Private mortgage bond buzz portends deal revival

Al Yoon - Analysis
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NEW YORK (Reuters) - U.S. mortgage bonds at the heart of the financial crisis may be revived by Wall Street as soon as this quarter, in what could be the most significant step yet toward repairing the credit and housing markets.

HOUSING MARKET

Rumblings have increased in recent weeks of the first new residential mortgage-backed securities (RMBS) packaged by private investment banks with traditional bond ratings since the mortgage crisis deepened in mid-2008, according to analysts, investors and a firm that assesses loan quality.

New issues would likely be first backed by conservative, "jumbo" mortgages above $417,000, sources said, a corner of the market that has seen limited access to funding. Restarting the RMBS market would give banks a chance to sell loans they originate instead of holding them on their balance sheets -- expanding the ability to boost lending crucial to the U.S. housing recovery.

"We will have a (mortgage) securitization within the next two months," predicted Sue Allon, chief executive of Denver-based Allonhill, which is talking with dealers to provide independent reviews on loans, in addition to the designations of traditional bond rating companies.

"Everyone has a goal of trying to see if they can get one out this quarter," she said, adding that the issues will initially be "small and very clean."

Trade groups, regulators and lawmakers have long urged the return of private sources of housing credit to build on what government programs offer. But colossal failures of subprime and other private mortgage bonds have tainted the market, and a recovery is partly based on issuers' abilities to provide increased transparency and accountability.

REGULATORY CLOUDS

Complicating the process are proposed rules from the Federal Deposit Insurance Corp, which include a requirement for banks to hold loans for up to a year before selling them. The FDIC also wants banks to retain some ownership interest as a way to ensure quality originations.

But critics say the need for housing credit exceeds that available from bank balance sheets or government programs.

Demand for Fannie Mae, Freddie Mac and Federal Housing Administration funding has soared since the private markets dried up in 2008. During the housing boom, high volumes from private issuers reduced FHA loans to a trickle and eroded Fannie Mae and Freddie Mac market share so much that the two companies began expanding into purchases of riskier mortgages.

"The private market could help diversify mortgage risk that the government is taking on," said Alex Wei, head of structured credit at Delaware Investments in Philadelphia.

Fresh issuance may be possible because investors are clamoring for the higher yield of existing mortgage securities, even those backed by loans defaulting at alarming rates. The demand is lowering yields that investors will accept to close to levels that make it profitable for dealers to buy the loans and resell them as securities, said Scott Buchta, a strategist at Guggenheim Capital Markets in Chicago.

PENT-UP DEMAND

Bonds backed by prime, 30-year fixed-rate jumbo mortgages traded in the mid-$80s in December, recovering from $55 at the depths of the credit crisis in March, according to Amherst Securities Group.

Some bonds with top-quality jumbo loans originated in 2004, before home prices peaked, are already trading above the $100 face value, Buchta said.

Yields on bonds backed by prime jumbo mortgages range from 6.5 percent to 9.5 percent.

"Demand for high-quality assets is out there," Buchta said. "So it's a matter of time before the economics of the deal make sense as yields continue to come in."

Delaware's Wei and Chris Sullivan, chief investment officer at United Nations Federal Credit Union, said they would consider a new prime RMBS, depending on the structure.

Dealers may be able to garner higher prices for new bonds with high-quality loans created under today's more stringent terms, Wei said. Strong demand for top-quality assets recently helped sell a handful of commercial mortgage bonds after a long silence there, he added.

Sadie Gurley, a managing director at Marathon Asset Management in New York, said hedge funds that need to buy the riskier parts of mortgage bonds are not yet enticed by yields generated in a new securitization, she said.

"The arbitrage isn't there yet," said Gurley, who has discussed possible structures with dealers. "By the first half of the year we will have one, but not in the next six weeks."

(Editing by Padraic Cassidy)