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Thoughts and Observations On The Market

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May 3, 2013

Spring has officially sprung. It is a time for rebirth and the opportunity for a fresh start on many fronts. The first quarter saw rates rise and volume drop. This was a great time for companies to take a breather and catch their breath. Unfortunately, we saw many firms run scared and fall back into bad habits. Fortunately for them, rates have dropped back down and things are starting to heat up again. We speak about two important items this week as it has become clear that many are missing the mark; failing to capitalize on opportunities and creating exposure. We hope people are listening out there because at the end of the day, success in this market is based on strong Operations, particularly when rates start to creep up.

We hope to see you at the Secondary conference in New York next week. Please email us if you'd like to meet.

We strive to keep you all well-informed, as we share our views. Staying a step ahead and running a tight operation are the keys to success in the mortgage banking world, and we are here to help bankers do so. We hope you find our newsletter useful, and if there is anything you want us to cover, please let us know.

Got Margins?

Throughout Q1 rates increased and volume slowed. Sales complained to anyone who would listen and locked pipelines started shrinking; management took quick notice. Most lenders we know either cut margins across the board or gave away pricing concessions like Halloween candy. Don't worry, we won't touch upon the fair lending exposure of these concessions - maybe we'll save that for next week. But now rates are down and once again at all-time lows. So with this volatility in rates, how closely are margins monitored?

Let's start with the simple question; With rates dropping, have you adjusted your margins? If not, we're very concerned! If yes,

how do they compare to the levels of Q3 and Q4? We sure hope Secondary Managers have broken out their trusty pricing models and supply/demand charts again.

We are fortunate to work with and meet many talented secondary managers in this market BUT many are tied up, spending their time working through weak or inefficient operational processes. Many are unduly influenced by others. And then there are the bankers who believe Secondary simply consists of a low-level lock desk personnel and a strong relationship with a hedge/risk advisory firm. As passionate secondary marketing professionals, these models continue to frustrate us and make us wonder what's it going to take for things to change?

The easiest thing to do when pipelines shrink is to lower margins to keep the pipeline afloat. We've always been hesitant to do so as a deeper analysis into most pipelines may show this is not the best strategy. There are always pockets of the pipeline which are not rate sensitive and we've always wondered how many loans a .25bps reduction in margin actually saves. There are good sales people who can react to market changes. Do across the board cuts really work? Or could they actually make things worse?

We always feel that the true impact of margins is under-appreciated. How many bankers know their TRUE net margin per loan after all costs? It's easy to cut margins by.25 bps when pricing is questioned and rates rise. Over time, these cuts are forgotten and often become the new norm. Watch out! With the market volatility over last few months, proactively managing margins could easily yield an additional 20-40bp net revenue; that is a tremendous number, especially when net margins for many bankers may only be 30-50bps in total.

There are numerous questions to vet out if margins are effectively managed, or maximized. Who makes these difficult decisions that have such a great impact? What variables are they looking at? Are they qualified? Is it a group effort? How much of a voice does sales, branch managers, or AEs have? Good managers and AEs will game many firms Secondary Managers who do not have the perspective, experience or corporate backing to respond appropriately - and this means big $$$.

Are you missing out? Does your Secondary Manager manage margins or react to pipeline changes? Do they understand data and dig deep into the multiple levels of information about your pipeline? Are people in sales positions influencers to Secondary? Yes, maybe, unsure? Call Matchbox today to have a detailed analysis of Secondary and margin management. We can almost guarantee that there are aspects of the workflow or strategy that if corrected would not force you to lower margins, in any rate environment.

Got EPDs?

What is an EPD anyway? In an industry that has so many acronyms and internal jargon, even the simple definition of an EPD is not exactly clear. It has become industry standard to consider EPDs (early payment defaults) as any loan whereby any one of the first six payments goes does down 90 or 120. In the correspondent space, bankers expect investors to issue a buyback or indemnification upon any EPD. If there's no word

from the investors, then there must be no EPDs, right? If there was a default per the loan purchase agreement, why wouldn't they issue a notice? It's really not that simple.

First, let's start with the definition. Although EPD's have become standard lingo, HUD has a different definition. Forget about one of the first six payments going down 90 or 120, HUD classifies EPDs as any loan reaching a 60 day delinquency status within the first six payments. As HUD and investors see the EPD with varying criteria, relying on investor notices to highlight EPDs is not a recommended model. While it is ok monitor performance with that particular investor, it leaves bankers open to infractions upon a HUD audit.

HUD requires additional and timely QC review for any EPDs and with a stricter definition the investor letters are useless. A lender can have countless files reach a 60 day delinquency and never hear a peep from say Wells Fargo or Chase, but HUD requirements mandate those files be carefully reviewed in QC. Third party QC firms will often ask lenders if they have any EPDs so they can appropriately review those files, but most will say "no EPDs here." Not so fast!!!!! While we are not QC experts we will certainly point out any area of exposure we notice as a growing trend. We've seen very few lenders actually following HUD requirements here. And we have a handful of clients who were all cited in HUD audits for failing to comply with HUD QC requirements. Why?

-Few lenders are even aware of the difference in defining an EPD and incorrectly rely on investor notices.

-Even fewer lenders know where or how to monitor and pull the HUD defined EPDs. The investor scorecards are not reliable, if the investor even issues one. So how can one expect to perform QC review on EPDs when they don't know how to recognize them.

If you want to get a real close look at how the portfolio is performing, real time, look no further than Neighborhood Watch. The data posted provides an incredible glimpse of trends and servicing data points, including EPD data.

About Us:

Matchbox is a collection of gritty industry veterans who decided to create a company aimed at helping mortgage companies ignite ideas that are outside the box to realize their true potential. We have years of real life, hands on experience in the business, and we want to offer our keen insight to others as they take on the challenges before them.

As individuals, we each contribute unique perspective and expertise. Collectively we provide a true roadmap to success, regardless of your current situation. Like any master craftsman, we are very passionate about our work and we approach each client as if your company were our own. In the end, we help you, be a better you.

Each week we see a number of readers open

Are you forwarding our Newsletter?

and forward our newsletter multiple times. If you like our letter and are forwarding, first of all, **Thank you**! Also ask your contacts to subscribe as we always like to increase our readership!!!