Insurance, eVault, Defect Rate, Warehouse Products; Easy-to-Understand Basis Risk Primer

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There are strange things going on out there. Revlon filing for bankruptcy. Atlanta's mayor calling for limits on investors buying homes. Delta Airlines limiting the amount of time you can spend in its lounge eating cubes of cheese and lukewarm chili. Many high earners are living paycheck to paycheck. What isn't strange, unfortunately, is lenders' net worth plummeting, and a good indicator of that is the price of publicly held stocks. loanDepot, which had a high of about $22 per share, hit $1.75 yesterday. Guild Holdings was over $17 per share, now near $10. Rocket over $23 per share now in the mid-$6 range. UWM over $13 per share at one point now in the low $3 range. It is the same story for Homepoint, Mr. Cooper, PennyMac, Finance of America… If you had saved up $1 million dollars in your retirement account and bought loanDepot at the high, it would now be worth $79,500. But remember that these stock prices reflect what is happening in the entire industry, so there is no joy in Mudville. Period. As servicing rights are sold, lenders are using up the cash reserves they've (hopefully) hoarded from two years of great times and are trying to increase their market share by working on fundamentals for the future. (Today's podcast is available here and this week's is sponsored by SimpleNexus, an nCino company and award-winning developer of mobile-first technology for the modern mortgage lender. Nexus Closing gives borrowers flexibility and convenience during closing from traditional, to hybrid, to full eClosings.)

Broker and Lender Services and Programs

Younger Gen Y Millennials are buying homes at a faster rate and Generation Z is just getting started. How are these buyers changing the market landscape? Download part two of our three-part series: Understanding the Next Generation of Home Buyers, The ABCs of Gen Y and Z to learn more!

"Planet Home Lending's Correspondent business continues to grow. Our recent Homepoint Delegated Correspondent acquisition brought a number of experienced, knowledgeable correspondent professionals to our team: VP, Eastern Division Michael Bender, plus new Regional Sales Managers Joe Griffin, Jim Janczy, Tony Nienas, Tiffany Ta, John Thiel, and Renovation Account Executive Margie Walsh. They're now armed with Planet niche products designed to increase your volume. Respond to rising home prices and tight markets by offering home loans for affordable manufactured housing. Get buyers out of the pipeline and into homes with renovation loans, including Fannie Mae HomeStyle®, Freddie Mac CHOICERenovation®. See us at the MBA Florida Eastern Secondary Market Conference June 21-23 or the Western Secondary Market Conference July 25-27 and spend 30 minutes that can support your business all year long. Reach out to SVP, Correspondent Sales, Jim Loving today: (414-270-0027)."

Western Alliance Bank's Specialized Mortgage Services Group continues to be solution-oriented in changing markets by providing multiple financing vehicles and Treasury Management Products and Services. The Warehouse Lending team finances a wide spectrum of loan types including Agency, Jumbo and Non-QM and works with borrowers to customize terms to meet investor and execution needs. Additional synergies exist for loans being sold to Western Alliance Bank's wholly-owned subsidiary, AmeriHome Mortgage. MSR financing provides lines of credit that leverage Fannie Mae, Freddie Mac, and Ginnie Mae collateral. Lines can be annual or bi-annual revolvers or revolvers followed by term finance. Flexible structures provide solutions to accommodate originators' MSR retention strategy. Additionally, the Specialized Mortgage Services Group provides Note Financing, Working Capital Lines and Commercial Real Estate solutions nationally. Western Alliance Bank, Member FDIC.

Critical Defect rate rose to 1.95% in Q4 2021. "While the overall defect rate rose slightly in Q4 2021, defect rates have improved in totality when comparing 2021 to 2020," said ACES Quality Management's EVP, Nick Volpe. "Given the uptick in Q4 and the persistent issues we're still seeing in the Income/Employment category, lenders should focus their efforts on shoring up this component of their underwriting process." Notable findings? The overall critical defect rate increased 0.08% to 1.95%. Income/Employment defects declined in overall share but remained the topmost frequently cited issue. Appraisal-related defects rose in Q4 2021 after experiencing minimal levels throughout the last refi cycle. Purchase review share was 20 points higher than refis. Conventional lending share is now 8 points below the pandemic peak.

"Wolters Kluwer recently launched the industry's first OmniVault for Real Estate Finance using its award-winning eVault technology. This new offering supports multiple asset classes on a single platform, including the industry's first eVault for digital home equity lending. Wolters Kluwer's proprietary technology has over 20 years of proven success. We are the leading eVault provider, managing 92% of all eNotes registered on MERS as of January 2022. Regardless of where you are on your digital journey, we can help you implement a digital experience for customers in any asset class, including your HELOC customers. Now is the right time to improve your digital strategy. To learn more, download our brochure."

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Basis Risk Primer

No lender likes volatility in the bond market. I am occasionally asked about how hedging works in terms of mortgage rate locks, why extensions and renegotiations cost money, and why mortgage-backed securities are so important in the process. The basics are relatively easy to understand. But recent activity and price movement has highlighted the reason why a pipeline of mortgages in process is hedged with securities backed by those mortgages and not other financial instruments like stocks, cryptocurrency, or Treasuries.

A quick analogy. If you are a car dealer, and you buy a car from the manufacturer for $30,000 and simultaneously sell that car to a customer for $33,000, you have no risk. You've locked in your profit. A lender is, in effect, buying a loan from the borrower and could simultaneously sell that loan to an investor (primarily Freddie Mac, Fannie Mae, an aggregator, or a portfolio), therefore appearing to lock in a profit. But that loan may not fund, in which case the lender still owes the investor something. The solution is to sell an asset, since the lender is buying an asset (the loan), to a broker dealer. And that asset being sold is primarily a generic mortgage-backed security (MBS), settling some time in the future that matches the rate lock period of the locks in the lenders pipeline.

But why not sell a Treasury security instead of an MBS? The basis answer is that the price of a Treasury security, or futures contract, may not move in the same way as an MBS. And since mortgage prices offered to borrowers are based on MBS prices, hedging "like with like" makes sense since it eliminates "basis risk." Basis risk is "the risk associated with imperfect hedging due to the variables or characteristics that affect the difference between the futures contract and the underlying cash position," in this case the rate lock.

Put another way, basis risk, something every capital markets staff tries to eliminate, arises because of the difference between the price of the asset to be hedged (the mortgage pipeline) and the price of the asset serving as the hedge. What a lender makes on the hedge should be matched by what they lose on the loan in the pipeline, and vice versa. A lender wouldn't want to lose money on the hedge AND lose money on the loans in the pipeline. Bond market volatility is bad enough without taking on basis risk. Make sense?

Capital Markets

Volatility has returned to markets along with recession fears: a Fed that pussyfoots around won't be strong enough on combatting inflation, a Fed that is too aggressive could drive the U.S. economy into a recession. **Hawkish signals from the Fed now outweigh hope that 75 basis point rate hikes won't be the norm**. Treasury yields fell and the yield curve flattened, signaling expectations that a Fed-triggered recession in the near future is becoming harder to avoid. The Fed knows it has an inflation problem and is prepared to trade higher unemployment for inflation-restrictive rates. We will see how long the Fed continues to claim that a soft landing is likely.

Yesterday, Freddie Mac confirmed what every LO knows and reported that mortgage rates surged up more than half a percentage point, marking the largest one-week increase in its survey since 1987. The Primary Mortgage Market Survey showed that the 30-year fixed-rate mortgage averaged 5.78 percent. "These higher rates are the result of a shift in expectations about inflation and the course of monetary policy," said Sam Khater, Freddie Mac's Chief Economist. "Higher mortgage rates will lead to **moderation from the blistering pace of housing activity that we have experienced coming out of the pandemic**, ultimately resulting in a more balanced housing market."

The latest numbers from Freddie have brought the high-quality refinance candidate population down to 472k, per Black Knight. This is the smallest this population has ever been, since at least 2000, when Black Knight began tracking this metric. Most of the remaining candidates are from 2008 and earlier vintages. Refinancing would extend their terms out to 30 years again, which results in excess monthly savings. It reflects more the impact of the term extension savings than rate-specific savings at this point and explains why the population is at a record low, but the savings are not. Should they decide to refinance, these 472k borrowers could save an aggregate $143 million/month, **or an average savings of $309/month.**

This week's economic calendar draws to a close with industrial production and capacity utilization and leading indicators, none of them early morning, "first-tier" economic releases. Before the data, Fed Chair Powell will deliver remarks. The Desk will purchase just $284 million UMBS15 3.5 percent and 4 percent using money from early payoffs. We begin the day with Agency MBS prices roughly unchanged the 10-year yielding 3.21 after closing yesterday at 3.31 percent.

Employment

“Many mortgage companies have had to make some difficult personnel decisions in 2022. But for those already affected by unfortunate layoffs and downsizing, or those that feel that it could be on the way, where do you begin your job search? At Pezian Search Group we want to assist you in getting back into the workforce in a long-term role quickly. With hundreds of clients nationwide, as well as over 12 years of industry experience, we actively market our candidates to our established network of mortgage and banking executives, managers, and HR leaders that we directly work with and who trust us to build and strengthen their teams. So if you or someone you know is wondering ‘what’s next?’, let us get to work. Follow us on LinkedIn, view all of our current openings, and contact us directly at info@peziansearchgroup.com to learn more.”

Are you a top producer who knows you’re not in the best situation, but the comfort of being busy the last 2 years has stopped you from making a move? “There are risks and costs to action. But they are far less than the long-range risks of comfortable inaction.” – John F Kennedy. It’s not uncommon for a veteran top producer to fall into the trap of comfortable inaction. Would the younger version of you stay with something just because it’s easy and comfortable? Would the younger you look for a strategic advantage and take action? We encourage our branches to build their own brand and branch the way they want. We provide our originators a plug and play opportunity to join an existing branch to utilize a seasoned operations team. It’s time to learn about the platform you’ve earned. Contact Anjelica Nixt to schedule a confidential conversation.

Here’s an incredible opportunity to lead the mortgage pipeline hedging team at Citizens. The Home Mortgage, Capital Markets director is seeking an experienced hedging manager to lead a team of traders in managing it’s estimated 2022 $25b pipeline and deliveries of FNMA, Freddie and GNMA MBS and cash deliveries. Experience with non-agency, a plus, as we consider targeted alternative executions to our balance sheet investments. QRM risk management a significant plus and preference. Position may have expanded responsibilities and opportunities, based on experience. Must have strong leadership skills, risk mitigation expertise and an ability to communicate complex concepts and market impacts to Finance and Executive leadership. Join a seasoned team with career growth opportunities and inquire today at Home Mortgage Hedging Director at Citizens.

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