FHN FINANCIAL
CAPITAL ASSETS CORP.

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CAPITAL ASSETS WEEKLY COMMENTS

Another One Bites the Dust: CMT ARMS!

As Mitchell Redd discussed in FHN Financial Capital Assets Corp. (Capital Assets) *Weekly Comments on* February 5 (**Adjustable Rate Mortgages: The Change From LIBOR to SOFR**), there is a lot going on and a lot to prepare for with the shift from LIBOR and CMT to SOFR. One issue that should not be overlooked is the impact on portfolio lenders with CMT becoming ineligible for agency delivery. At the moment, depositaries have options for CMTs that are likely to go away sooner than you expect.

Banks and credit unions commonly sell a segment of their seasoned loan portfolio to create liquidity to make more loans. When the need for a liquidity strategy arises, you naturally want to structure that transaction in the most price efficient manner possible. Until a year ago, the best price for a pool of seasoned Libor Arms could be achieved by doing a Fannie or Freddie securitization. Fannie Mae and Freddie Mac are still accepting new production Libor Arms, but Libors seasoned over six months were discontinued in spring 2019. Last week's announcement that CMT eligibility will go away in 2021 echoes 2019's Libor message. Although both GSEs are currently accepting seasoned CMTs, don't be surprised if the rug is pulled out from under seasoned CMTs in the coming months ahead of when eligibility is eliminated all-together. For this reason, we are encouraging customers to evaluate the merits of a CMT loan strategy before the ability to obtain MBS pricing goes away.

Show Me the Money

Seasoned, conforming balance CMTs that can be securitized price in direct correlation to the MBS market. Seasoned whole loans price at a "liquidity and credit" spread back of MBS, which is around 100bps. Said another way, the whole loan buyer rightly requires a yield around 100bps higher than the yield on an agency Arm MBS backed by the same pool of loans. The reason is that bonds are credit enhanced and highly liquid; whole loans are not credit enhanced and although liquid, they are not as liquid as a bond.

So what does that mean in terms of price?

The price difference on a given pool of loans will vary depending on its seasoning, months to the roll, coupon, etc., but roughly speaking, a pool of seasoned CMT loans swapped to an Arm MBS will price 1.50%–2.00% higher than that same pool if sold in the whole loan market!

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Summary

The window is still open for CMT sales to the agencies and because the price enhancement is so significant, I encourage you to explore a balance sheet management strategy to produce liquidity or address another issue before the MBS option for seasoned CMT goes away. Please contact your sales representative or Capital Assets directly at 1.800.456.5460 for more information on having a no-cost/no-obligation analysis conducted on your loans.