and corresponding Treasuries. That was sparked in part by a totally separate policy change, which was the Trump administration’s move to have Fannie and Freddie purchase more mortgage bonds.

Interestingly, the market seems to be thinking long term right now. Shares of banks have recently outperformed their nonbank mortgage rivals, even against the backdrop of falling mortgage rates, which ought to be a big boost to refinance activity. The KBW Nasdaq Bank Index is up about 4% over the past three months, while Rocket is down 8%.

But the forces driving mortgage rates right now have more to do with lower Treasury yields and higher demand for mortgage bonds. Those, not a new wave of bank lending, are home buyers’ best bet for near-term relief.

—Telis Demos

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