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The determinants of mortgage yield spread differentials: Securitization

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Abstract

This paper examines securitization and mortgage yield spread differentials among four groups of Australian mortgage providers: mortgage corporations, commercial banks, building societies and credit unions. The dataset includes over 2000 observations of standard adjustable rate mortgages from 180 institutions. Several studies on the impact of securitization (e.g., reduced funding costs, information costs, agency costs, regulatory tax and improved mortgage marketability and liquidity) can be found, but there is a little empirical evidence, particularly in an Australian context. Our results suggest that mortgage corporations that securitize all their loans have both the narrowest nominal and effective yield spreads among the four groups, consistent with the existing securitization and mortgage cost literature. The regression findings also indicate that both minimum and maximum amounts of loans are significantly associated with spreads.

JEL classification: G21; G30

Keywords: Securitization; Information asymmetry; Yield spreads; Mortgage lenders

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1. Introduction

Over the last three decades advances in technology, deregulation, re-regulation, liberalization and globalization have brought substantial changes and innovations to the financial sector. This has driven financial institutions increasingly to the capital market for funding, particularly for mortgage lenders. In an effort to meet the demand for housing loans, these institutions began to securitize these loans into the capital markets. This innovation has helped mortgage finance to become a major part of the capital market and the economy.

Mortgage securitization in the U.S. and more recently in Australia plays an increasing role in mortgage finance. It has been a chief funding channel for lenders. It constitutes the largest part of all fixed income securities, soaring to US$ 5.1 trillion in 2002 and over 60% of all types of mortgages in the U.S. are securitized. Australia's mortgage securitization market is second to the U.S., with over AU$ 100 billion outstanding in 2003 (Liu et al., 2004).

The Australian secondary mortgage market is different from that of the U.S. due to its reliance on the private sector activity instead of government agencies. Over 50% of mortgage-backed securities in Australia are issued to global capital markets. Around 80% of these mortgages have adjustable rates. Therefore, any mortgage rate changes immediately effect borrower costs of not only newly originated loans but also existing ones.

In recent years, particular attention has been given by regulators, policy makers, academics, the public and the industry to securitization and its costs and benefits. Most of literature concentrates on the U.S. market where three government-sponsored enterprises (GSEs)[1] play a key role in the secondary mortgage market. It may be difficult for researchers to distinguish the GSEs' contribution from that of securitization itself in reducing mortgage costs. Most other securitization research on private label and asset-backed securities (ABS) transactions[2] suggest that securitization can help reduce a range of costs, such as funding costs, information costs, agency costs, regulatory tax and improved marketability and liquidity.

However, there is a little empirical evidence on its effects, in particular in an Australian context. This paper attempts to fill this gap. Objectives of this paper are threefold. Firstly, its empirical results should help policymakers and regulators to understand the impact of securitization. Secondly, it should help lenders to understand what factors statistically affect their yield spreads in forming credit policy. Thirdly, it should assist borrowers in choosing which type lenders and when they should invest.

This paper makes several contributions to literature. It is the first paper to examine mortgage yield spread differentials across different groups of lenders (mortgage corporations,[3] commercial banks, building societies and credit unions) in Australia. It is also the first to

[1] The Government National Mortgage Association, GNMA or Ginnie Mae; the Federal National Mortgage Association, FNMA or Fannie Mae; and, the Federal Home Loan Mortgage Corporation, Freddie Mac, an indirect agency of the government.

[2] Private label mortgage securitization is known as non-agency transactions, and asset securitization is to securitize other categories of assets (e.g. credit card loans, auto loans and receivables).

[3] They are also known as mortgage mangers or wholesale lenders in Australia, e.g. Aussie Home Loan, that focus their business on mortgage originations, servicing, etc, Their funding is from the capital markets by issuing mortgage-backed securities (MBS). Unlike commercial banks and other forms of depository institutions, they do