# Servicing Value Observations; Affiliated Pulls DU Refi Plus; Lots of M&A News

By: Rob Chrisman | Wed, Sep 5 2012, 10:40 AM

Yes, most kids are back to school. How many is that? The Census Bureau reports that there are about *80 million children and adults enrolled in school throughout the country from nursery school to college*. They comprise 27% of the entire population age 3 and older. The numbers are a couple years old, but **24% of elementary through high school students had at least one foreign-born parent**. Nearly 12 million school-age children (5 to 17) speak a language other than English at home (8.5 million of these children spoke Spanish). And of college students, 16% were 35 and older. 56% of college students are women, and overall 41% of 18-24 year olds are enrolled in college. More

Although not totally applicable, there's that old saying that in a consolidating industry, you either are the consolidator, you sell to the consolidator, or you go out of business. An experienced, well-financed mortgage-banking group is actively pursuing opportunities to purchase controlling or full interest in an established mortgage bank with current annual production in the $50 million to $300 million range. In 2013, the minimum liquid capital requirement will be $2.5 million for many types of business. "Our group will provide a minimum of $5 million injection of equity. We will provide a strong forward and reverse origination strategy to build a national platform with the right firm. The mortgage-banking firm MUST have minimum of a New York state license - multi-state license is preferred - and must be Direct Endorsed FHA lender and preferably have seller/servicer approval from Fannie and/or Freddie. We would like Chase and/or Wells (preferably both) to be current approved investors; of course other investors are also a positive. Our offer will be based on the number of state licenses held as well as other criteria mentioned above. All inquiries will be kept strictly confidential." Please contact Mr. Kalin at mk@buildaforce .com to discuss further.

Well, we're a few weeks into the **FinCen money laundering regulations** for mortgage banks. I assume that everything is good (if not, uh oh...) but if you need a little brushing up on the AML subject, here's a good article and an interview by Jonathan Foxx, the president of **Lenders Compliance Group**.

Ruminations continue about the announced **g-fee increases**, and possible/probably future g-fee increases. I received this note: "**By winding down the GSE's, what then is the alternative plan for ease of credit in the mortgage marketplace?** Does the government, or Treasury, or FHFA, really believe that some entity with the ability to handle $100 billion per month will step in? What we need to look at is who can possibly do that. The 'Big 5' cannot do it and meet BASEL III guidelines, as I understand them. Hedge funds? Sure - at rates 2% above where they are now. And what new entity is interested with all of the regulatory uncertainty?"

And this, in response to this commentary mentioning a note that went, "I attended a conference where Fannie indicated that newly approved sellers would be subject to a 20x net worth ANNUAL sales cap to Fannie. They were also looking at how they were going to apply this methodology/philosophy to existing sellers. Further discussions indicated there may be some' flexibility in the 20x number... they had to start somewhere... but the message is clear that they are moving down the path of managing perceived counterparty risk through sales caps." I received this note from a long-time banking vet who is an officer at a very well capitalized (nearly $300 million in assets) depository: "We're a recently approved (over a year ago) Fannie seller/servicer. **We got our new 'Addendum' with the production cap and it is 10 times net worth, not 20.** The addendum was very brief, and gave us a nice round number that works out to 10 time current capital. We have very strong capital ratios and good earnings."

So guarantee fees are on the rise, and sales volumes to the agencies may/will be capped. But they're only one slice of the pricing pie. Another is **servicing values (mortgage servicing rights, or "MSR's), which are all over the map**, but generally speaking the cash value of the cash flows to the holder of servicing is much greater than the value in the market place. So what is the latest?

"While MSR trade levels have gradually picked up of late depending on seller status and product composition, we're still talking about the lowest note rate / highest credit quality / longest duration mortgages ever originated, and as such, **we continue to see live trade prices lag behind true economic or fair values.** Ginnie II's specifically are a concern for MSR buyers given primarily their oft-lower servicing fee of 19 or 31.5 basis points (versus the solid 44 basis points of Ginnie I's). And since GNMA's are generally more cash intensive to service than Freddie & Fannie loans, those Ginnie II prices are always subject to more 'gravity' than GNIs. Now all that being said, we've definitely seen different approaches on the GN I vs. II servicing multiple deltas, yet in many instances GN II secondary desks are choosing to hold those SRPs rather than sell." Thank you to Stephen Fleming, VP at **Phoenix Capital**, for this. (It's challenging to summarize a complex subject in a few lines, so feel free to reach out to Stephen if you have questions or comments at sfleming@phnxcap .com.)

And this observation: "The demand for MSRs is the highest it has been in five years. And there are **four distinct types of servicing being**

**traded today**: M&A activity related to some large servicers looking to exit the business, seasoned, higher delinquency private or conventional servicing, newer bifurcated co-issue servicing, and newer non-bifurcated servicing. Buyers of seasoned servicing are high touch, special servicers who are willing to work through ugly portfolios for 15-20% returns. Newer originated servicing (bifurcated or non-bifurcated) trades continue their march closer to consensus fair value levels (11% to 14% returns). This has resulted in direct seller/servicers being able to reduce their reliance on the large aggregators and better their all-in loan execution." For more information on MSR fair and market prices or what steps need to be taken to sell MSRs, contact Matt Maurer with **Mountain View** at mmaurer@mvcg .com.

**Let's take a look at some M&A, investor, and warehouse bank updates.**

**Affiliated Mortgage Co**. told its clients, "Beginning on and after Wednesday, September 5th, 2012, AMC will no longer allow DU Refi Plus Products to be locked, re-locked or extended." (Loans) must be delivered in fundable condition to AMC on or before Tuesday, October 9th and purchased by AMC on or before Wednesday, October 17th.

**Stonegate Mortgage, which seems to be growing by leaps and bounds, announced that it has acquired warehouse lender NattyMac** from Guggenheim Partners. "NattyMac has been providing warehouse financing to independent mortgage bankers since 2004 and unlike many of the bank owned warehouse lenders, they continued to do so during the credit crisis," said Jim Cutillo, CEO of Stonegate Mortgage. "We intend to ensure that the independent mortgage banker has access not only to warehouse financing, but liquidity for their agency loans." (In March 2012, Stonegate announced plans to expand its third party originations and servicing portfolio after completing a private equity transaction with Long Ridge Equity Partners.

Regarding the rumored closure of **InterCap's wholesale group**, here is the official line: "Due to human resources being strained by the number of wholesale file touches and loan volume, Intercap Lending is "pausing" outside wholesale business effective immediately. *Intercap will continue to service a small group of mortgage brokers through its Inside Wholesale channel.* Intercap has decided to focus its attention on building out its retail branch platform by leveraging exclusive "DU Like" pre-qualified purchase leads (10,000+ per month) that are generated from 20-25 million unique monthly website visitors. The branch expansion will target groups that are currently purchase focused and closing $5mm+ in retail loan volume. By providing pre-qualified purchase leads to these groups, in addition to the many other Intercap tools, we feel that our retail branch platform will be highly sought after by the professional retail originator. Intercap Lending is a direct FNMA, FHLMC and GNMA Seller/Servicer/Issuer. To obtain additional information regarding this opportunity please contact Joel Harrison at jharrison@intercaplending .com."

**Bank of Commerce Holdings ($929mm, CA) will sell its 51% ownership position in Bank of Commerce Mortgage to Simonich Corp.** (which owns the rest of the stock). Bank of Commerce said they took the action due to **increased regulatory burden**. Bank of Commerce Mortgage funds $1 billion in first mortgages each year and the bank will continue to provide much of the funding for the operation.

KBW put together the deal whereby **Walter Investment Management Corp. is purchasing Reverse Mortgage Solutions, Inc.** in a transaction valued at $120.0 million ($60.0 million of cash, $25.0 million of WAC stock and a $35.0 million seller MSR note). "The Company anticipates the acquisition of RMS will be significantly accretive to both earnings and cash flow, and estimates that, on a pro forma basis, the acquisition would have been accretive to 2012 core earnings per share by approximately 25% had the acquisition been completed at the beginning of this year. The $120.0 million transaction value represents a multiple of approximately 2.6x RMS' expected 2012 EBITDA, or 4.1x its 2012 expected core earnings."

Yesterday seemed to continue the non-volatile August trading sessions. One trader used the word "lethargic" - which is fine with many secondary marketing managers who usually are not fans of volatility. We learned that the ISM Manufacturing Index Decreased to 49.6 in August from 49.8 a month earlier, the lowest since July 2009. And that Construction Spending decreased 0.9% during July 2012, but that during the first 7 months of this year, construction spending was 9.3% higher than the same period in 2011. Both pieces of news pointed to a slow economy, which helped continue the thinking that the Fed will buy more bonds to keep prices high and rates low.

Call it a holiday week, the last week of the summer, whatever, fewer borrowers wanted to lock in rates last week. The MBA released its usual Wednesday mortgage application numbers, this time showing apps dropped 2.5%. Refi's were down 3% (back to May levels!) and purchases were down almost 1%. (Refi's are still about 79% of apps - how long will they hold on?)

Looking specifically at mortgages, investors love 'em! Not only is new production well documented, well appraised, and well underwritten, but the upcoming guarantee fee increase creates yet another pricing road block to refinancing. And let's just see, if Fannie and Freddie go away, who can refi if rates are a lot higher! Mortgage banker selling, per Tradeweb, was about 70% of the average over the last month - so although the 10-yr Treasury worsened by nearly .250 (closing at 1.58%), residential MBS prices remained roughly unchanged.

For today, the market noticed (but didn't react too much to) news that China's services-sector activity cooled to a one-year low in August, with more businesses growing downbeat about their outlook, per HSBC. Europe waits for tomorrow, which I bet is a non-event, and our markets wait for Friday's job numbers. Today we have the final Q2 reading (old news!) on Productivity (+2.2%) and Unit Labor Costs (+1.5%). **Once again rates are nearly unchanged from the previous day with the 10-yr at 1.59%.**

Lots of folks love salmon, and here's a classic 30 second commercial for them.

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