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Thoughts and Observations on the Mortgage Industry

March 23, 2015

matchbox consulting services - we speak mortgage...

2015 started with a surge as refinances have filled everyone's pipelines. Volume levels are the strongest they have been in years and fears about a repeat of 2014's poor Q1 are a distant memory. It has been a strong recovery since a year ago and as audited statements work their way to completion, lenders are reminded about how the year started and the critical rebound. So with everyone in good spirits and motivated for a great year of low rates and expansion, let's take a few minutes to look forward and get prepared for what's coming in the months ahead.

Refocus Through Refi's

Although many clients are stating that refi's have not increased much, we know that is not the case; maybe they haven't run any YoY production reports. Granted, many have built very strong purchase platforms and we're heading into the Spring purchase market, but the bulk of the increase in volume is largely due to refinance activity. This uptick is welcome and keeping everyone busy, but can also pose some challenges, changes and concern.

As a purchase heavy pipeline is rebalanced with refinances, Ops will have to quickly recognize the different elements of a refinance transaction. There is no contact end date that all parties are working towards and aside from a rate lock, the pressure to close the loan by a specific date is gone. Clients may not be in a rush to close and will take their time to get you what is needed. I'm sure Loan Officers and Processors just love when a client disappears on vacation for two weeks with not a word in advance. Packages come back later and then you have the rescission period so the funding process is later. This is all pretty basic stuff, so why are we bringing this up? Well, it's likely that the pendulum is going to swing right back. Just as your Ops staff is

getting into a groove of closing refi's, the purchase pipeline should explode as Spring begins. So just as your Ops team is getting into a groove closing these refi"s, they are going to be hit with a surge of purchase business and their priorities and balance are going to need to be rebalanced again. With Underwriting queues and bins filling up already, firms should get ahead of the second wave of volume that is sure to come. Excess volume is never a bad thing, but some are better than others in preparing for and supporting it. Here's a hint, just ask yourself this: Over the last year, has technology and improved oversight helped EVERY department become better, more efficient, and execute on it's responsibilities? Has scalability improved?

In addition to the possible Ops challenges of a volatile pipeline, we are also looking at two looming changes that will have a dramatic effect on the origination process. With TRID coming in August and the door open for a possible rate hike later this year, Q3 and Q4 could turn stressful and downright ugly if preparations are not made. We know TRID is coming on new applications starting August 1st and the changes are going to be significant.

It is going to have a dramatic effect on almost all departments. Some firms are thinking it is only going to affect originations and closing, but they are wrong. The 3 day prior to closing requirement is going to put extreme pressure on Processing, Underwriting to get deals cleared quicker so that closing dates are not pushed. This is where the growing pipeline comes into play. It will be CRITICAL for lenders to closely monitor their pipelines and the estimated turn times for closing. Do you often see Friday's and month-end with a tremendous closing list with only a few loans already cleared? Those days are over with TRID and we can't imagine any secondary departments forward looking enough to recognize the impact "free extensions" will ultimately have. With growing volume and TRID requirements, loans will likely need a few extra lock days and we all know that those charge will not be passed to the borrower so...unless you are running a point bank (what's that?) the cost is absorbed by Secondary and corporate. Just think about how many Loan Officers are going to be lining up to make sure these deals get cleared to make it for the month. We all know this is going to happen, so why wait to prepare and establish procedures, business rules and pipeline management tools? Start gauging the effect of this change and manage to it today so when August rolls around, you will be ready for it.

Stuck. In Best Effort or Hedge Stagnation.

We've only been harping on this for 5 years now. We are still often asked basic questions, met with concern over the unknowns of hedging and given excuses.

"What is the right volume level to move to selling on a mandatory basis?"
"How does hedging actually work?"
"Aren't we taking greater risk?"
"Do we have the appropriate policies for this? Are we ready?"
"We don't have anyone who understands this and can oversee it"

And for those already hedging...
"Why aren't we making more?"
"Who else should we be selling to?"
"We're doing alright, but I know we're sloppy"

All are fair questions and concerns, but it's time to move past this. We always preach being prepared for the future and being ready to capitalize on market opportunities. So with volume up and execution outlets/opportunities growing, there should be no excuses. Ultimately, Underwriting, pipeline management, investor mix, liquidity and post closing strength all play a part in whether you are ready to start hedging and maximizing execution. Lenders must strive to really know their business model, data, and the changes that are needed in order to make the jump to mandatory; or improve execution for those

already trading.

There should be no excuses at this point. To throw out a large number, but still applicable for those originating over 30-40MM, if we were to say that lenders could yield an additional 500-750k net with minimal to no risk, we would expect that any management team would do whatever was necessary to implement this 'new idea'. No excuses. Top priority. Time to invest and figure it out. Here we'll break down some basic elements that lenders struggle with:

Underwriting. This process will change from knowing where a loan is being sold to a number of possible investors. Underwriters need to underwrite to a series of guidelines instead of a known target. Underwriters cannot be given the power to dictate the targeted investor. Secondary's goal is to streamline this process, efficiently report the data and oversee it's progress.

Pipeline Management. Hedging models are based on historical and actual pull through rates. Reliable data is of utmost important and significant shifts in origination models/strategies should be recognized and accounted for.

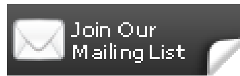
Investor Mix. Most successful hedging platforms are based on a diversified investor mix where firms can go to market and obtain the current best execution pricing for their closed pipeline. As mandatory pricing is live and short term, it is more fluid than Best Efforts pricing so firms can take advantage of various investors improved pricing when available. Having more options provides a better opportunity for better pricing. If you only have 1-2 investors, then your options for pick up are limited. ***Pro Tip:*** **If you haven't expanded your investor mix over the last 6-12 months, you're missing tremendous opportunities and forgoing revenue.** The last few years have seen execution strategies grow and grow. The correspondent investor landscape is greater and more competitive than it's been in years. More lenders than ever before are trading AOTs, accepting bid tapes, selling to the GSEs, pooling/selling MBS and executing co-issue relationships (more on this in our next edition). Every option should be on the table. Again, no excuses.

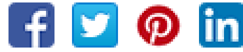
Liquidity. Moving to mandatory involves putting on hedge transactions with a Broker Dealer and ultimately present another cash flow item that corresponds with your loan sales. These trades have defined settlements and when the market is volatile, so can be cash flow liabilities and margin calls. Secondary and Accounting best be on the same page and have open communication.

Post Closing Strength. It's not just business as usual here. Secondary and Post Closing communication, or lack thereof, can erode gains through hedging and mandatory. It's actually quite common. After performing dozens of independent secondary and hedging reviews, almost all lenders have profit leakage in the Post Closing department. Executing on early delivery credits and avoiding rolls/extensions is part of every strategy. How well does each lender do? That's another story.

We can go on and on here. Polices and procedures, margin management, rate sheet/PPE administration. Sure, the most profitable lenders are hitting on all cylinders. Most are lacking a few pieces; some more-so than others. Regardless of your current model, BE or already hedging, our message here is that you can do more, make more and be more efficient. If you're not actively looking to make improvements now, you're stuck in stagnation mode. It's time to forget the excuses and start making more money. Give us a

call to discuss this in more detail As you can probably tell, we love this stuff!





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