Good News Fraying: An Overview Of Today's Warehouse-Lending Sector

Although the number of warehouse-line providers is increasing, the problems facing the wider industry may create new woes.

By Frank Fiore

A year ago, there were fewer warehouse banks in the market, and volumes were much higher, leaving many lines at capacity levels. In addition, it was about this time last year that National City and Guaranty Bank announced they were exiting the business. This left an already fragile market with even more uncertainty, whittling down the circle of six major warehouse providers to a tight quartet.

Furthermore, the government was doing its best to stimulate the housing market by extending a tax credit on purchase transactions, and the rate environment was very attractive. Both of these conditions kept loan volumes high and active lines flush with volume. As a consequence, warehouse providers were dictating the terms.

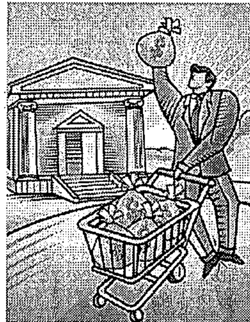
Since then, many new players have entered the market, and it is commonly accepted that there are 50-60 warehouse providers in the market today. With new outlets for warehousing and significantly lower volume in 2011, providers are faced with either improving terms to retain their current commitments or risking the loss of their business to one of the newer companies.

Who are the new warehouse lenders? In the past year, MetLife, NexBank, People's United Bank, Community Trust Bank, Northpointe Bank and Horizon Bank have entered the warehouse-lending market, to name a few. The market for non-traditional warehousing has also increased, reflecting the increased interest of hedge funds in the space.

Many community banks are also entering the retail and wholesale markets, using their own capital for funding. This is an interesting occurrence, because these self-funded banks do not supply "warehouse numbers" to the market. Therefore, this liquidity is not being tracked under normal warehouse commitments and outstanding reports.

However, community banks are going to have a difficult time meeting the increasing compliance rules while remaining competitive. The larger banks are able to withstand these changes and incorporate the costs of them into their model. The community banks may not be able to do so, and some may look to consolidate by offering warehouse funds exclusively to their clients.

Also changing the sector is the return of industry veterans. Experienced warehouse executives who were previously in charge of warehouse facilities are running many of the new companies. Furthermore, companies with excess capital see the warehouse market as attractive, with the ability to achieve a strong return on investment.



But this raises another question: Does having extra capacity in the market translate into an easier ability to get a warehouse line? With more options available, it is definitely a better environment - but it is not necessarily any easier. If your company fits into the specific niche of the newer warehouse lenders - and most have a niche - then it would be easier.

Today's warehouse-lending market can be divided into two categories. First, there are the highly capitalized lenders that are looking to consolidate their lines and seeking to increase one of their existing commitments. Second, there are a number of new providers focused on broker-to-banker conversions. Those providers are looking for experienced people with a reliable pipeline of volume that can be converted onto the line upon approval.

Causes for uncertainty

Under positive compensating factors, warehouse providers are making exceptions to both obtain and retain business. These exceptions would come in the form of increased leverage or the reduction of reserve requirements.

Also, there is the question of the product being originated. The collateral today is composed almost entirely of vanilla product for purchase by the government-sponsored enterprises (GSEs), and the underwriting process is so tight that very few lenders see loans stay on the line longer than three weeks.

Another key consideration is the dramatically rising cost of originating loans. Increased costs and tightening margins have forced companies to re-evaluate their cost structure. Included in the evaluation is a review of existing warehouse charges, such as non-usage fees and interest-rate floors included in their contracts.

Additionally, renewal and application fees are being waived to place or retain a client. Finally, with reduced margins, more lenders are looking to convert to mandatory delivery to maximize the potential gain on sale for every loan. In order to do so, many warehouse lenders are becoming more comfortable with issuing approvals or sub-limits, allowing companies to hedge and fund uncommitted volume.

However, a major problem that will have wider-reaching implications is the future of the GSEs. The federal government secured stability by stepping in when the private market eroded, albeit at the expense of U.S. taxpayers.

Some people have said that the GSEs are part of the problem, and others will defend the GSEs by saying they did what they needed and were expected to do. But ultimately, it boils down to the private sector returning to the market, which will be a welcome change on the warehouse front, where private investors have seen value in the business and are returning. The securitization and correspondent markets have not yet followed suit, which is also adding stress to the GSE position in the market.

There is also another federal impact on the sector: loan officer compensation. The impact of these changes will be felt on the secondary side in the next two to three months. Many owners and managers have been focused on getting compensation plans issued and rolled out and have not focused on the financial impact of the changes. These updates may cause many lenders intense financial stress, which will ultimately impact their relationships and terms with warehouse-line providers.

But all of that will be overshadowed if the wider economy weakens and a double-dip recession in housing comes to life. First and foremost, it will impact warehouse lending in the volume outstanding: As of today, volumes are off 50% to 60% from a year ago due to rising rates and a still-very-high unemployment rate.

Then, the potential changes on the servicing side of the business will be next year's item of concern. There is a lot of talk about potential changes due to the flaws in the foreclosure process - and the numbers that are being discussed to address these concerns are not low.

Each month, it seems like more and more people leave the mortgage industry, and the loan officer compensation updates have not helped. The industry has consolidated over the past few years, so the drop in volume can be absorbed with a much smaller workforce, but the economy is not providing positive solutions to get the industry back on track, especially with rates expected to rise in the future. SME

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