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Fitch: Mortgage Delinquencies Will Not Notably Affect Property Tax Payments

Fitch Ratings-New York-29 September 2020: Fitch Ratings does not expect fiscal 2021 property tax collections to be meaningfully affected by mortgage forbearance programs or delinquencies, but potential for timing delays is elevated. Mortgage servicers are obligated to advance property taxes when a borrower is not making mortgage payments and, due to the elevated number of delinquent loans and loans in forbearance, servicer liquidity is critical. Unemployment levels remain high, and Fitch expects a slower economic recovery following a third-quarter 2020 bounce back. In the absence of further federal aid, mortgage delinquencies may increase, placing greater pressure on mortgage servicers.

Property taxes have traditionally been a stable and predictable source of revenues for local governments, moderating higher volatility in more economically sensitive taxes, service charges and state aid. Overall property tax collections saw minimal declines during the Great Recession despite widespread mortgage defaults and foreclosures.

Home prices are still rising, as detailed in our U.S. RMBS Sustainable Home Price Report (Second-Quarter 2020), although growth is decelerating. Mortgage delinquencies, excluding mortgages in foreclosure, declined in August to 6.9%, but the rate of decline was slower than in the previous two months, according to Black Knight. The states with the highest delinquency rates were Mississippi, Louisiana, Hawaii, New York and Florida. During the Great Recession, the total delinquency rate peaked at 10.6%.

Forbearance has been offered in greater numbers than during the Great Recession but is trending downward from its peak in June. The share of mortgages in forbearance was 6.87% as of September 20, per the Mortgage Bankers Association. Mortgages in forbearance are generally reported as delinquent, although some borrowers with loans in forbearance are still making payments on time.

A few local governments postponed property tax deadlines or waived late payment fees for payers who can demonstrate they are affected by the coronavirus. Property tax delays are predictable and allow officials to plan for alternate sources of liquidity until tax payments are received. In contrast, an inability by servicers to advance payments to governments could cause an unexpected short-term liquidity shortfall. Almost all Fitch-rated local governments have sufficient liquidity, through internal resources, cash management tools or access to the short-term market, to offset this risk, which is reflected in higher ratings. Those local governments with weaker liquidity tend to be rated low investment-grade or non-investment grade.

A majority of US mortgages are pooled in securitizations as a tool for financing the loans. US mortgage servicers for private residential mortgage-backed securities (RMBS), Government National Mortgage Association (GNMA) RMBS, or Fannie Mae and Freddie Mac (Government Sponsored Enterprises, or GSEs) RMBS, are required by transaction documents or servicing guidelines to advance property taxes for delinquent borrowers to preserve the lien position, and did so even through the 2007-2008 housing crisis. Servicers of GSE and GNMA loans are also incentivized to continue to advance principal and interest (P&I) and taxes and insurance (T&I) to maintain their relationships with GSEs and GNMA, which guarantee mortgage performance. Mortgages guaranteed by the GSEs comprise 60%-70% of the mortgage market, while the remainder is mainly held by bank and credit union portfolios.

While most banks are unlikely to face near-term difficulties with advancing requirements, nonbank servicers, which have weaker credit profiles, are more challenged as they have greater loan exposure by dollar amount than banks. In response, master servicers, the GSEs and GNMA increased oversight of nonbank primary servicers to ensure servicer continuity and continued payments of P&I and T&I.

Many nonbank servicers secured additional lines of credit to make advances, and diversified entities benefitted from the GSE's four-month limit on the obligation to advance P&I. So far, servicers have shown adequate liquidity to advance missed payments, and T&I are generally a smaller percentage of total monthly payments and do not materially add to servicers' advancing obligations.

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