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More on Mortgage Rates

We expand on last week's discussion of mortgage rates.[6]

Mortgage Rates Vary From Lender to Lender

It is no surprise that mortgage rates vary from lender to lender, but it is worth noting that the variation in rates can be substantial. Recently, two of the largest lenders in the country had rate quotes for California that differed by 3/8%.[7] Some of the gap might be due to differences in the times at which the quotes were given (for example, morning versus afternoon). But it is also natural to expect differences in quoted rates because the mortgage industry, like the retail industry which has retail stores that compete for shoppers, has many players that provide differing levels of service and compete for borrowers to differing degrees.

The mortgage industry is still fragmented.

Despite the high-profile mergers that have occurred in recent years, the mortgage industry remains fragmented. The Mortgage Bankers Association (MBA) has 3,200 members, including mortgage companies, mortgage brokers, commercial banks, and thrifts. The National Association of Mortgage Brokers has more than 13,000 members. Moreover, lenders can quote differing rates for a number of reasons. Some lenders might be reluctant to lower rates if they are already operating at full capacity. Established lenders might not feel compelled to lower their rates as much as smaller/newer lenders who might offer relatively low mortgage rates to attract borrowers. Thus, surveys are generally relied on to gauge mortgage rates at any given time.

What Do the Surveys Say About Current Rates?

The Freddie Mac Primary Mortgage Market Survey is probably the most widely followed survey. Freddie surveys 125 thrifts, commercial banks, and mortgage lending companies on a weekly basis (rates quoted can be from Monday, Tuesday, or Wednesday of the week, depending on when the lender completes the survey). Bankrate.com conducts a weekly survey of the 50 largest banks and 50 largest thrifts in the ten largest metropolitan areas in the country. The survey consists of rates quoted on the Wednesday of that week. (Bankrate.com also computes a more volatile daily average mortgage rate, covering about 4,000 banks.) Both these surveys cover conforming mortgages.[8] (Descriptions of other surveys can be found in "The Fuzziness of Mortgage Rates," *Bond Market Roundup: Strategy*, November 20, 1998.)

[6] "Mortgage Rates Rally to New Lows," *Bond Market Roundup: Strategy*, Salomon Smith Barney, September 21, 2001. See also "The Fuzziness of Mortgage Rates," *Bond Market Roundup: Strategy*, Salomon Smith Barney, November 20, 1998, for a discussion of mortgage rates.

[7] Rate quotes from BanxQuote. Both rates were quoted with about 1 point. (A similarly sized difference in major lender rate quotes was exhibited on Bankrate.com.)

[8] Bankrate.com does its survey for a loan size of $150,000. The weekly survey done by the MBA includes both conforming and jumbo loans.

Figure 25. Mortgage Rates — Current and Low Reached in Late 1998

Rate Source (Release Date for Current Rate)	Current Rate (%)	Current Points	Late 1998 Low (%)	Monthly Average Low in Late 1998 (%)
Freddie Mac Weekly Survey (27 Sep)	6.72	0.90	6.49	6.71
Bankrate.com Weekly Survey (27 Sep)	6.70	0.65	6.46	—
MBA Weekly Survey (26 Sep)	6.63	1.27	6.36	—
Base Mortgage Rate (27 Sep close)	6.40	—	6.32	6.62

Sources: Freddie Mac, Bankrate.com, Mortgage Bankers Association, and Salomon Smith Barney.

Mortgage rates have not yet reached late-1998 historic lows.

Figure 25 suggests that primary mortgage market rates have not yet reached the historic lows of late 1998, with current Freddie and Bankrate.com survey rates about 20bp–25bp from their lows (of 6.49% and 6.46%, respectively). The difference is somewhat overstated because rates have rallied in the past couple of days since the surveys were done. The Base Mortgage Rate, which is obtained by taking the Fannie Mae current-coupon rate[9] and adding 50bp, is about 10bp from its low point. While individual low points are significant because activity during a month tends to be concentrated at the lows (when borrowers lock in their rate), in late 1998 the lows were reached for a fairly brief time, so monthly average rates might give a better indication of sustained refinancing activity. In terms of monthly average rates, the Freddie Survey Rate is just about at the low reached in late 1998 (6.71%), while the Base Mortgage Rate is below its late-1998 monthly average low point (6.62%). As discussed last week, primary mortgage market rates have exhibited stickiness during the rally, resulting in the Base Mortgage Rate diverging from higher primary market rates.

Is a New Low in Rates Still Important?

The boost in prepayment speeds that used to be observed when a historic low in rates was reached may now be weaker. The attention that historic lows previously tended to receive would help inform borrowers that they might want to consider refinancing. With technology making it easier for lenders to solicit borrowers and for borrowers to obtain information such as rate quotes, the impact of the additional media attention resulting from a new low in rates may now be substantially diminished. However, a new rate low will still likely boost speeds somewhat, as historic lows in rates will still mean refinancing opportunities not seen before for some borrowers.

Will the Base Mortgage Rate Converge to Primary Market Rates?

As shown graphically last week, the Base Mortgage Rate tends to track the Freddie Mac Survey Rate, although there can be periods when the two deviate from one another. Figure 26 shows the two rate series over the past 11 years to show how similarly the two series have behaved over a longer historical period.[10]

[9] Monthly compounded rate.

[10] Users of Yield Book™ can plot both of these series on the Historical Data page. These figures also remind us that late-1993 mortgage rates were *not* lower than rates in late 1998.

The Freddie Mac Survey Rate and Base Mortgage Rate have tracked each other closely over the past 11 years.

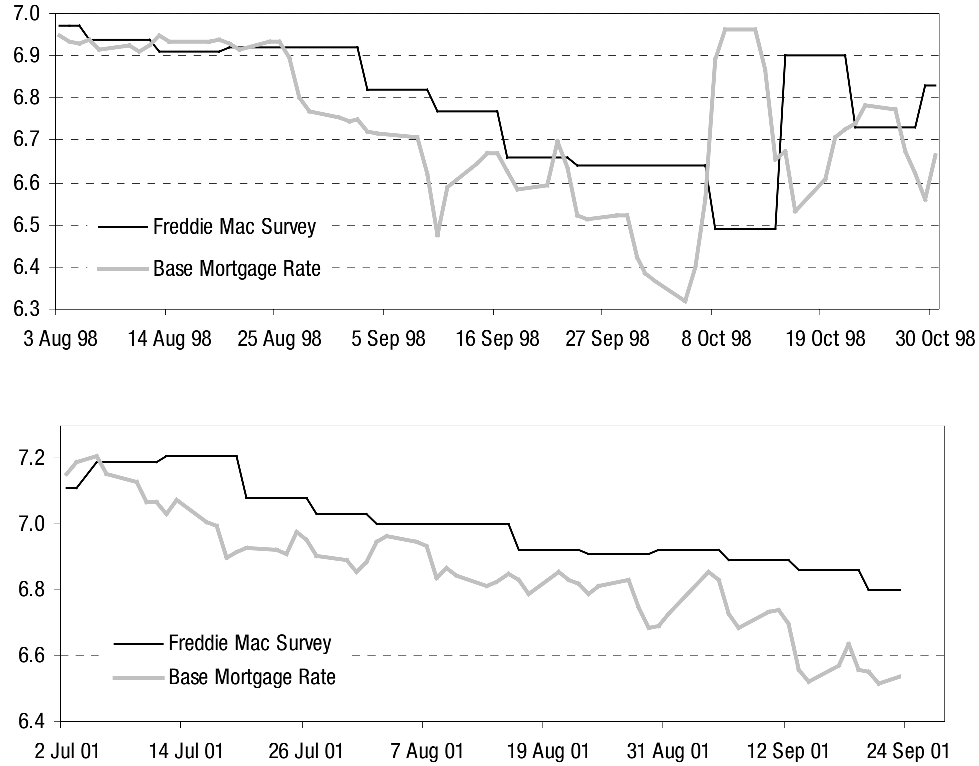
Figure 26. Freddie Mac Survey Rate Versus Base Mortgage Rate, Jan 90–Sep 01

Sources: Freddie Mac and Salomon Smith Barney.

However, while the two series tend to track one another, they can diverge at times, for example, when rates rally substantially. Figure 27 shows that a divergence occurred during the late-1998 rally (which bears a striking resemblance to the current rally[11]), but a sharp sell-off made the difference less noticeable. Given that the Base Mortgage Rate has tracked the Freddie Mac Survey Rate fairly well for a long time, we believe that primary mortgage market rates will eventually converge to the secondary-market-derived Base Mortgage Rate.

[11] See the last graph in manifold MB781.

Figure 27. Freddie Mac Survey Rate and Base Mortgage Rate, Late 1998 Versus Jul 01–Sep 01



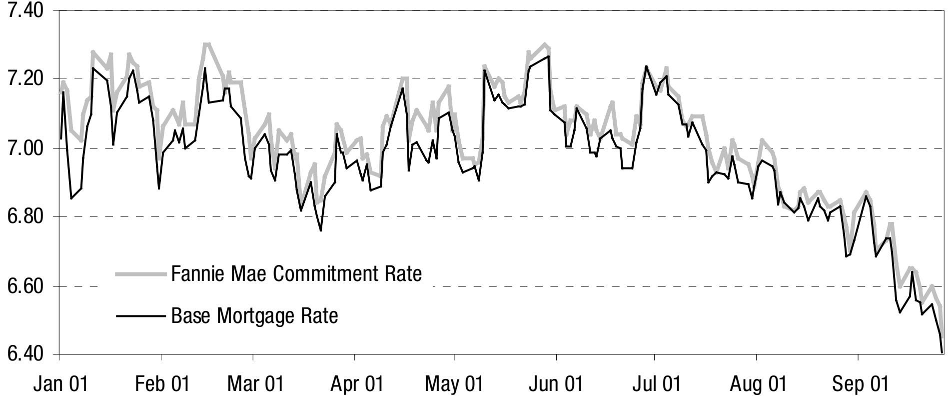
Sources: Freddie Mac and Salomon Smith Barney.

Mortgage Commitment Rates

The Base Mortgage Rate and the Fannie Mae 30-Day Commitment Rate shown in Figure 28 have performed similarly in recent months, suggesting that the Base Mortgage Rate is, at least, not unilaterally wandering away from other mortgage rates. No growing gap, as seen in the lower panel of Figure 27, is observed in Figure 28. Commitment rates are the rates at which loans can be sold to another entity, such as Fannie Mae and Freddie Mac or other lenders. The Fannie Mae Commitment Rate is the rate that Fannie requires for a par-priced loan. From the commitment rate, Fannie extracts its guarantee fee (which has tended to average around 19bp). The remaining interest goes to the secondary market investor. So, the Fannie Mae Commitment Rate is loosely the sum of the Fannie Mae current-coupon rate and Fannie Mae's guarantee fee.[12] This suggests that it is not Fannie Mae or Freddie Mac, but primary market lenders themselves who are keeping primary mortgage market rates higher than usual (relative to the secondary market).

[12] Note that the Fannie 30-Day Commitment Rate cannot be directly compared to primary mortgage market rates because of differences between the two. Besides the difference in (loan administration) servicing, the commitment rate does not involve any points, for example. Also, the rate lock-in period for primary mortgage market rates can sometimes exceed 30 days.

Figure 28. Base Mortgage Rate and Fannie Mae 30-Day Commitment Rate, Jan 01–Sep 01



Source: Fannie Mae and Salomon Smith Barney.