New Year, New Realities

EDITOR'S NOTE—*This is the latest in a series dealing with the issues facing the real estate finance industry. Each issue we touch on a different topic, asking CMBA's experts for their thoughts on the issue at hand. In this issue of CMFN, we ask three experts about the new lending landscape, now that several new mortgage rules have gone into effect.* ***Nick Pabarcus*** *is a Correspondent Regional Sales Manager for Stearns Lending, Inc, a leading national mortgage lender.* ***Jay Hughes*** *is a Managing Director for Mortgage Guaranty Insurance Corp. (MGIC),one of the top mortgage insurers, and* ***Chris Ortigara*** *is a Director with CrossCheck Compliance, LLC, a professional services firm specializing in audit, compliance, risk management and more.*

Q: What must originators do to both survive and thrive in the new regulatory environment, now that QM is in effect?

Pabarcus: Now that the QM is in effect it is paramount to drive efficiencies and only bring strong, defendable transactions to their respective credit groups. The underwriting units of many firms will now have an additional layer of credit review comprised of the minimum requirements for making an ability to repay determination (as outlined by the CFPB): (1) current or reasonably expected income or assets; (2) current employment status; (3) the monthly payment on the covered transaction; (4) the monthly payment on any simultaneous loan; (5) the monthly payment for mortgage-related obligations; (6) current debt obligations, alimony, and child support; (7) the monthly debt-to-income ratio or residual income; and (8) credit history. Many of our skills to truly credit grade a transaction have atrophied with the reliance on the AUS engines. As originators, specifically focusing on #2 and #8 above would be key to defending an application to their respective credit groups. Getting back to asking the question of, "will the borrower repay the loan?" is critical on the subjective data in a transaction. The fact remains that a QM transaction does not protect a firm from a claim, but it does create a path for said claim to be dismissed as early as summary judgment. With that possible legal and judgment cost looming firms may have an additional layer of review and originators being able to intelligently defend the ability to repay of an application will be critical.

Hughes: Survive: Read the fine print and don't risk non-compliance. Unlike the RESPA of old and other loosely enforced regulations, the government means business this time. In the end (and not without some pain) this is very positive for our collective reputation. Those of us that have devoted our careers to this industry and take great pride in it will welcome the day when we regain the full trust of our ultimate customer - the consumer.

Thrive: MI companies have the privilege of calling on thousand of originators in all business segments. A few originators spend quite a bit of time wallowing in the negative aspects of regulation while most put resources behind ensuring that they and their companies are safe. But the ones that thrive are the ones that see change, in whatever form, as opportunity. I recently attended a lender summit right in the back yard of the CMBA that spent meaningful time and effort making sure that its originators understood the regulatory landscape and even more time laying out how they intended to use it to meet their goals for 2014. The originators walked out motivated and secure in the fact that there was an above board, achievable plan. Very impressive. And don't ignore non-QM opportunities: thorough processes and ability to repay documentation can mean capturing less contested business in what looks to be a very competitive market.

Ortigara: Originators that have been substantially dependent on the refinance market will likely not be survivors let alone experience great success. Yes, there is more paperwork and more regulations to consider in the current environment, but loan originators with a solid network of purchase money business can thrive. There are a record number of highly seasoned loan officers retiring

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from the business, so this presents an opportunity for those remaining in or entering the business. The economy continues to improve, despite the recent turbulence in the equity markets. Rent is increasing. Unemployment appears to be easing. This frigid and relentless winter across the country has postponed activity, but it may actually foster pent-up-demand for a very active start this spring.

The consensus on how QM will impact the mortgage business is somewhat divided. On one side are the mortgage bankers that believe QM is just not an issue. This group points to the 43% DTI limitation and rightly comments that historically few loans were made in excess of 43% DTI --- with the notable exception of the 2005-2008 era. The differing view expresses concern about the 3% rule and lack of uniformity about what is and is not included in the 3%, as well as how it will negatively impact lower loan amounts and possibly cause harm to the very group that cannot withstand additional economic burdens. The different interpretations among large correspondent investors about what is and is not included in the 3% presents additional challenges for clients selling to multiple correspondent investors. Also, some large investors have expressed surprise that their correspondent clients have not placed appropriate focus on all aspects of the QM regulations and are not sufficiently testing their product, performing pre- and post-closing reviews, and drilling down into the regulations.

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Q: Will jumbo lending continue to increase in 2014? What challenges will lenders and consumers face, and how can they find success?

Ortigara: The jumbo market will continue to expand. Jumbo interest rates have, in recent months, often been at (and even lower than) conforming interest rates. This is an historical anomaly. It is also a significant indication of the strong appetite for jumbo product and possibly a weak supply of the product. Several of the largest financial institutions have embraced growing the jumbo market as a key component of their business plan. Some view it as an extension of their private banking unit or affiliated with their commercial clients. Many of these large institutions are generating non-QM jumbo business for their own retail clients but will not purchase non-QM business from 3rd party entities. This presents a particular challenge for non-depository based mortgage bankers that are seeking a source for non-QM jumbo loans. It is very difficult to find an investor willing to purchase non-QM jumbo loans.

The self-employed jumbo loan consumer may have difficulty obtaining a loan. Lenders who want to cultivate that market will either need to have a staff capable of dissecting financial statements and balance sheets, or they will need sources to purchase non-QM product.

Hughes: All signs point toward increased jumbo lending and one need look no further than the American Securitization Forum conference in Las Vegas at the beginning of each year. There are a myriad of well capitalized companies waiting on the sidelines to enter the jumbo market. The hesitancy in the past few years stemmed from regulatory uncertainty and an inability to achieve acceptable margins due to the fact that they were competing with GSE and FHA high balance loan amounts and pricing. No matter which side of the fence you're on with regard to GSE and FHA reform, one common thread seems to be a reduction in their footprint in the jumbo sector. With QM and QRM better defined, potentially escalating guarantee fees, and reduced loan limits, 2014 could well be the year that they jump in.

The MI's are willing to insure more in the jumbo space and will with portfolio lenders - typically up to a 90% LTV. We offer a very competitive execution vis a vis the FHA. We still have some work to do in the securitization world due to financial ratings which currently dilute the value of our credit enhancement. We're working on it but it's a process.

Pabarcus: Jumbo Lending should continue to increase in 2014 but the increase will come with changes to the overall lending environment and landscape. With the QM implementation that was previously mentioned the tollgates needed to originate a non-QM jumbo transaction may be more stringent. There are and will be players who originate jumbo transactions at a DTI that exceeds 43% as an example but that will come with potentially higher credit score bands, additional asset and reserve requirements, etc… In the same vein overall product may be restricted or have higher qualification standards for previously popular jumbo product options such as Interest Only and Balloons. In addition, you may see some pricing compression on the fixed product lines as investors especially on the depository side may make ARM product lines more attractive. Until the secondary market become more active with securitization options these remain largely a balance sheet product and a long term fixed investment is not as attractive as ARM products to protect against volatility. On a positive side the forecast will call for a reduction in down payment requirements. As the market becomes more comfortable with housing valuation and more healthy competition in the jumbo space overall credit standards may begin to relax. While a non-QM jumbo transaction may carry additional requirements as aforementioned the anticipation is that the credit box will loosen allowing more borrowers to qualify for jumbo financing.

Q: What will be the big surprise in lending this year, and why?

Hughes: What's surprising to some is yesterday's news to others but it might surprise originators that if they do all of the things that they know they should do (make effective calls on the right realtors/builders/financial planners/etc. and work their databases effectively) then 2014 will be a very solid year. It might also surprise some that, if they pour all of their energy into doing everything but make effective sales calls, 2014 could

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spell an end to quite a few careers.

It's no different in MI. I'm a sometimes marathoner and have always said that 'you can't cheat a marathon'. The parallel is that you can't cheat the sales process. It takes a lot of work, finesse, and a thick skin but it's very rewarding when done well. Back to surprises....the media will begin to write positive stories about our industry (Rob Chrisman excluded - he's already positive and even when he isn't he's still a CMBA member!). We might also be surprised by the impact of the recent appointment of Mel Watt as FHFA Director.

Ortigara: The new TILA may be more time consuming than QM. Managing volume in a shrinking margin environment will be difficult. There may be loans that are unsaleable due to issues with QM. Some problems may not be curable after closing. However, the biggest surprise would be for private investors to enter the market in a big way --- well, compared to the virtual standstill since 2008. This could be the year for the private securitization market. There is a need for a vibrant non-conforming market and certainly jumbo product might be the impetus that is needed to get it started.

Pabarcus: The biggest surprise of the year will be how 2014 treats the mini-correspondent lending model. With QM implementation behind us as of January 10th there was a mad dash for wholesalers to launch their mini-correspondent channels anticipating the migration of many brokers into the banker model. This was seemingly driven by the 3% points and fees cap and uncertainly surrounding the calculation which arguably has since been defined. While the mini-correspondent transaction type is far from new in the marketplace the QM deadline created rush to the channel greater than the Reg X and new GFE implementation just a few years back. Camps seem to be divided on the viability and compliance risks of the channel. From an investors perspective profitability without scale can be challenging even if they are comfortable with the compliance concerns. Mini-Correspondents will expect a pricing pick up from traditional wholesale models, but there is little reduction in operational costs as all normal tasks in the loan cycle are completed by the investor apart from the doc and funding functions while adding a post-closing audit piece. Additional costs from the mini-correspondent can reduce profitability in the form of potential enhanced pricing needs (secondary desk, etc…), warehousing costs, doc costs, additional staffing (potentially credit and closers). However, there have been many shops and investors that have made the model work extremely well. The surprise I believe will be which investors stay the course with the mini-correspondent model and which retreat back to traditional wholesale work flows. In your local markets you may be surprised by which firms find success with marketing and recruiting efforts as a mini-correspondent and which find it more financially viable to broker their transactions.