Maine Policy Review

Volume 8
Issue 1 *Housing*

1999

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(Or, Who Sets Mortgage Rates, Anyway?)

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Some have argued that the state of Maine sits in a far away corner of our nation's transportation system, and others feel that map makers have slighted our state in terms of its northern and eastern boundaries to accommodate large, flat maps of the country. Maine's mortgage market may well be the opposite situation as both rates and a bank's funding sources are not uniquely positioned as transportation or cartography may be. Rather, our mortgage business is part of a complex web of international markets that, for all practical purposes, has taken rate-setting away from Maine lenders and provided Maine consumers with choice rates.

What many do not realize is that the ability of individual lenders to establish price, terms and conditions for that single, large financial decision are long gone.

INTRODUCTION

For most individuals, the purchase of a home—or these days, the refinancing of their existing home—remains the largest single financial transaction they will conduct. The complex pile of documents, the signatures required and the transfer of funds all neatly tallied on the settlement sheet cause most consumers to simply raise their eyebrows and trust the loan closing agent to make the deal "work." Most who are familiar with the industry recognize that the mystique of the loan closing fades after the first hour of document signing. What many do not realize is that the ability of individual lenders to establish price, terms and conditions for that single, large financial decision are long gone. The globalization of business now includes the financing of your home despite our energies at convincing customers that everything is said and done locally. This discussion is intended to develop awareness for the complexity of mortgage lending and its impact on the Maine economic scene.

LOOKING FOR FUNDING SOURCES

Less than twenty years ago, nearly all home lending was delivered through in-state financial institutions at terms and conditions established by a local board of directors or senior managers. Additionally, those dollars that funded your first home came from neighbors and other customers of the bank who put their deposits in banks for safekeeping. In case anyone has forgotten, banks do not offer a line of products as your local mall retailer does. Rather, they take money from individuals and invest those funds in the lending needs of other individuals and, in theory, there is sufficient money left over to pay the employees and provide additional capital for the institution's growth.

The real change in the last two decades is that depositors no longer think of banks as a primary depository for either short- or long-term deposits. Today, bank management must seek other sources to fund those loans. Those sources come from both the private sector and from the Federal Home Loan Bank (FHLB) system. The FHLB, of which the Boston Bank is the conduit for New England, provides wholesale funding for Maine's lenders. Without the availability of those funds, there would be a return to those days when banks were out of money for loan purposes until the following month. For some reading this article, they will recall those days when disintermediation (the net outflow of deposits) occurred and created a banking crisis, as "no loans this week" was a common sign in Maine's financial institutions.

One additional point: There is a general misunderstanding by consumers that banks should not sell their loans. In fact, nearly every mortgage company in the country sells both the loan and the servicing immediately after closing (according to Maine's Bureau of Banking, nearly 50% of the loans originated in Maine are done by mortgage companies not by financial institutions). In general, Maine's financial institutions retain the servicing of loans they originate although many securitize or sell their loans to the secondary market.

SETTING THE MORTGAGE RATES

Loan rates have historically reflected risk, and borrowers assume they will be charged according to the potential loss they might cause their lender. Today, the national and international pooling of mortgages provides a very safe means for investors to purchase pools of mortgage loans so the vast majority of applicants receive the same deal. So safe, in fact, are these loan pools that the primary packagers are two United States government agencies: Fannie Mae and Freddie Mac. Both utilize the full faith and credit of the federal government as their guarantor.

This helps to explain that when customers have shopped for rates in recent years, most lenders have the same or nearly the same rates. Overall, the smallest customer in Maine receives the same product as the urban applicant in California or New York. Also, when The Federal Reserve Bank adjusts rates, the impact from that change, felt nationally, is also reflected to the Maine consumer.

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CONCLUSION

In Maine, the availability of mortgage money from financial institutions is directly related to the existing secondary market. Funds available at all times allow lenders to constantly make money available to qualified borrowers. Since the rates are set internationally, Mainers enjoy a continuing offering of nationalized mortgage rates. What a deal for the citizens from the state that barely fits onto a United States map or is the transportation cul-de-sac of the country.

Christopher W. Pinkham is president of the Maine Association of Community Banks, the state trade association representing Maine's community banks with twenty-six member institutions. The thirteen employees of the organization provide insurance programs, educational seminars, and training conferences for the industry. The Association has two for-profit subsidiaries; one that manages three smaller trade associations and sells publications related to the industry, and a second, a fully licensed insurance agency that provides products to the community bank industry. Beyond the management of these activities, Chris is the chief lobbyist on both the state and federal level for the member banks. Chris has been with the Association for twenty-four years and its head since 1980.