Audit, AMC, Underwriting, and DPA Tools; Primer on Prepayments and EPOs

By: Rob Chrisman | Thu, Jan 30 2020, 9:00 AM

What if you bought into an investment thinking you were going to earn a decent return for 30 years and instead it paid off in four months? Not only that, but you paid 103 for it, only received 100 in four months, and now had to invest the money and earn a lower return? You wouldn't like it. A year ago the industry was dealing with a price war among the three major wholesalers, due in part to how one company may value servicing differently than another. Yes, the value of servicing is included in pricing to your borrowers, and "how rate sheets work" is worth any loan officer knowing. (Recently the commentary had a piece that spelled it out.) The price "war" has long since died down, but now, with the decline in rates due to the unexpected potential impact of the coronavirus on world economies, lenders are now grappling with investors sending them early payoff penalties (EPOs) on loans that investors thought would be on their books much longer. More below.

Lender Services and Products

Make your New Year's Resolution to do more business come true. Planet Home Lending will be at MBA's Independent Mortgage Bankers Annual Conference Feb 3-6. Contact Jim Loving for an appointment to see how we can improve your margins and increase your product lines: Jim Loving (414-270-0027).

Critics of down payment assistance (DPA) claim that DPA programs negatively impact the performance of government-insured FHA loans. But that myth has been debunked by a ground-breaking report from the Harvard Joint Center for Housing Studies. "The receipt of DPA is not significantly associated with default risk," says a center working paper, A Cautionary Tale of How the Presence and Type of Down Payment Assistance Affects the Performance of Affordable Mortgage Loans. "In particular, while grant assistance from a government or community organization is marginally significant as a predictor of default risk, this effect disappears altogether when racial controls are incorporated in the model. Thus, the receipt of DPA appears to be unrelated to default risk." Click here to access a link to the full report.

After a remarkable 2019, ACES Risk Management (ARMCO), the leading provider of enterprise financial risk mitigation solutions, is looking ahead to 2020 for what promises to be an outstanding year. In addition to adding several lenders to its growing roster of clients (including multiple top-25 mortgage companies like Bay Equity Loans, KWIK Mortgage and The KLR Group), ARMCO also achieved a company record in 2019 of one million audits conducted in a single year in its flagship audit platform ACES Audit Technology. "One of the biggest strengths of ACES Audit Technology is its ability to function as an enterprise solution, providing organizations with one platform and removing the need for disparate software solutions and manual processes," ARMCO CEO Trevor Gauthier said. Read the press release.

Prepayment Primer: Why do Investors Penalize Us?

One unique aspect of mortgage-backed securities is the element of **prepayment risk**. Under a normal amortization schedule, principal value of the underlying security shrinks over time, which in turn leads to a gradual reduction in interest income. Prepayment risk is the risk that borrowers decide to pay back the principal on their mortgages ahead of schedule. The result, for investors in MBS, is an early return of principal, and a forced hand of reinvesting the returned principal at lower rates. Prepayment speeds are a glaring concern for investors as they decide what they are willing to pay for a pool of mortgages.

Lenders should also care about prepayment speeds because **no investor is going to want to buy a loan at 103 and have it prepaid in four months**, costing three points and the value of future servicing with an early prepayment option. Prepayment risk is typically highest when interest rates are falling since more homeowners are inclined to refinance their mortgages. They also vary by state, and by the company who originated the loan. Lenders should always read the agreement they sign with investors concerning liability.

Since so much money is at stake there are plenty of analysts and computers to slice and dice the data. From June through November 2019, the credit performance of residential mortgage-backed securities backed by non-qualified, or non-QM, mortgage loans remained generally favorable. Fast voluntary prepayments, especially from loans originated in 2018, continued to bolster credit performance by causing credit-enhancement levels for all rated MBS to rise because the pools paid down. Borrowers willing to refinance at these rates seem to have already done so, meaning there is less incentive to currently do so, and in turn less overall refinance volume.

Higher interest rates Q4 helped reduce prepayment concerns, and December prepayment speeds undershot expectations. Prepayment speeds were approximately unchanged in December from November, both down 15 percent from the peak of the refinance volume for 2019 in October. Average primary mortgage rates were unchanged, to slightly up for December and activity was understandably slow in the latter third of the month. Western states (UT, CO, NM, AZ, WY) continue to lead the country in prepayment speeds, while Southern states (TX, OK, AR, LA) experienced the slowest regional speeds. Utah continues to lead the country in prepayment speeds (24.5 percent CPR), while New York brings up the rear with the slowest prepayment speeds (10.5 percent CPR) over the month.

Conditional prepayment rate (CPR) is a loan prepayment rate equivalent to the proportion of a loan pool's principal that is assumed to be paid off ahead of time in each period, which helps to calculate and normalize portfolio runoff. The higher the rate, the quicker the pool of mortgages pays off. Although total CPRs experienced a decrease into November and December 2019, all products' prepayment speeds are still at least 50 percent above their levels compared to November 2018. Both the conventional 30-year par rate and the government 30-year par rate **dropped around 100 bps over the course of 2019, helping drive refi volume.**

It seems better credit borrowers are starting to burn out at a faster rate than anticipated. 2018 collateral has been the fastest prepaying vintage across product types and coupons, owing to very high servicing spread and limited seasoning. This means prepayment speed generally has the most room to slow from peak to trough. As borrowers with the highest propensity to refinance exit the pool, the remaining borrowers will demonstrate a weaker responsiveness to refi incentive and slower prepayment speeds.

Year after year January and February have the slowest seasonal turnover of the calendar year. While January 2020 has the same number of business days as December (21), February gets no help from leap year and only has 19 business days. Primary mortgage rates during the January applications window have been a little higher than December, meaning prepayment speeds should be successively slower over the next two months. January CPR is projected to be down -14 percent in 30s, and the refi index is projected to be down -12 percent; seasonals down -24 percent.

This means more burnout, consistent with the refi index, as the refinance pipeline begins clearing, biasing speeds slower. This will in turn have an effect on the spread at origination. Just because we are in a low-rate environment does not mean that refinances will remain strong, and the refinance boom for this economic cycle may be over unless rates really drop.

Last week Michael Ehrlich sent out the latest from Adam Quinones and the mortgage team at Refinitiv: a new approach to the measurement of benchmark prepayment speeds. "This innovation is not intended to replace existing methodologies (but to) enhance perspective and improve transparency at a time when the mortgage industry desperately needs a way to understand the impact of digital process investments on MBS cash flows."

Refinitiv present CPRs based on their chronological schedule after issuance and removed time. "We've aligned payment periods regardless of issue date. Month-1 CPR1, Month-2 CPR1, Month-3 CPR1, etc. This is a true MBS aging curve or 'ramp' with time-series as opposed to a chart of CPRs at a single point in time based on current age. We call them Chronological CPRs. They solve the problem of age-distorted CPR1 comparisons across vintages." These measures are already available in its Advanced Mortgage Analytics product and there are chronological CPRs by state for GOVIE, FHA Only, VA Only and RD only.

Capital Markets

U.S. Treasuries rallied to yesterday (including the 10-year yield to below 1.60 percent), primarily after a **very weak Pending Home Sales report** for December showed a sharp contraction in the morning. When it came to moving the market, that print outweighed Fed-related events and the signing of the new USMCA, which replaces NAFTA and has a larger estimated economic impact than the China trade deal.

To no one's surprise, in a 10-0 vote, the FOMC left rates unchanged again, issued an essentially unchanged statement from the last meeting in December, announced repurchase operations will continue through April, and projected a dovish stance through Chairman Powell during his press conference. The statement reiterated that strength in the labor market and consumer activity is being balanced against weakness in business spending and exports. Economic activity continues at a moderate pace and there has been no meaningful change in inflation expectations. That said, the committee noted that household spending has been rising at a "moderate" pace, **which represents a slight downgrade from the "strong" pace in December.**

Today the Bank of England was out with its latest policy decision (). Domestically, we had Weekly Initial Claims (216k), and the always-important advance Q4 GDP (+2.1%, as expected, inflation tame). Later this morning, Q4 housing vacancies and homeownership will be released. In the early going Agency MBS prices are roughly unchanged and the 10-year is yielding 1.58 percent after closing yesterday at 1.59 percent.

Employment and Transitions

Michigan's Success Mortgage Partners, Inc., an independent mortgage bank, announced that 25-year industry vet Allison Johnston, CMB, is its new president. Allison has achieved many milestones in her career including past president of the Michigan Mortgage Lenders

Association, board member of The Mortgage Collaborative, and the State of Michigan mortgage advisory board chairwoman. SMP currently has a presence in 28 states and the District of Columbia and has over 400 employees. With its commitment to the mortgage industry, SMP enjoys a history of accelerated growth and is always looking for more talent. For more information on joining its team visit www.successmortgagepartners.com.

The future is now! As part of an initiative to provide a fully digital mortgage experience, Mann Mortgage is thrilled to announce the company's rollout of eNotes. Mann launched eNotes as a hybrid process, letting borrowers electronically sign their note and still wet sign their other closing documents. Mann Mortgage's eNotes bring faster purchases, reducing carrying costs and giving Mann's branch managers a stronger competitive edge. Mann is dead-set on providing a trusted alternative to the often faceless and automated behemoths of the online mortgage world, while still offering the very best of bleeding-edge mortgage technology to provide borrowers, and Loan Officers, with a simpler mortgage experience. Mann Mortgage is always looking for top mortgage professionals. Help lead the charge in the mortgage industry for the next thirty years and explore career options by reaching out to Cassidy O'Sullivan or by visiting mannmortgage.com/branch-opportunities.

American Financial Network, Inc. (AFN; NMLS 237341), a national mortgage lender entering its 19th year in business, finished strong in 2019 as it shattered previous records and continued to gain brand recognition and strengthen its position in the mortgage banking industry. As AFN continues to gain momentum across America, it is partnering with entrepreneurs who want to maintain their autonomy, while having the opportunity to become an integral part of something bigger. AFN proudly brings experienced branch managers and loan originators into the fold, supports them in their endeavors by offering training, branch support, highly experienced operations staff, sales coaching, real-time branch accounting, an amazing culture and cutting edge technology, and helps them to meet and exceed their production goals year-after-year. Product offerings are unrivaled as AFN has programs to suit all borrowers' needs. To learn more about AFN and join a nationwide award-winning team, visit AFN online at joinAFN.com.

Interested in moving to management? A privately held community bank with over 25 years of successful mortgage banking experience is seeking to further expand its presence in Wisconsin and Florida. Partnering directly with Senior Management, the ideal candidate(s) will be responsible for directing the growth in these markets, while having a voice in the operation of the overall mortgage division. These are P&L level positions, that will have the opportunity to share in the financial success of the organization and the markets being developed. Please send your resume to Chrisman LLC's Anjelica Nixt for forwarding and confidential consideration.

Gold Star Mortgage, an award-winning leader in process automation technology, announces the addition of proprietary artificial intelligence to its digital lending platform, ConnectGS. This AI identifies probable purchase and refinance opportunities within the MLO's owndatabase and delivers MLO alerts as well as message-specific communications to their clients in real time. Additional game-changing opportunities unique to Gold Star include its Preferred Lender status with Craig Proctor Coaching, providing Gold Star MLOs with unlimited access to top-producing Realtor® Teams from coast-to-coast, as well its popular FastPass Pre-Approval that levels the playing field against all-cash offers. Loan Officers tired of multi-layer, red-tape management structures will also love Gold Star's refreshingly direct access to senior execs and the leading regional margin they're able to offer as a result. In Gold Star's case, it appears the grass may truly be greener. For more information click here.

ACT Appraisal, Inc. has announced that Nick Roberson has joined the company as Vice President of National Sales. Working out of ACT's California office, Nick's 25 plus years of experience in the industry and dedication to supporting the mortgage industry via his involvement in the California Association of Mortgage Professionals and other industry organizations, will be an enhancement to ACT Appraisal's award-winning team. Please feel free to email Nickand congratulate him.

Solidifi Title & Closing, LLC announced that Ted Bouloukos joined as SVP, Commercial Services, responsible for sales and delivery of Solidifi's commercial products and services. Ted will report to Bob Smith, President.

Top of Mind Networks announced Sherwood Lawrence will take on the role of chief marketing officer in addition to his current position as chief creative officer. Lawrence founded Top of Mind in 2003, and as chief marketing officer he will align Top of Mind's marketing strategy with the organization's sales and user adoption goals. (Lawrence will also continue to serve Surefire clients as Top of Mind's chief creative officer.)

Out in Washington Evergreen Home Loans announced the appointment of Chuck Iverson as the new EVP of Production and will play "a crucial role in the success of Evergreen's digital closing technology.

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