Although I am neutral to positive macro mortgage and housing for the next few months, as transitory factors will make data print flat to higher for the remainder of the purchase season making many thing yet another housing bottom in here, there are significant risks that could act as a wet blanket over the sector even if the numbers are printing better...the same that will lead to lower lows in Q4/Q1 once the transitory effects are over.

I have detailed each in previous notes over the past couple of months, as being in play now. **All are providing support or a pull-forward effect this purchase season but will also lead to a greater hangover effect -- particularly at the mid-to-high end -- once the purchase season is over.**

1) GSE/FHA loan amount reductions for all loans closed AFTER Oct 1, which will particularly hurtful to the mid-to-high end price bands and cause pressure across the price curve.
2) QRM rules targeting 20% down and more importantly 28/36% DTI (GSE's now go to 63% DTI for better borrowers and all GSE loans will not be exempt from what I hear).
3) Potential loss or reduction mortgage interest tax benefit that again will be especially harsh on the mid-to-high end and cause pressure across the price curve.
4) Near historic low rates.

NAR restatement...a wet blanket wildcard to be mindful of is the NAR restatement that could come any day and reveal they have over estimated sales by 20% in recent years.

Right now #1 through #3 are not finalized. But if they are finalized at or close to worse case scenario I am not sure investors are factoring these in as large risks and they are.

One immediate trade I can think of is short TOL if we see moderate to worse case on any of #1 through #3...seems like a fairly good risk/reward especially if you are long other names for a trade over the next few months.

Anyway, some more chatter on the mortgage interest tax deduction out just now - story below -- not pretty.
"The President's bipartisan commission proposed turning the MID into a 12% tax credit and limiting its reach to $500,000 in mortgage debt but only for primary residences.
For homeowners in the 25% tax bracket that pay $6,000 in mortgage interest, the proposed 12% tax credit would give them $720 to reduce their total tax liability. The current MID would give the homeowner a $1,500 tax deduction."

Mark Hanson

Mortgage Interest Deduction May be Cut in Budget Deal

Friday, July 22, 2011
By Paul Muolo and Brian Collins
It appears that the sacred cow known as the mortgage interest deduction is on the table as the White House and Congress grapple on a budget deal to lift the federal debt ceiling.

According to industry officials, capping the MID, and eliminating it entirely for second homes and home equity loans is being discussed, but at press time no further details were available.

According to combined news reports, changing the MID is part of a deal being negotiated between President Obama and House Speaker John Boehner, R-Ohio.

Traditionally, the mortgage industry has been adamant against altering the MID, which is currently capped at mortgage debt of $1 million. The way things stand today, interest paid on second homes and HELOCs can be written off.

Glen Corso, managing director of the Community Mortgage Banking Project, said changing the MID now would damage an already weak housing and loan market. “Home sales are very slow right now,” he said. “Is this really the time to start talking about doing this?”

Corso noted that many lenders qualify applicants based on “what the rules are today.” He said changing those rules could wreak havoc on the business.

Late last year a bi-partisan presidential commission proposed cutting the MID, which led to an outcry from lenders, Realtors, and the housing industry.

A deficit reduction plan being advanced by the "Gang of Six" senators is vague when it comes to clipping the MID. The plan directs the tax committees to "reform not eliminate" tax expenditures for health, charitable giving, and homeownership.

This leaves the tax writing panels with several options to reduce the MID, including whittling down the $1 million to $500,000.

The President’s bipartisan commission proposed turning the MID into a 12% tax credit and limiting its reach to $500,000 in mortgage debt but only for primary residences.

For homeowners in the 25% tax bracket that pay $6,000 in mortgage interest, the proposed 12% tax credit would give them $720 to reduce their total tax liability. The current MID would give the homeowner a $1,500 tax deduction.

Best Regards,

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