National Mortgage News

nationalmortgagenews.com

June 2018 • Volume 42, Issue 11

EXPANDING QM

Anticipated changes to the qualified mortgage rule will give lenders more options and force them to rethink their views on risk

SourceMedia

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Be Careful What You Wish For

The Consumer Financial Protection Bureau's pending "five-year lookback" of the qualified mortgage rule may lead to QM being redefined with looser standards. As this month's cover story explains, these efforts stand to create more options for the mortgage industry, but they will also require lenders and investors to recalibrate the levels and types of credit risks that they're willing to take.

On the surface, changing QM by lowering the requirements for loans that receive safe harbor protection seems like a classic, "get the government out of the way of business" move. But with seemingly no end in sight to the government conservatorship of Fannie Mae and Freddie Mac, loosening QM has the potential to actually increase the federal government's involvement and exposure to the mortgage market.

Fannie and Freddie already buy loans that fall outside of the standard QM definition. But because of a temporary provision known as "the patch," these loans receive QM status because they're purchased by the GSEs. The same waiver applies for loans that receive government guarantees, such as the Federal Housing Administration insurance program. The QM waiver the GSEs and government loans enjoy isn't permanent, and is set to expire in 2021, absent an extension or earlier end to the GSE conservatorship.

In other words, if any other private secondary market investor were buying these loans, they wouldn't qualify. As a result, the boundaries of the non-QM market have been set not by the statutory provisions of QM itself, but by Fannie and Freddie's criteria.

It's unclear whether relaxing QM would move the standard beyond the current criteria of agency-eligible loans. But if it does, the GSEs will have a choice to make: stick to their existing credit box, and lose market share to a new "private-label QM" market; or open up their credit box even more and leverage "the patch," to gain an edge over the private market.

The GSEs have been re-establishing their competitive spirit for years now, rolling out new products and tools to help lenders better assess and manage risk. To be sure, much of those efforts have been beneficial to the industry overall and make the originations market safer for all involved.

In any event, the non-QM market, which finally started to come into its own last year, is also in danger of being squeezed by an expanded QM universe. In that case, lenders and investors will have to decide how far down the spectrum of non-QM they're willing to go in search of profit.

It's entirely conceivable that with the right tools in place, lower QM standards — and perhaps even lower agency standards — could safely open up the market to more borrowers. But it's a slippery slope, and one that could easily spin out of control.

Send your comments, questions and story ideas to Editor in Chief Austin Kilgore: austin.kilgore@sourcemedia.com

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National Mortgage News

Winner of the Polk Award for Financial Reporting
Winner of an ASBPE Editorial Excellence Award
Winner of a NAJA Editorial Award

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National Mortgage News (ISSN #1050-3331) is published monthly with an extra issue in October by SourceMedia, Inc., One State Street Plaza, 27th Floor New York, NY 10004, 212-803-8200. Subscription price: $349 per year in the U.S.; $389 for all other countries. Change of Address: Notice should include both old and new address, including ZIP code. POSTMASTER: Please send all address changes to *National Mortgage News*/One State Street Plaza, New York, NY 10004. For subscriptions, renewals, address changes and delivery service issues contact our Customer Service department at (212) 803-8500 or email: help@sourcemedia.com. Periodicals postage paid at New York, NY and additional U.S. mailing offices.

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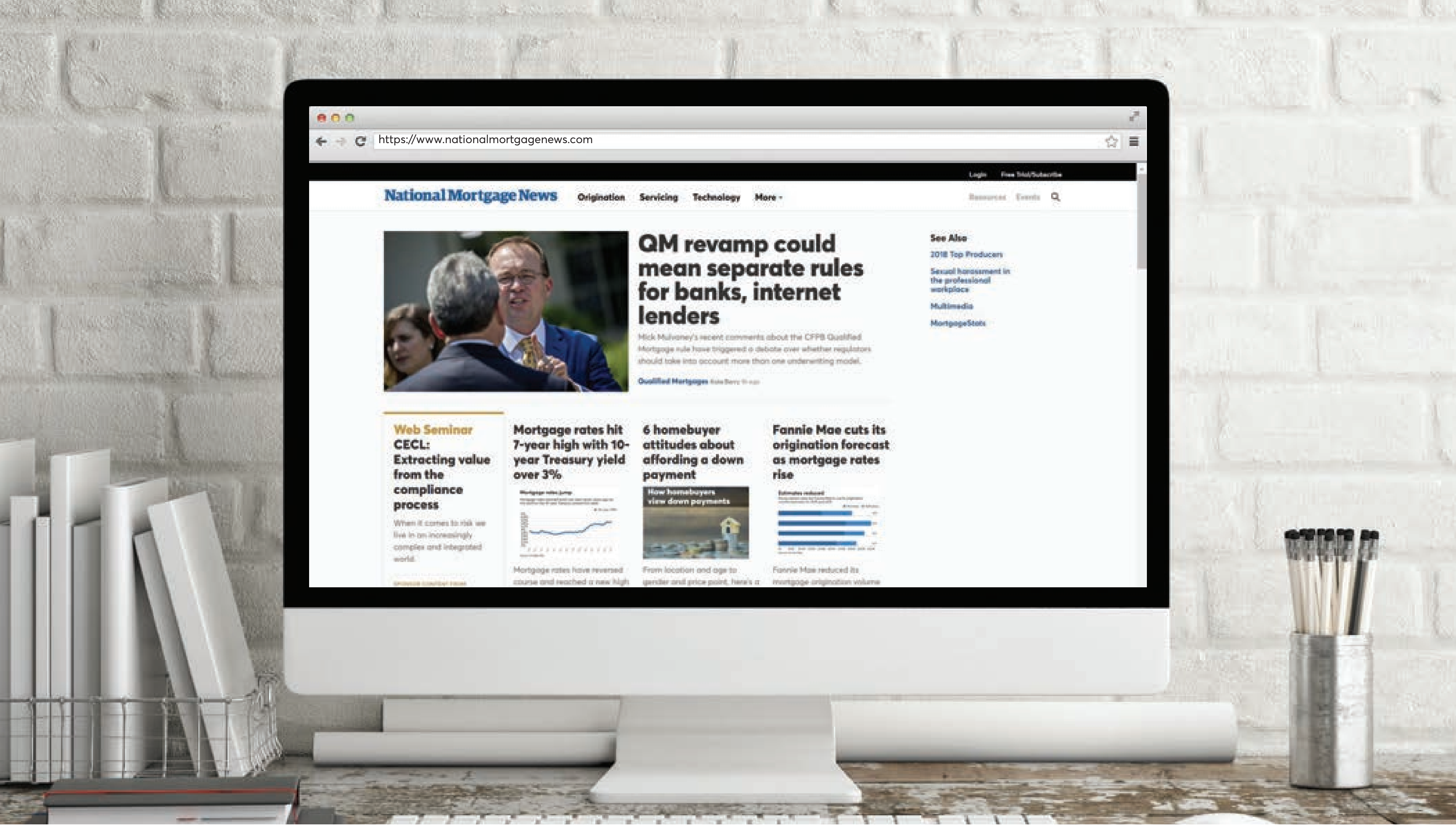

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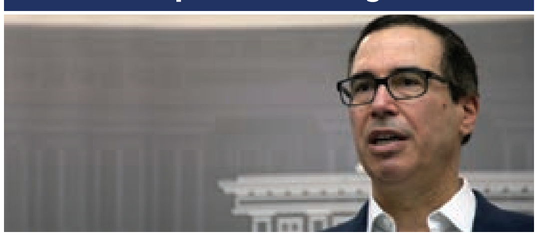
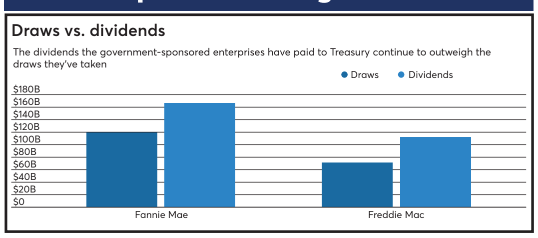


GSE Reform Unlikely to Happen This Year: Mnuchin

The Treasury secretary said reforming Fannie Mae and Freddie Mac will come into focus more in 2019, when Federal Housing Finance Agency Director Mel Watt's term will end.

People are talking about ...



Fannie Mae Rebuilds Capital Cushion with Enough Left to Pay Dividend

Prudent Underwriter: "During 2017 alone Fannie reversed $4.7 billion in previous allowances set aside to provision for loan losses against their portfolio originally built up at the inception of conservatorship."

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MISMO Spring Summit
Denver, Colorado
bit.ly/2wip0d2

June 24-27
ABA Regulatory Compliance Conference
Nashville, Tennessee
bit.ly/2lxbYzv

July 11-12
MBA CREF Market Intelligence Symposium
New York, New York
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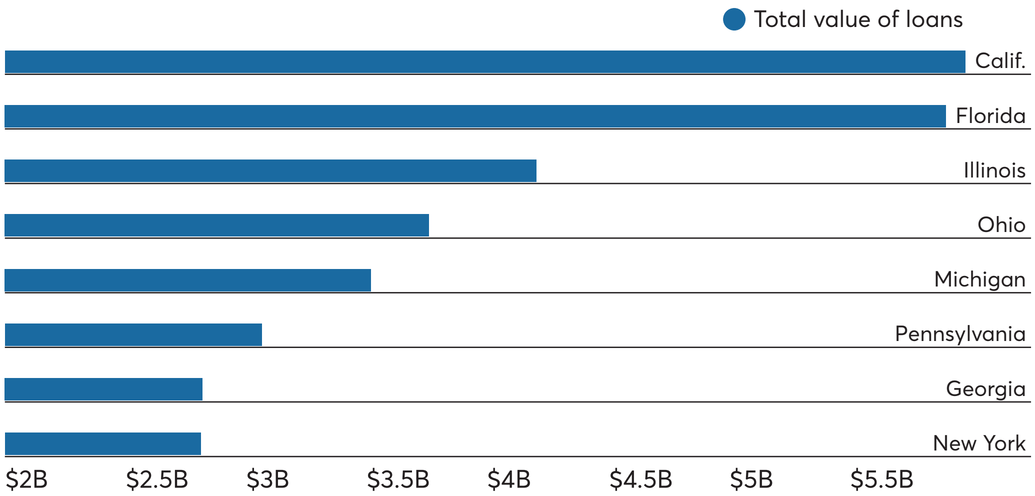
A welcome change

Community bankers pressed for the rule change that raises the loan threshold for which an appraisal is required on a commercial property to $500,000. These states have the most outstanding CRE loans ranging between $250,000 and $500,000



Source: CoStar

Small Banks Count on New Appraisal Rule to Boost Lending

The removal of costly appraisal requirements on tens of thousands of smaller commercial properties could help community banks better compete for loans they say they have been losing to nonbank lenders.

By Andy Peters

Community bankers are counting on a new federal rule that relaxes requirements on real estate appraisals to help them better compete with nonbank lenders on smaller commercial real estate loans, but appraisers themselves say that the change will only encourage banks to take more risks.

The three federal bank regulatory agencies recently increased the threshold for loans that require an outside appraisal on the property used as collateral from $250,000 to $500,000. The rule was last updated in 1994 and lenders say regulators changed it because it did not accurately reflect current property values.

The rule change will remove the costly appraisal requirement on tens of thousands of commercial properties, which could allow banks to make more loans in this size range, said Justin Bakst, the director of capital markets at CoStar. As of April 20, roughly 154,000 properties nationwide were each valued at between $250,000 and $500,000, according to CoStar. Those properties are valued at about $68 billion.

Though these loans should be right in community banks' wheelhouse, many small banks have actually shied away from them because they became too costly to make once appraisal fees were factored in, said Jon Winick, CEO at Clark Street Capital, a Chicago firm that advises banks on loan sales.

"To spend $3,500 for an appraisal on a $250,000 loan, that wasn't worth it," Winick said.

Community bankers said that the rule change should help them better compete with insurance companies, individual investors and other nonbank lenders that were not subject to the same appraisal requirements. Eliminating in-person appraisals for loans of less than $500,000 will both reduce costs for small banks — allowing them to offer better rates and terms — and speed up decision-making, they said.

Banks had not officially asked for an increase in the threshold since it was last updated in 1994, said Chris Capurso, an attorney at Hudson Cook in Richmond, Va., who advises banks on lending laws. But a federal law that requires federal agencies to review their regulations every decade opened the door for the current push, Capurso said.

Additionally, the price of commercial real estate has significantly increased since the financial crisis, which made it more palatable for regulators to boost the threshold, said Curt Everson, president of the South Dakota Bankers Association.

Banks will still need to value their collateral, but instead of hiring a certified independent appraiser, they now can commission an evaluation of properties in this value range using publicly available real estate data.

"Evaluations cost less than appraisals, take less time than appraisals and do not require the bank to go out and find a certified appraiser," Capurso said. "All of this adds up to banks, especially banks with fewer resources, being able to make more CRE loans."

However, appraisers have questioned why regulators are making it easier for banks to make CRE loans at a time when they've been concerned about overexposure to the sector. The rule change is "yet another relaxation of sound collateral risk policies that provide minimal benefit to financial institutions while creating significant potential risk to the financial markets as well as consumers," the Collateral Risk Network, which represents appraisers and risk managers, wrote in a September letter to regulators.

The Federal Deposit Insurance Corp., the Office of the Comptroller of the Currency and the Federal Reserve Board dismissed concerns about the change posing increased risk to the financial system.

"The agencies … determined that the increased threshold will not pose a threat to the safety and soundness of financial institutions," they said in a joint press release.

Bankers in rural areas have also supported the rule change, as they believe it will help address the problem of a dearth of commercial real estate appraisers in certain sections of the country.

"The supply of licensed and certified appraisers, especially those willing to work in rural areas, has diminished," Everson wrote in a September letter to regulators.

"In too many instances … owners of small businesses on main street, farmers and ranchers seeking to restructure current year operating loans into longer term notes incur higher costs … because of appraisal threshold requirements that have not been updated in decades," Everson wrote.

Some bankers had called for regulators to raise the appraisal-requirement threshold to $1 million, saying that the $500,000 cap would still shut them out of too many deals. However, Capurso noted that regulators based the $500,000 figure on the increase in the Federal Reserve's Commercial Real Estate Price Index over the past 24 years.

"The agencies didn't come to the limit haphazardly by merely doubling the previous limit," Capurso said. "There's a basis to it, and I think it's a fair one to use." NMN

Why This 125-Year-Old Thrift Is Getting Into Commercial Lending

By Jackie Stewart

After 125 years, Capitol Federal Financial in Topeka, Kan., is stepping outside its comfort zone.

The $9 billion-asset company had been an industry stalwart, living up to its status as a thrift by focusing heavily on mortgages. In recent years, however, it has built a small commercial real estate book by buying loan participations.

Capitol Federal is set to distance itself even more from its past with the pending purchase of the $434 million-asset Capital City Bancshares, which is known more for its commercial focus. The $38 million deal will add business banking to Capitol Federal's offerings for the first time.

The shift makes sense given challenges in the mortgage business and the benefits that can come with having cheaper commercial deposits, industry experts said.

It also highlights the overall challenges that mortgage-centric thrifts face maintaining their business models. The number of savings institutions has decreased by about 40% over the past decade, to about 750 institutions, according to data from the Federal Deposit Insurance Corp.

Other banks, including Flagstar Bancorp, have de-emphasized mortgages to pour more resources into commercial lending.

"Everyone is wanting to get more into commercial lending," said Lynn David, CEO of Community Bank Consulting Services. "A lot of your commercial accounts are noninterest bearing. That's still a reason why [banks] go after commercial loans — because they want the commercial deposits."

Capitol Federal, for its part, has no plans to completely scrap its old model. It will still originate and hold residential mortgages.

"We won't abandon our retail operations," said Kent Townsend, the company's chief financial officer and treasurer. "This is really just being adaptive. [Capital City] matches up with our conservative assets."

Capitol Federal originates a variety of fixed- and adjustable-rate mortgages that it keeps on its book. It also buys residential mortgages from other lenders. Roughly two-thirds of its loans are 30-year fixed-rate mortgages, Townsend said,

The model has historically succeeded because of the company's scale and its use of technology to address compliance issues, Townsend said. Capitol Federal's efficiency ratio was around 43% on March 31. In contrast, the average efficiency ratio for banks with $1 billion to $10 billion of assets was almost 60%, according to FDIC data.

Still, Capitol Federal decided to expand into commercial lending to help offset some of its risk tied to long-term residential lending, Townsend said.

Due to historically low interest rates, it's likely that the mortgages on Capitol Federal's balance sheet will stick around longer than normal, said Damon DelMonte, an analyst at Keefe, Bruyette & Woods. That will weigh against the company as interest rates rise and institutions start to pay more for deposits.

"I think they could have continued with their previous business model, but their overall profitability is starting to shrink," DelMonte said. "Their funding has become an issue."

Capitol Federal has relied on mostly retail deposits and wholesale funds to support its loan growth. Its loan-to-deposit ratio is 133%, according to the FDIC.

Commercial loans tend to have shorter durations and reprice faster, while retail deposits typically cost more than commercial funding, industry experts said.

Capital City addresses those issues.

Capitol Federal has been experimenting with commercial lending, amassing about $460 million in commercial real estate loans over the past five years, tapping into its network of correspondent banks. Doing so allowed management to become familiar with commercial lending with little risk.

"Capitol Federal is entering [commercial lending] the right way," said Bob Wray, a managing director of Capital Corp., which advised Capital City on the deal. "First, they dipped their toe in by buying participations so they could see how they work."

The deal also helps with Capitol Federal's funding issues by bringing in lower-cost commercial deposits. Core deposits make up more than 93% of Capital City's funding, the companies said.

Commercial deposit accounts are generally larger than retail accounts, especially for a bank of Capitol Federal's size and potential legal lending limits, said Andrew Christians, a managing director at Donnelly Penman & Partners. And banks often give commercial clients better loan rates if they bring their deposits over.

While the deal draws attentions to challenges with the thrift model, it should not be viewed as a death knell, industry experts said.

"I would never say the industry is dead but just challenged," Christians said. "It has been for some time. "If interest rates start increasing and the economy stays strong, it is a viable business model."

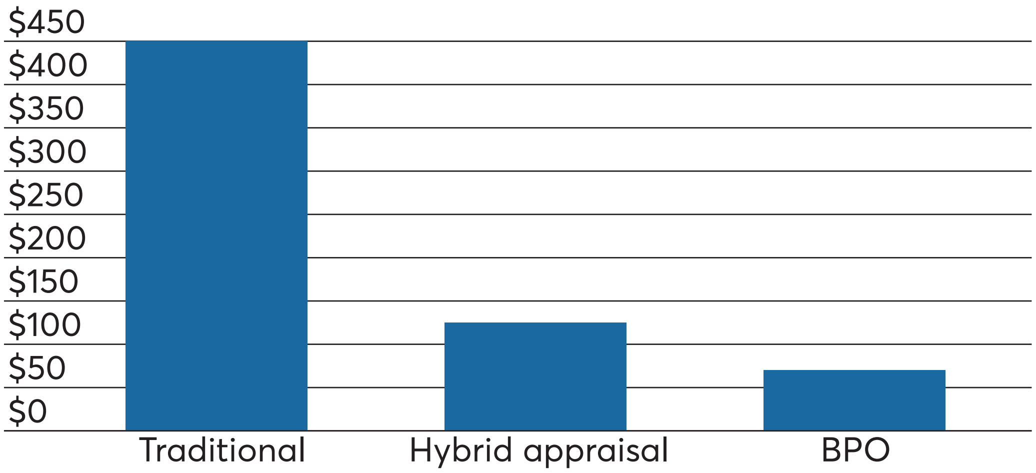
Capitol Federal plans to stay below $10 billion of assets, a threshold that triggers more regulation, Townsend said. Management doesn't have set targets for commercial lending, though it may buy fewer participations as originations increase.

Additional acquisitions are possible if this first foray into commercial lending goes well, said Andrew Liesch, an analyst at Sandler O'Neill. But he also noted that the acquisition of Capital City was a unique situation that includes keeping President and CEO Bob Kobbeman on to help run the commercial lending platform.

"I think they will start with this one and see how it goes," Liesch added. NMN

Cost comparison

Appraisal alternatives could compress timelines and introduce savings, but the integrity of the data they produce varies



Source: Moody's Investors Service estimate of starting price point

Mortgages Without Appraiser Visits? Fannie Pilot Asks Why Not

In a bid to cut time and costs, Fannie Mae is testing whether appraisers can accurately determine a home's value without visiting the property.

By Bonnie Sinnock

In a bid to cut time and costs from the mortgage process, Fannie Mae is testing whether appraisers can accurately determine a home's value without actually visiting the property.

Instead, the government-sponsored enterprise is asking appraisers to combine local market data with property-specific details from a home inspection to create a "hybrid appraisal" report.

Fannie Mae declined to comment about the program, but the pilot was described to NMN by multiple sources familiar with the tests.

Hybrid appraisals tend to be faster for lenders and cheaper for borrowers than traditional, "full" appraisals, particularly in rural areas and hot markets where there are appraiser shortages, and they are being increasingly used for originations in the home equity market in response to higher rates, costs and competition.

"We think it's a game changer, the fact that they're going down the path of testing it," said Jim Smith, president of Property Solutions, the valuations, title and asset management division of Computershare.

The use of alternative appraisal products has long raised questions about data integrity and accuracy. For example, the quality of the subject-property data in a hybrid appraisal will vary based on the skill and experience of the home inspector, said Mark Johnson, president of property valuation company LRES.

"The pro for the lenders is everything is faster and easier. Really what you are doing there is taking the appraiser out of the drive-time and appointment equation, and allowing them to focus on the analysis and conclusion. An appraiser can do more appraisals per day sitting at his desk," Johnson said.

"The disadvantages are obviously it's a different pair of eyeballs out there and boots on the ground writing the report," he continued. "The guy writing the report can't really know what the other guy saw out there. You don't have a real, true licensed appraiser noticing all those nuances."

If the GSEs approved hybrid appraisals, "I think we'd gladly follow along," said Rick Bechtel, head of U.S. mortgage banking at TD Bank, which recently started gearing up to use hybrid appraisals in conjunction with home equity lines of credit.

However, Bechtel said he'd be cautious about using hybrid appraisals to evaluate distinct jumbo properties or for use with higher-risk government loans. Meanwhile, GSE acceptance of hybrid appraisals, while by no means certain, is looking more likely.

Both GSEs already are using other appraisal alternatives; and Freddie Mac "wouldn't rule out testing the use of hybrid appraisals as part of the way we're working with lenders," said Sam Oliver, a vice president at Freddie who works with the agency's Loan Advisor Suite of technology products.

Some appraisal alternatives are more reliable than others, Moody's Investors Service noted in a recent report, and neither GSE is likely to move ahead with a full hybrid appraisal rollout without a statistically sound set of consistent data elements that validate the product's integrity.

The GSEs also may need to identify a practice that bridges variations in state laws governing appraisals.

For example, while a real estate agent or broker can collect on-site information in some types of hybrid appraisals, the West Virginia Real Estate Commission has a 2007 memorandum that can be interpreted as disallowing real estate brokers from doing inspections related to valuation reports or broker price opinions in the state, Smith noted. Fannie is testing hybrid appraisals based on information collected by home inspectors.

If hybrid appraisals do get approved by either or both GSEs, they will likely have limited applicability based on the amount of comparable data available to back them up and how distinct the property in question is.

"It all comes down to homogeneous properties," said Johnson. A hybrid appraisal may be appropriate to size up similar low- or mid-tier properties with lot of recent comparable data, but with more high-end homes that tend to be more custom-built, using a hybrid appraisal "gets complicated," he said. NMN

Freddie Mac Eases 3% Down Payment Limits for First-Time Homebuyers

By Brad Finkelstein

In its latest effort to reach first-time homebuyers, Freddie Mac is launching a new 3% down payment program that casts aside a number of restrictions in its existing low down payment offerings.

The program, called HomeOne, doesn't have income caps or geographic limits like previous 3% down programs. But one of the borrowers on the loan must be a first-time homebuyer and the property type is limited to a one-unit primary residence.

Its current low down payment program, Home Possible, is capped at a 95% loan-to-value ratio, except for the Home Possible Advantage loan that goes to a 97% LTV. However those loans are subject to income limits.

Rising home prices continue due to inventory shortages is making it tougher to save up for a down payment, said Danny Gardner, Freddie Mac's senior vice president of single-family affordable lending and access to credit.

The Home Possible program has been well-received in the market since it launched about three years ago, Gardner said. But lenders found that Home Possible's guidelines "were so specific. [Borrowers] have to meet income thresholds; you have to meet thresholds based on certain geographies. And things change a lot during a loan transaction," he said, like a lender discovering additional income sources that would make a borrower ineligible for Home Possible. Another example: a spouse that originally wasn't going to be on the mortgage changing his or her mind.

"That caused a level of complexity for lenders and consumers to understand those nuances. By having a more broad-based product where the metric is whether or not you are first-time homebuyer makes those other if/then statements obsolete and lenders can be more confident promoting an option for borrowers," Gardner said.

Similar to Home Possible, lenders must use Loan Product Advisor to underwrite HomeOne mortgages. The loan must be fixed-rate and can't be "super conforming loan." It also can't be used for a cash-out refinance, second home or investment property.

However, Freddie Mac officials did not specify any other underwriting requirements to mitigate the qualification differences between HomeOne and Home Possible.

There are very limited refinance situations permitted to use HomeOne (Home Possible can be used for refinance loans, but there has been very limited volume); current Freddie Mac borrowers that were first-time buyers can refinance into a 97% LTV loan; or if the borrower has a community second mortgage and the lender agrees to subordinate the lien, Gardner said. Borrowers are required to obtain private mortgage insurance for HomeOne.

In January, the first-time homebuyer share of purchase loans at Freddie Mac and Fannie Mae was 48.1%, the highest level since the turn of the century, according to Urban Institute estimates. Over the same period, the Federal Housing Administration share of first-time buyers remained relatively flat in the 80% range; in January it was 82%. The combined GSE and FHA share in January was 58.9%.

A separate study by private mortgage insurer Genworth found 157,000 loans to first-time homebuyers in the fourth quarter of 2017 used private mortgage insurance, compared with 167,000 that were insured by the FHA.

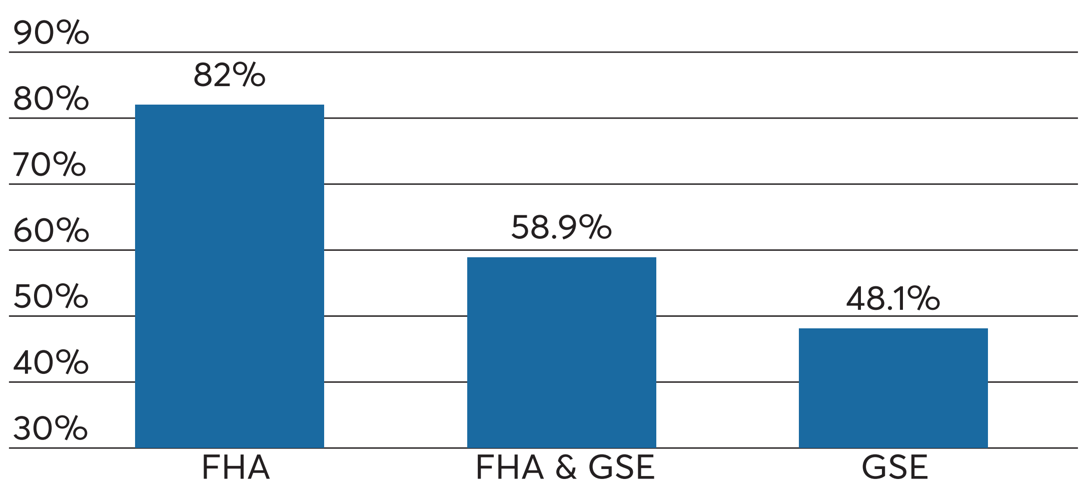
"When I joined Freddie Mac three years, that was one of the issues everybody was concerned about, was whether or not millennials would be given the opportunity to purchase homes, whether or not they wanted to purchase homes and why were we not seeing the historical rates of homeownership for first-time homebuyer," said Gardner.

However, the Urban Institute also notes that repeat buyers have characteristics that get them lower rates, such as higher credit scores and lower LTVs. For first-time buyers, borrowers approved for conforming loans get lower rates than FHA borrowers.

First-time homebuyers that get conforming financing have an average loan amount of $231,000, a 737.7 average credit score, an 87.2% average LTV and an average debt-to-income ratio of 36%. The first-time buyer that took an FHA loan has an average loan amount of $203,677, average credit score of 673.4, average LTV of 95.5% and average DTI of 42.9%. The average interest rate was 4.32%. NMN

First-time share

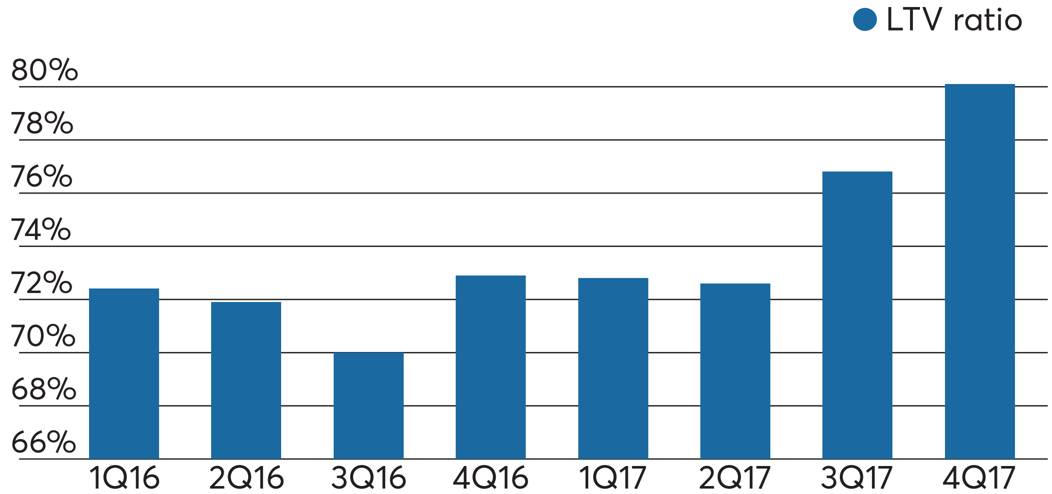
The share of GSE purchase mortgages for first-time buyers reached 48.1% in January, the highest since in the 21st century



Source: Urban Institute

Creeping up

The average loan-to-value ratio for commercial real estate deals rose last year



Source: PrecisionLender

Lesson in High-Profile Foreclosure: Resist Temptation to Relax Terms

Preferred Bank's experience with an apartment developer is a reminder of how important strict underwriting terms will be as loan demand increases, rates rise and lenders try to outdo each other.

By John Reosti

A high-profile foreclosure in New York is highlighting the importance of disciplined underwriting.

Preferred Bank in Los Angeles disclosed recently that it has begun foreclosure proceedings on a pair of luxury apartment buildings in Manhattan, a move that will dramatically increase the level of nonperforming assets on its balance sheet. The loans have an outstanding balance of $41.7 million.

If there's a silver lining, it's that the $3.8 billion-asset bank expects the financial hit to be minimal because the loan-to-value ratio — the balance divided by the appraised value at origination — for each of the loans is below 70%.

Preferred's experience serves a reminder of how important terms will be as loan demand increases, interest rates rise and lenders try to gain a competitive edge. Those who get too aggressive could be burned when the economic cycle takes the inevitable turn for the worse, bankers and industry observers said.

"If you're going to compete on commodities — that's where the cycle starts to turn," said Joseph Campanelli, CEO at the $2.1 billion-asset Needham Bank in Massachusetts, adding that it can be tempting to follow the pack in areas such as rate and terms.

"Well, so-and-so is doing this rate, so let's match it," Campanelli said. "Or so-and-so is doing it without recourse, or doing a higher loan-to-value, let's match it. That's the slippery slope."

The average loan-to-value ratio for commercial real estate deals increased to about 80% in the fourth quarter from 73% a year earlier, according to PrecisionLender, a technology firm that helps lenders fine-tune pricing and terms. The firm evaluated more than $2 billion in quarterly volume by its clients.

To be sure, many banks are sticking to their guns when it comes to LTV.

Campanelli and Edward Czajka, Preferred's chief financial officer, said they are seeing very few signs that lenders are throwing caution to the wind. "I don't see any trends pushing standards in the opposite direction," Czajka said, adding that the average loan-to-value ratio in Preferred's $1.3 billion-asset commercial real estate portfolio is 56%.

"One of the things we're seeing this go-around is a lot more liquidity going into deals," Campanelli said. "It's not uncommon to do a deal at 65% loan-to-value."

Needham, like Preferred, is a significant commercial real estate lender with more than $400 million of CRE-related loans on its books.

While Preferred did not disclose the reason for the foreclosures, other media outlets have noted that Michael Paul D'Alessio, a developer and one of the properties' owners, is facing lawsuits alleging that funds intended for a number of projects were improperly diverted for other uses.

D'Alessio is also being sued by three New York banks — Greater Hudson Bank, Westchester Bank and BNB Bank — that are trying to recoup $6.4 million through an involuntary bankruptcy petition filed recently in the U.S. Bankruptcy Court for the Southern District of New York.

The situation at Preferred shows how important it is to fully vet a borrower and not just an isolated deal, industry experts said.

"Problems can cascade," said Jon Winick, CEO of the Chicago advisory firm Clark Street Capital. "Trouble with one project drags down another one. … A borrower can be highly coveted and, all of the sudden, no one wants to touch them."

"What else does that developer or real estate group have going on?" Campanelli said. "If they're overleveraged in other areas, you would have to conclude that, on a global basis, the cash flows aren't strong enough, even though the individual project looks OK."

Preferred still considers itself a conservative lender, Czajka said, noting that the bank's credit quality had been uniformly excellent for years. While the bank is pursuing foreclosure now, it is is keeping all its options — including selling the loans — on the table.

In its first-quarter report, Preferred reported $3.3 million of nonaccrual loans, or 0.11% of total loans.

Winick said he expects loan-to-value ratios to be lower on large CRE loans, which seems to be the case with Preferred's deals. As a result, the bank's minimal-loss forecast "seems reasonable," but there are no guarantees. NMN

Former ICE Agent Pleads Guilty to Fraud In GSE, SunTrust Short Sale

By Bonnie Sinnock

A special agent who used to work for an investigative arm of Immigration and Customs Enforcement pleaded guilty to defrauding Freddie Mac and SunTrust Mortgage through a short sale.

The former Homeland Security Investigations agent, Shauna Kay N. Sutherland of Corpus Christi, Texas, admitted in a plea agreement that she allowed a short sale of her property in Gainesville, Ga., to a family friend who was a straw buyer.

"Sutherland falsely represented that there were no hidden agreements and requested forgiveness of over $40,000 owned on the mortgage due to her purported financial hardship," according to a Department of Justice press release.

"Based on those material representations, SunTrust Mortgage and Freddie Mac accepted the short sale offer, with the family friend 'purchasing' the property for approximately $34,000, in exchange for SunTrust Mortgage and Freddie Mac releasing Sutherland from her outstanding debt."

But Sutherland secretly used funds wired to her by her mother to fund the family friend's purchase of the short sale, collected rents from the property, paid for maintenance, and eventually sold the property to buy another piece of real estate in Florida, all in the straw buyer's name.

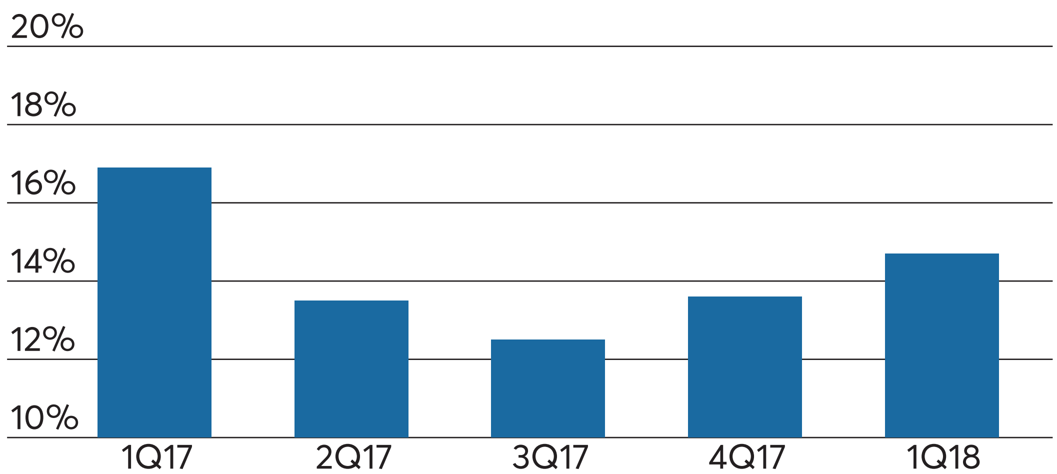
Freddie Mac calculated a total loss of $42,000 from the transaction.

Sutherland pleaded guilty to one count of wire fraud before U.S. District Judge Robert N. Scola Jr. of the Southern District of Florida, and faces sentencing in June. The Federal Bureau of Investigation, the Department of Homeland Security's Office of Inspector General, and ICE's Office of Professional Responsibility all investigated the case. The U.S. Customs and Border Protection Office of Professional Responsibility also assisted in the investigation.

In general, distressed home sales — including real estate owned, third-party foreclosure auction sales and short sales — accounted for 14.7% of all single-family home and condo sales in the first quarter, up from 13.6% in the fourth quarter of 2017 but still down from 16.9% for the first quarter of 2017, according to Attom Data Solutions. NMN

More distress

The percentage of homes sold in the market that are short sales or otherwise distressed has rebounded recently



Source: Attom Data Solutions

Mortgage Delinquencies Show Improvement

By Bonnie Sinnock

Late payments on single-family home mortgages improved on a consecutive quarter basis as more recovery from Hurricanes Harvey and Irma took hold, but more potential loan performance concerns lie ahead. Overall, seasonally adjusted delinquencies in the first quarter declined by 54 basis points from the previous quarter but were just 8 basis points lower than the same period in 2017, according to the Mortgage Bankers Association.

"Mortgage delinquencies decreased from the previous quarter across all loan types — conventional, VA, and in particular, FHA — as the effects of the September hurricanes dissipated," Marina Walsh, the MBA's vice president of industry analysis, said in a press release. "The strong economy, low unemployment rate, tax refunds and bonuses and home price appreciation were key factors that helped push delinquencies down in the first quarter."

But for the time being, even the later-term delinquencies and defaults that were up in fourth quarter of 2017 look to have improved on a consecutive quarter basis. Most notably, the delinquency rate for FHA loans plummeted. The 136-basis-point consecutive quarter improvement in the delinquency rate for FHA loans recorded in the first quarter marked the largest single-quarter decline ever seen in the MBA's National Delinquency Survey. NMN

ADOBESTOCK

Why This Bank Ventured into The Landlord-Tenant War Zone

Leader Bank says it can land property managers as commercial clients by helping them handle tenant deposits.

By Bryan Yurcan

Landlords around the country — and, by extension, their banks — are subject to varying state rules governing tenant security deposits.

Massachusetts, for instance, requires landlords to keep the deposit in an interest-bearing account, provide the tenant with the account number, name and address of the bank holding the funds, and also pay tenants 5% interest on the security deposit per year, or the amount of interest paid by the bank.

Leader Bank in Arlington, Mass., says there's a fintech opportunity to help landlords manage tenant security deposits better and enable other banks do the same.

The $1.2 billion-asset bank created and recently launched a new digital tool called ZDeposit, designed to streamline the security deposit collection process.

The digital portal allows the bank's landlords and property managers to create security deposit accounts online by taking a picture of a check and inviting tenants to enter their information digitally. Additionally, it automates many paper-based compliance requirements for landlords, such as generating account disclosure forms and apartment conditions statements.

"Most landlords are not in compliance with many" of these regulations, said Jay Tuli, head of retail banking and residential lending at Leader Bank and creator of ZDeposit. "Especially if you're managing over 100 units, it can be a real hassle."

Massachusetts security deposit laws are so tenant-friendly that "many lawyers advise their landlord clients not to take security deposits because staying in compliance with the statute is not easy," wrote attorney Arthur Hardy-Doubleday in a blog post from earlier this year. "Further, a violation of the statute may award tenants three times their deposit plus attorney fees."

Tuli said ZDeposit aims to solve many of these compliance headaches for landlords so they don't have to be afraid of even taking a security deposit from a tenant.

"Bigger landlords might have a person who is solely dedicated to just handling security deposits," he added. "If you can automate that, then you're providing them with real value."

The product could be successful in attracting more landlord clients to the bank, said Julie Conroy, director of research at Aite Group.

"We're in an age where people want to do stuff digitally," she said. "If it can help with compliance and digitize a previously manual process, that's a good combination. Landlords are like most other merchants; they just want to sell something and don't want to become payments and compliance experts."

ZDeposit is the second offering developed by Leader Bank's in-house innovation unit, which launched three years ago. That same year, it developed ZRent, an online portal that lets landlords collect rent payments via ACH transactions. Tuli estimates that since ZRent's launch in 2015, about 500 new landlord clients have become customers of Leader Bank. The segment "is an important target to our bank," he said.

ZRent "has been a nice little profitable product for us," which is why the bank sought to develop a companion offering in ZDeposit, Tuli said. (In 2016, the year after ZRent debuted, Leader was the most profitable bank based in Massachusetts by return on assets, according to FDIC data.)

After its initial success with ZRent, Leader decided to license the product to other banks; currently five banks white-label the service. The bank has the same plans for ZDeposit, and said it can be customized to comply with state regulations that may be different from Massachusetts' for security deposits.

"We built the technology so that it can be customizable state by state," Tuli said. "So as we get interest from other banks, we can figure out the components specific to their state." Indeed, more than half the states in the U.S. have some sort of requirements relating to tenant security deposits, according the website legalnature.com.

For this reason, ZDeposit could be an appealing tool to license for banks that, like Leader, focus on attracting landlords and property managers as commercial clients, said Aite Group's Conroy.

"I don't know if it will be the next multimillion-dollar moneymaker for the bank, but it could definitely generate some revenue as a niche offering," she said.

Tuli says it can also help Leader Bank and other banks that use the product to increase commercial real estate lending, which many banks are lagging in.

"It's a good way of tying in CRE clients, if they see this as something that can help the managers who run their properties," he said.

Leader Bank's practice of developing digital products in-house happened somewhat by circumstance. Earlier this decade the bank was seeking a way to increase deposits, and in 2013 created its own rewards checking account that Tuli said brought in $70 million in new deposits.

"Using some lessons from that, and frankly some confidence from the success, we thought about the next products we could develop," he said. "We're already thinking about what our next projects could be for 2019 and 2020." NMN

A Mortgage in 30 Minutes? Fintech Says It's Coming

By Penny Crosman

Quicken Loans' Rocket Mortgage has made waves because it promises to process a mortgage application in minutes and close the loan in under a month, but a new upstart is aiming to knock the firm, now the largest nonbank home lender in the country, off its perch.

Lenda claims to make the fastest mortgages out there — currently two weeks start to finish, with an eventual goal of 30 minutes in a nearly all-digital process.

Launched in 2014, Lenda has made $200 million worth of mortgages, is licensed in 12 states and plans to expand to 12 more later this year. Jason van den Brand, its co-founder and CEO, said that despite other big players, the mortgage arena is ripe for further disruption. "Mortgages are stuck in the dark ages when it comes to technology," he said. "The big banks are working on technology that was built in the '70s. We cater to the customer who lives on their phone, laptop and tablet and shops online and compares online."

Lenda is following other fintechs that also aim to improve the customer experience in the mortgage process, including Lend, Social Finance (or SoFi) and Roostify. But it aims to be the quickest on the block.

Lenda has built an online mortgage process in which, according to van den Brand, the underwriting starts while the consumer fills out an application.

"We're able to look at their credit data to approve them and make sure they're qualified for the loan," he said. Compliance disclosures are automated and delivered in 30 seconds. Documentation is pulled automatically — Lenda lets the consumer log in to their bank account from its portal to retrieve the necessary three months of bank statements. (They could also download the statements from their Dropbox, Box or Google Drive account and then upload them to Lenda.)

Income verification and employment verification are automated where possible. To be sure, some employers don't share employment data with databases used by lenders. In such cases employment verification needs to be manual.

The basic mortgage underwriting rules used by Fannie Mae and Freddie Mac are built into the software, ensuring the loans are easy to sell to the government-sponsored enterprises once they are made.

"You could have a human try to determine whether something qualifies or you can build that into tech and start doing it at lightning speed," van den Brand said. The software makes sure the potential borrower is qualified and will provide a notice of denial within 45 seconds if a red flag crops up that could lead to denial.

"We don't want to waste the customer's time if they're not going to be approved," he said.

The appraisal process, which typically is not automated, remains a problem. A human appraiser usually goes to a home, takes pictures, makes sure there's nothing terribly wrong with the structure. It takes seven to 10 days to turn around, van den Brand said. But this, too, could be automated, he claimed.

"Appraisals are just data," he said. Satellites could take pictures of a home. Comparable data for the neighborhood can be looked up. Eventually, an appraiser won't have to come to the house, cutting seven to 10 days from the process.

Lenda has also piloted a digital alternative to in-person document signing or having a notary come to the borrower's house. It tested digital signing of mortgage documents through video chat with a notary in January in a pilot project in Washington state.

Lenda's back-office technology lets its human underwriters focus on what really matters, van den Brand said.

The entire lending process start to finish is about 13 days, he said. Competitors take two weeks to two months, he said. Lenda also charges no fees and its rates are an eighth to a quarter of a percent lower than traditional lenders.

In the future, Lenda's portal will be a place where consumers can access their loan documentation and obtain status updates.

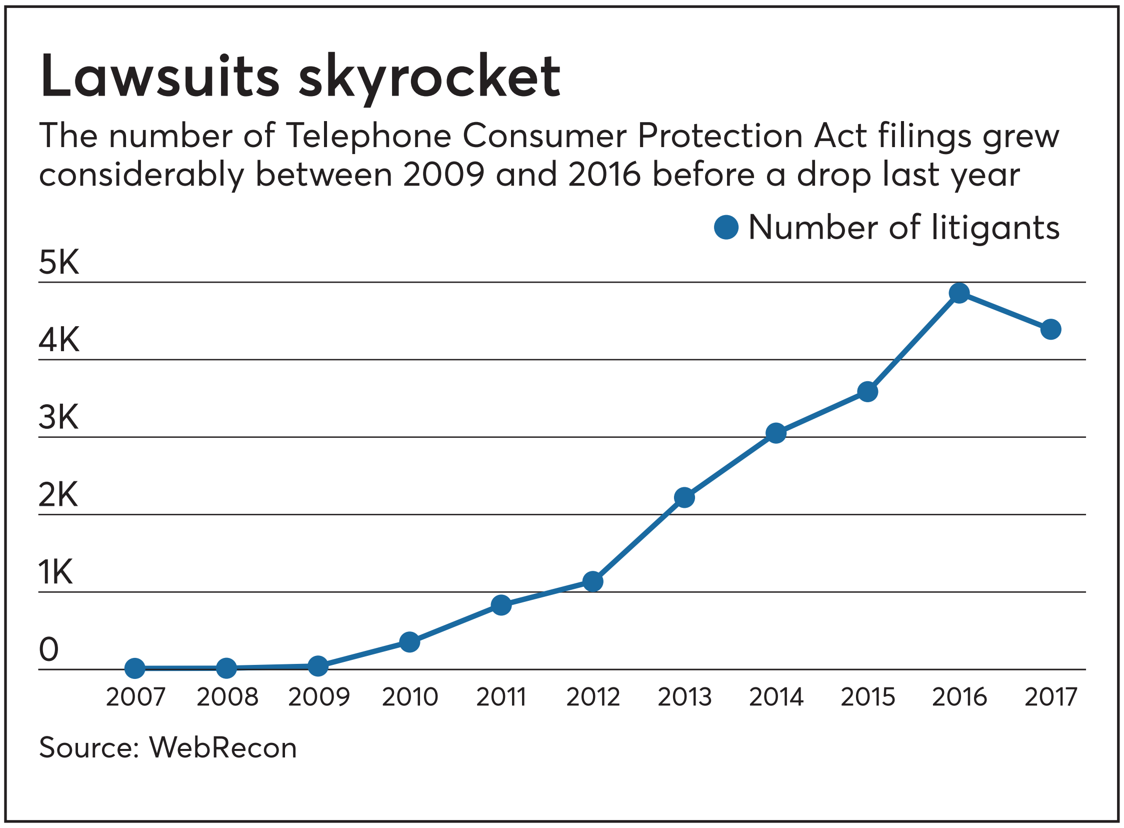
Closing mortgages within half an hour of application might sound like a systemic collapse waiting to happen. But the company is not trying to repeat the lead-up to the mortgage crisis, where banks and mortgage brokers pumped out thousands of no-doc, low-doc and robo-signed mortgages a day to meet the demands of Wall Street. Instead, this automated solution can ensure certain verifications are locked in, just completed much faster.

Consumers, meanwhile, seem to be increasingly ready for digital mortgages. According to a Harris poll commissioned by Fiserv, 69% of consumers already research loan options online and 68% said they review loan documents online. Among millennials, 48% said they would be comfortable researching loan options on their smartphone.

"A lot of consumers want an all-digital mortgage or a more-digital mortgage," said Craig Focardi, senior analyst at Celent. "We're not that far away where we can enter info on our smartphones and check status and communicate. if lenders can combine and automate their compliance checks, then we can get to a digital mortgage very quickly."

Van den Brand says that time is coming faster than most imagine.

"We're underwriting customers in 30 minutes, appraisals are getting to the point where they're going to be automatic and we have completed closings that are borderline automatic," he said. "By 2025, as a consumer, you'll be able to sit down at your lunch break and your loan will be completed, done. A real estate agent could drive a client around to look at properties and give the customer the keys to a house the same day. And it will be a higher-quality, better-underwritten product because of data, because of technology." NMN



Financial Industry Petitions FCC to Make Robocall Suits Harder to Win

Banking and mortgage groups are asking the FCC to issue new TCPA rules that would make consumer lawsuits over robocalls harder to win.

By Brad Finkelstein

If a financial industry petition to the Federal Communications Commission on the use of autodialers is successful, it could make Telephone Consumer Protection Act cases more difficult to prove for consumer attorneys. But a favorable ruling likely won't halt the proliferation of these suits.

There are 17 signatories to the petition, including the American Bankers Association, Credit Union National Association, Mortgage Bankers Association and other banking, credit union and mortgage industry groups.

They are seeking a declaratory ruling that follows up an appellate court win that vacated much of a 2015 FCC ruling on the use of autodialers to call cell phones. That ruling said any device capable of making an automated call was subject to the TCPA, whether or not that capability was being used.

In March, the D.C. Circuit struck down that interpretation. But, "the court didn't say this is what the standard ought to be," said Michael Goodman, an attorney with Hudson Cook, who specializes in regulations about customer communications with various types of businesses, including mortgage lenders. "The court said what the FCC came up with isn't good enough, isn't sensible enough," and left it to the agency to come up with a new standard.

It is quite likely the FCC will agree with what the petitioners are seeking, said Sarah-Nell Walsh, an attorney with Baker Donelson, who represents mortgage companies, based on a statement that FCC Chairman Ajit Pai made in opposition to the 2015 ruling when he was a commissioner of the agency.

"In short, we should read the TCPA to mean what it says: Equipment that cannot store, produce, or dial a random or sequential telephone number does not qualify as an automatic telephone dialing system because it does not have the capacity to store, produce, or dial a random or sequential telephone number," Pai said.

"That is exactly what this petition seeks to do. They seek that exact same definition of an ADTS," Walsh said. The petition asks the FCC to define an automatic telephone dialing system as one that uses a random or sequential number generator without any human intervention and the functions must be active at the time the call is made. If human intervention is required, then the equipment is not considered to be automatic.

"There's an opportunity here, the chairman could do something that is far reaching that is not just limited to this petition. He could use this as his opportunity to take some big action relating to the TCPA," Walsh said.

Violations can be costly. Damages are set at a minimum of $500 per call or per text and the courts can triple that for a knowing or willful violation. And that's what makes TCPA low-hanging fruit for the plaintiffs' bar.

"It's just another instance where the legislation is stale. Congress has been too busy or too paralyzed or too whatever's going on in D.C. to pay attention to providing a clear definition to accommodate current practice and legitimate business needs," said Jordan Dorchuck, the executive vice president and chief compliance officer at BSI Financial Services, a subservicer.

"So the cost to service [mortgages] increases and ultimately it comes out in the wash somewhere because servicers have to spend a lot of money to do it the right way. The 2015 ruling was using an ax instead of a scalpel to fix a problem."

In July 2017, Ocwen Financial Corp. agreed to settle two TCPA cases for a combined $17.5 million.

"While the company believes that it had sound legal and factual defenses, Ocwen agreed to this settlement to avoid the uncertain outcome of litigation and the additional expense and demands on the time of its senior management that such litigation would involve," spokesman John Lovallo said in a statement.

But last November, RoundPoint Mortgage Servicing Corp. won a bench trial in the U.S. District Court for the Middle District of Florida. The judge ruled the plaintiff had provided prior consent to be called. A footnote in the ruling said the plaintiff, Larry Harrington, had previously won two TCPA cases and was awarded damages of $123,500 and $15,000.

TCPA actions have increased across all industries to 4,392 last year (after peaking at 4,860 in 2016) from just 14 in 2007, according to the consulting firm WebRecon. In the first three months of 2018, 954 TCPA cases were filed, a decline of 21% from the same period in 2017.

Even if the petition is successful, lenders shouldn't become complacent about TCPA compliance. Consent — whether it was given in the first place and/or properly revoked — remains a path for plaintiff's attorneys to start proceedings, Walsh said.

Meanwhile, Rep. Frank Pallone, D-N.J., the ranking member of the House Energy and Commerce Committee, has proposed the Stopping Bad Robocalls Act, which if passed and signed into law, could once again make TCPA compliance difficult.

"The Stopping Bad Robocalls Act would empower the FCC and the Federal Trade Commission to put an end to the annoying robocalls consumers face day in and day out," Pallone said in a press release. "Unfortunately, robocalls are proliferating and our agencies need new tools and authorities for the 21st century to better protect consumers from the abusive practices robocallers are employing." NMN

White House Looks to Extend Mulvaney's CFPB Tenure Until the End of the Year or Longer

By Kate Berry

The White House is dragging out the nomination of a permanent director for the Consumer Financial Protection Bureau to ensure that acting CFPB Director Mick Mulvaney calls the shots at the agency until the end of the year or longer, according to sources.

President Trump is expected to name J. Mark McWatters, the chairman of the National Credit Union Administration, as his CFPB nominee close to June 22, according to sources familiar with the situation.

McWatters' nomination has long been rumored, but waiting until late June would also maximize the tenure of Mulvaney, who has moved aggressively to reshape the agency. Under the Federal Vacancies Reform Act, Mulvaney can only serve for six months — a deadline up in late June — unless a permanent successor is nominated. Once that nomination is made, however, the acting appointee can stay in office as long as it is pending, a period that could extend for months.

That would leave Mulvaney in office at least for the remainder of the year given likely Senate delays in approving any CFPB nominee. It might also provide incentive for Democrats to try and move faster on a McWatters nomination, given their opposition to Mulvaney's agenda.

"The Democratic resistance to Mulvaney makes for softer deadlines because at some point the Democrats might have to consider a Republican nominee just to replace Mulvaney," said Charles Gabriel, the president of Capital Alpha Partners, an independent research firm.

Yet Gabriel added that the apparent White House strategy has risks. If the White House fails to name a permanent director by the June deadline, it could face a legal challenge to Mulvaney's appointment. Meanwhile, if a permanent director is nominated but not confirmed by the end of the year, and the Senate changes hands in a Democratic wave in the midterm elections, it is unclear how the administration would proceed.

"If they want to keep Mulvaney there, the best thing to do is to nominate a permanent director before the end of June, but they have to move somebody who they could confirm before November because the Democrats could freeze the nomination," Gabriel said.

The White House did not immediately respond to a request for comment.

The confirmation process for all nominees has become so long and contentious that in this case the White House is using it to their advantage. By keeping Mulvaney in place, they allow him to continue to drastically revamp the agency, pulling back on rulemaking and enforcement activities.

McWatters, by contrast, is viewed as more of a pragmatist than an ideologue. Though he has the support of House Financial Services Committee Chairman Jeb Hensarling, McWatters has also worked directly with Sen. Elizabeth Warren, D-Mass., the bureau's staunchest defender and a harsh critic of Mulvaney's policies. (They both served together on the Congressional Oversight Panel for the Troubled Asset Relief Program following the financial crisis.)

Still, lawmakers would likely zero in on McWatters' views on the CFPB's governance, his thoughts on Mulvaney's actions at the bureau, and how he would navigate "the holy war between banks and credit unions," said Isaac Boltansky, director of policy research at Compass Point Research & Trading.

"Any nominee for the CFPB directorship would face a contentious hearing given that the bureau is such a lightning rod, but I think that McWatters has the background and temperament necessary to win confirmation," Boltansky said.

If McWatters is the eventual nominee, his confirmation process could pry open old wounds that pit traditional banks against tax-exempt credit unions. The agency he currently leads is at times viewed as an advocate for the credit union sector as opposed to a government regulator. As NCUA chair, he requested that the CFPB carve out all credit unions from the agency's regulations.

A CFPB nominee would have to be confirmed by the Senate Banking Committee, a process that could be relatively quick if the nomination won broad support. But a vote on the Senate floor is a different matter. If even one senator requests full debate on the nomination, it would take 30 hours of floor time, which, given the nature of the legislative calendar, could take two weeks. That time is hard to find given the other nominations Senate leaders are trying to move.

Trump picked Mulvaney, who is also the White House budget director, as acting director of the CFPB in late November. He replaced Richard Cordray, who resigned to run for governor of Ohio.

Since coming aboard, Mulvaney has reversed the CFPB's course that had been set in motion by Cordray and Warren. He has reopened the agency's payday lending rule, floated the idea of changing the CFPB's name, temporarily frozen data collection efforts, proposed ending public access to the agency's consumer complaint database and ordered a top-to-bottom review of all of the agency's processes, among other things.

Some in the banking industry initially opposed the idea of McWatters running the CFPB when he was first floated, due to his having backed a proposal that credit unions not be subject to full CFPB oversight. NMN

Expanding QM

Anticipated changes to the qualified mortgage rule will give lenders more options and force them to rethink their views on risk

By Brad Finkelstein

With the Consumer Financial Protection Bureau in the midst of reviewing the qualified mortgage rule, mortgage lenders and the secondary market are closely watching to see if the more industry-friendly bureau will loosen some of the consumer protections established by the Dodd-Frank Act provision.

The result could be increased secondary market options for lenders, particularly if more loans meet the criteria of QM's safe harbor, which protects lenders from borrower legal challenges that a lender didn't follow the ability-to-repay rule.

Right now, the secondary market is perceived as having two flavors: the loan meets the qualified mortgage test or it doesn't. In the four years since the qualified mortgage rule have been in effect, an overwhelming number of loans originated has been in the safe harbor it provides to lenders.

The simplest and easiest way to stay in that harbor is to originate loans that are sold to Fannie Mae or Freddie Mac. Loans sold to the government-sponsored enterprises are automatically deemed to be a qualified mortgage because of what is known as "the patch." Similarly, all government-guaranteed mortgages currently receive automatic QM status.

That's given the GSEs and loans originated for sale in Ginnie Mae securities a stranglehold on the QM market. And from a sales perspective, having fewer potential buyers doesn't necessarily provide the optimal price for the loan.

But absent further action either by the CFPB or Congress, the patch is set to expire when Fannie Mae and Freddie Max exit their government conservatorship or on Jan. 10, 2021, whichever comes first.

Meanwhile, the nascent non-qualified mortgage market sprung up because there are many consumers who do not meet either conforming or government loan program underwriting guidelines, but would still be responsible borrowers. In three short years, the volume of securitizations of non-QM loans has grown exponentially and so far, has been expected to do so in the near term.

Non-QM is a broad category with a number of variations, unlike the plain-vanilla conforming lending. However, there are some options starting to creep in that are providing variety to the qualified mortgage market. That includes taking loans that are agency eligible into the private-label market because the seller can get a better price for them.

That changes the real dividing line for a mortgage lender's origination and exit strategy. Rather than making secondary market execution decisions based on whether the loan qualifies for the QM safe harbor, lenders may be better served evaluating whether the loan qualifies for purchase by Fannie Mae and Freddie Mac. In that context, even with a broader definition of what is a qualified mortgage, the nonagency space is going to expand as the market moves to serve those borrowers who couldn't get loans because lenders would not go outside the safe harbor.

In essence, the conventional mortgage secondary market could develop into a number of boxes, like agency QM; nonagency QM; agency-eligible private-label QM; and nonagency non-QM.

That variety could bring more investors to the market — and having more demand will likely mean better pricing, and profitability, for lenders.

MATTHEW LAZNICKA

After several years of little to no volume, non-QM originations and securitizations started to see significant levels of activity in 2017.

Only $369 million of non-QM mortgage-backed securities were issued in 2015, according to Nomura Securities. But year-over-year growth has been exponential. There was $990 million of issuance in 2016 and $3.9 billion in 2017.

And investors are bringing a variety of non-QM products to market, according to AllRegs, the investor product and underwriting guideline repository owned by Ellie Mae. About 26% of the investors that publish products on AllRegs Online added non-QM programs in 2017, representing nearly 25% of all new loan programs added to the platform last year.

Lenders originated between $7 billion and $9 billion in non-QM loans in 2017, more than double 2016's volume, Nomura estimates. And in 2018, non-QM securitization volume is projected to be between $10 billion and $11 billion, with originations in the $15 billion to $18 billion range.

Using 2004 as its base year — the last year before the subprime market became extremely frothy — Nomura extrapolated the growth opportunity for the non-QM market. It found non-QM loans to borrowers previously served by the Alt-A mortgage market could reach $100 billion in 10 years, while loans to borrowers with credit scores between 650 and 700 could generate an additional $40 billion to $60 billion in volume over the same time period.

However, those estimates do not account for any changes to the QM rule that can shift the market distribution. And based on recent comments from the CFPB's acting director, Mick Mulvaney, a QM change is inevitable.

In June 2017 — while the agency was still run by Richard Cordray — the CFPB solicited comments for a Dodd-Frank Act mandated review for both the QM rule and the ability-to-repay standard. The act provides the CFPB with broad statutory authority to amend the QM definition, said Laurence Platt, an attorney with Mayer Brown who represents mortgage companies.

The QM review is part of the five-year lookbacks on all Dodd-Frank Act provisions. As part of the review process, there were a total of 485 comments, with many that called for changes to the points and fees restrictions while others called for raising the debt-to-income ratio and/or changing documentation requirements.

"Virtually all of those could be handled through new rulemaking if the bureau wants to," Platt said.

When Dodd-Frank passed, Democrats controlled Congress and the White House, and the provision's supporters likely envisioned the CFPB using that authority to further tighten lending standards, not to broaden them.

The comments are asking for small changes to the rule. "That's what I call playing around the edges or playing around the margins, rather than, to use a basketball phrase, taking the ball to the hoop and trying to get it eliminated, rather than limiting its applicability," Platt said.

Mulvaney recently declared he wants to "bring some sanity" to the market, including significant changes to the QM rule. Platt compared Mulvaney's remarks to those of Tom Cruise's character in "Jerry Maguire," when he tells his client "help me help you." In other words, Mulvaney wants to make changes, but he needs more comments from the industry for direction.

In the QM request, "the responses were muted, modest. Notwithstanding the statutory provision, the CFPB has authority to completely eliminate the total points and fee test. So why argue about what should be in the test when you can get rid of the whole test?" Platt continued.

And other QM changes could come from Congress. The regulatory reform bill already approved by the Senate and expected to pass the House contains a provision relaxing QM for portfolio loans at lenders with under $10 billion in assets.

Since the standard became effective, QM lending has become synonymous with mortgages purchased by the GSEs or guaranteed by government agencies like the Federal Housing Administration and Department of Veterans Affairs.

The recent growth in the non-QM market and concurrently, in private-label securitizations, is a result of participants across the loan life cycle becoming more comfortable with the risk characteristics of these loans, especially as interest rates rise.

There are lenders that have or will securitize agency-eligible mortgages in the private-label market now because they can get a better execution. A change to the QM definition could provide a boost to those securitizations.

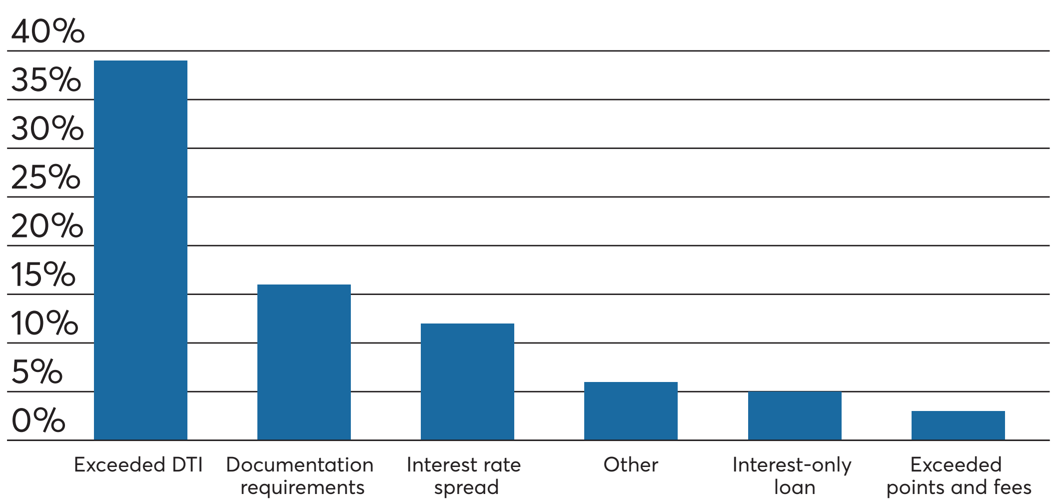
The current administration would like to pull back the government guarantee on certain types of loans such as cash-out refinancings, high-balance loans, second home mortgages and investor loans, said Peter Norden, CEO of HomeBridge Financial Services. The Trump administration would prefer the private sector own the paper and take the risk, rather than the government giving an implied or explicit guarantee, he added.

It is one of the reasons HomeBridge is working on a deal where it would securitize otherwise agency-eligible paper in the private market.

HomeBridge wouldn't be the first. Some recent private-label deals that included agency-eligible paper were from loanDepot, which did a $299.8

Non-QM status

Banks cited the following as the leading reasons on how a loan became a non-qualified mortgage



Source: American Bankers Association

million securitization in March made up of 226 prime jumbo loans and 227 high-balance GSE-eligible loans, while Flagstar did a $329 million transaction consisting of 1,077 agency-eligible loans secured by investment properties.

"The private-label execution on some QM loans that qualify for the agencies that have a lot of loan-level adjusters can be as good as or better than the agencies," Norden said.

Nor does he see an expanded definition of the QM rule as a zero-sum game. In a changed environment, both the non-QM and expanded definition QM private-label markets can thrive.

"The paper that is eligible for the agencies will in fact be cut back and become part of the private-label securitization market going forward," Norden said. "And whether or not they change the definition of QM on those loans or not remains to be seen."

What he is wary of, though, is the potential size of the market for private-label securitizations of lower-credit-quality mortgages.

"I, for one, have no desire to go back to where we were prior to 2007 from an underwriting perspective because I do not think that would bode very well for the entire mortgage banking industry or for the consumer," Norden said.

There are people who have lower credit scores but also have the income to make the payments and they should be able to get a loan. But those loans should not be combined with a high loan-to-value ratio.

"I am hoping we have some amount of common sense in this business going forward and that we really are driven towards helping the consumer in any way we possibly can as well as helping our overall mortgage-banking community," Norden said.

The clients of LoanScorecard do not look at the market split as being between QM-eligible and non-QM-eligible paper. "The clients we work with, it is not about non-QM as it is about nonagency," said Ben Wu, executive director of the automated underwriting system vendor that's a division of Calyx Software. "How much of the market is left underserved, where these nonagency players and product options may come into play."

If the CFPB is willing to loosen what it defines as a QM loan, "that would help the nonagency players more because more of their loans would have that legal protection that many believe exists. So in that sense, the expansion of the QM definition, that QM implied protection, actually helps nonagency lending," Wu said.

Carrington Mortgage Services started concentrating on originating mortgages to borrowers with credit scores under 640 about four years ago, serving them through government-guaranteed loan programs. It has now rolled out a suite of non-QM products to lower-credit-score borrowers.

"It's going to turn out differently because we learned something from the last decade. We're going to make sure our borrowers understand what they're getting themselves into," said Carrington President Ray Brousseau.

The default risk falls on Carrington because it will retain these loans through affiliates and service them in-house. It has a long-term incentive to ensure these loans continue to perform.

When it went into the government space, it introduced a proprietary credit learning program called My Loan Detail. Borrowers go through answering a series of questions about the loan transaction, the terms of the loan, their income and even the consequences if they don't make payments.

Any changes to QM should not impact the Carrington program, added Carrington Executive Vice President Rick Sharga. "It depends on what aspects of the QM rules are relaxed, and I can't imagine they'd be relaxed so significantly that we'd see a significant impact on the volume of loans in the non-QM space.

"There is nothing in the QM rules or in the ATR guidelines that says a low FICO score borrower can't get a loan. There is no FICO minimum for a QM loan. The problem is that most lenders, particularly the depository banks, decided not to participate with those borrowers," he said.

If the CFPB widened the QM tent, it would theoretically be a net benefit to lenders like Carrington, said Sharga. But on other hand, it also might increase the number of lenders that participate in the lower-credit-score space and make it more difficult to maintain market share.

"There's still a comfort level that whatever the expansion in the credit spectrum and in the requirement spectrum by the CFPB is, good loans can still get made," said John Vella, chief revenue officer of Altisource Portfolio Solutions. "Because let's face it, the CFPB is probably seeing it too."

And that is a positive for the entire nonagency spectrum. "With more volume, there's more incentive for the secondary market and there's more financial upside for all the players in the entire spectrum," Vella said, explaining that increased volume offsets costs and brings in revenue for everyone involved in the transaction.

Verus Mortgage Capital is a correspondent aggregator of whole loans affiliated with investment management firm Invictus Capital Partners. Its market is "expanded nonagency," including jumbo loans, self-employed bank statement borrowers, single-family rental and fix-and-flip loans, said Dane Smith, president of the Washington, D.C.-based firm.

It has 145 approved clients with 72 active sellers. Verus purchased about $2 billion in closed loans, both QM and non-QM, since the company started in business and it did $400 million in acquisitions in the first quarter of this year.

"The QM designation doesn't have a huge impact.… We're looking for well-underwritten borrowers with attractive credit risk profiles," said Smith.

Securitization is the way that many lenders get term financing on a non-QM loan because of the risk retention requirements.

"People used to think of securitization as a risk transfer; it's no longer a risk transfer, it's a financing," Smith said. "There's significant skin in the game; the non-QM issuers have significant skin in the game today."

There is a secondary market developing because "liquidity begets more liquidity. As more buyers enter the market, the more comfortable originators become originating," he said.

Yet the non-QM business is at a crossroads. In 2017, the non-QM borrower was someone who applied for a loan and was surprised if an application was denied, Smith said. Now, it's starting to consist of people who are discovering they have access to credit after all of the negative news of the past few years.

"We're moving into a period where people will start actively sourcing and generating leads around this space. We're starting to see that with our customers," Smith said. This shift will continue through this year and into next. "It's takes a while for this industry to move forward."

If the QM rules are changed on the margins, conforming lenders could open their underwriting box. But none of the proposed changes raised in the comment process impact Verus' business. If the GSE patch ended, it "actually creates more opportunity for us," Smith said, as fewer loans would be sold to Fannie Mae and Freddie Mac.

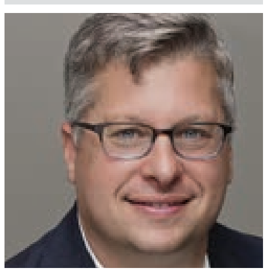
"ATR is really the guiding light for the whole industry," he said. The QM rule establishes the legal threshold for which someone needs to prove the case to challenge whether the lender properly assessed the ability to repay. "But ATR itself is essentially the metric." NMN

Big Data Means Small Margins in Mortgage Industry of the Future

Automating the mortgage process will force tighter margins, but drive higher volume, for lenders.

By Jeremy Sicklick

The big story in mortgages today is the rise in mortgage loan rates. For the first time in years, we're seeing 30-year fixed mortgage rates consistently above 4%, and a 5% rate is in sight. Higher rates make sense if you look at it one way: the economy is strong, inflation is climbing, and it's safe to expect Federal Reserve hikes in 2018 and 2019.



Industry veterans might be sighing with relief. In the 10 years since the burst of the housing bubble, we've seen a slow economic recovery, a federal funds rate stuck at 0, and 30-year mortgage rates in the high 3% range for fixed-rate loans and lower for floating-rate loans. Is this the long-awaited return to normalcy, even if that normalcy comes with stricter lending standards?

The answer, I'm afraid, is no. Macro factors are pushing mortgage rates higher, but another element is going to start influencing mortgage rates, too: technology. And the direction of technology's pressure on rates only goes in one direction — down. It's not inconceivable that, 10 years from now, we'll be remembering a 30-year fixed rate of 3.75% as the "good old days" of mortgage margin.

As rates have risen in the last 12 months, many people have pointed out that rates are still low by historical standards. And they're right: when I bought my first home in the early 2000s, I would have killed for a rate that was under 5%. But it's worth asking if those historical standards still apply in 2018?

The fact is that the historical standards emerged from a real estate and mortgage industry that is based primarily on gut decisions — people fall in love with homes, or think they've got just the opportunity to make a quick buck to pay for next year's vacation. The problem is that gut thinking applies collectively to everyone, not just individual homebuyers.

I got into the business of real estate in 2009. My goal was to help clean up the mess that all these gut-led investment decisions had created. There were investors buying up the homes of NINJA (no income, no job, no assets) borrowers from foreclosure and dealing with ripple effects from the residential real estate "bubble" popping.

It's not like the lenders had no information about the properties or the buyers. Credit scores were available, and property details and records existed in a multitude of bank, city and state offices. But the technology to collect this information and make sense of it wasn't available. So we relied on human judgment … and, well, we all know how that turned out. Today, the technology is here. The disparate data sources are beginning to collaborate and standardize how data is entered and processed in the cloud. Financial institutions have gotten smart about allowing access to data and systems through APIs. Most importantly, artificial intelligence is advanced enough to effectively analyze data and make objective, data-driven decisions.

This is all heading to a place that can be summed up with a single word: automation. Many of the tasks that humans performed to help a buyer obtain a mortgage — from assessing a property's value to pinpointing the buyer's creditworthiness to sharing documents for buyer and seller to sign — can now be done using software. That's making the industry faster. Homeowners can get a loan in a few days, rather than weeks. More and better data will also mean more and better loans, as valuations become more accurate and faster appraisals send earlier alerts to lenders and buyers about any potential loan issues.

But this trend will also mean lower rates. Today, the supply chain of a real estate transaction eats up about 12% (3% buyers agent commission, 3% sellers agent commission, 2% closing costs and 4% loan origination costs) of the money exchanged. That 12% pays the mortgage broker, the real estate agent, and, of course, the lender. That number is going to fall by at least a third in the next 10 years — and mortgage lenders will see their shares fall the most.

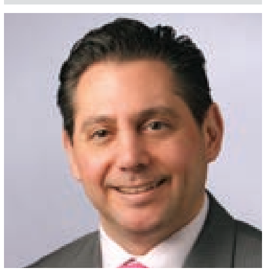
Jeremy Sicklick is co-founder and CEO at HouseCanary in San Francisco.

Why Lenders Should Jump at Easier Fix for Back Pay Disputes

A Department of Labor pilot program will let lenders resolve wage and hour liabilities without exposing themselves to additional FLSA risks.

By Ari Karen

For the better part of the last decade, lenders have been struggling (often in vain) to comply with the Fair Labor Standards Act. However, curing these problems has often gone hand-in-hand with acknowledging significant liabilities and the risk that well intentioned changes could spark litigation.



Now, the U.S. Department of Labor has announced the PAID (Payroll Audit Independent Determination) program: a six-month pilot program where employers can correct past wrongs without having to pay liquidated damages and attorneys' fees. In essence, the PAID program allows employers to address and discharge existing liabilities without the threat of litigation or liquidated damages.

For lenders, PAID may provide a respite from the swarm of wage-hour litigation that has enveloped the industry. Because the FLSA provides plaintiffs lawyers easy paths toward conditional certification and notice, liquidated damages and attorneys' fees, as well as employee friendly presumptions, lenders facing these cases are often in an unfavorable position from the inception. As such, millions have been recovered by loan officers against lenders under the FLSA for minimum wage and overtime.

Despite this, lenders have continued to struggle in terms of FLSA compliance. There are many reasons for this. First, the job of loan officers is hard to contain to set hours because of its sales-related nature. In other words, is a loan officer working when during happy hour with friends they are introduced to someone who is looking to buy a house? Indeed, the never ending job of loan officers makes determining "work hours" a mere folly.

Additionally, the manner in which overtime is calculated — inclusive of commissions and non-discretionary bonuses — renders payroll nearly impossible. On top of all this, loan officers see their position as a commissioned sales job and thus recording hours is at best not a priority and most often viewed as a nuisance they are reluctant to engage in. Yet, even with all of these challenges, one of the biggest reasons for FLSA liabilities is that lenders rarely understand the nuances of the FLSA and are other unaware of risks or believe there are few ways to manage them.

PAID gives lenders a chance to determine and eliminate their risks and correct problems moving forward. Under the program, employers who are not the subject of a pending investigation or FLSA lawsuit can calculate the wages owed and request participation in the program. If approved by the Department of Labor, all back wages would be paid subject to a settlement agreement for individual employees to sign. While employees are not required to do so and can essentially opt out of receiving the monies, most would likely accept the bird in hand, enabling the employer to avoid class-action lawsuits before they start and at a substantially lower cost.

The details of this program are not yet fully known. Importantly, employers need to discern the effect on state law claims, and how and whether the DOL can use the information moving forward. Despite this, lenders — many of whom are sitting on substantial liability — should seriously consider re-evaluating their pay practices and curing past wrongs.

The PAID program is only slated to last six months. After it is over, the heightened attention it will bring to pay practices will likely lead to more lawsuits, as employees who begin receiving checks in the mail from one former employer may realize another did not pay them correctly.

Accordingly, correcting things moving forward is potentially more critical now than ever, even if an employer does not want to take advantage of this opportunity to fix the "sins of the past." While some believe ignorance is bliss, in this case what you decide not to know may prove costly if the chance to resolve a significant liability is missed at the same time its existence becomes far more transparent.

Ari Karen is a principal at Offit Kurman and CEO of Strategic Compliance Partners.

People

CALIFORNIA

SHERMAN OAKS

Matic has tapped **Shahrzad "Shaz" Kojouri** as vice president of legal and compliance. A licensed attorney with more than 15 years of experience in corporate compliance, Kojouri will have responsibility over corporate governance, regulatory compliance and vendor management at Matic.

Prior to joining Matic, she was assistant general counsel for nonprofit student loan provider AccessLex Institute.

IOWA

DES MOINES

Fintech startup **LenderClose** has hired **Brad Bach** to serve as vice president of sales. Bach brings more than 15 years of marketing, sales and financial services experience to the LenderClose team.

He has held mortgage and consumer lending roles with Wells Fargo and HSBC and served as a senior financial advisor for Principal Financial Group.

NEW JERSEY

CRANBURY

Visionet Systems Inc. has hired **John Spencer** as vice president, consumer lending.

Spencer, who brings over 30 years of mortgage industry experience, most recently served with Fannie Mae as a senior technology account manager.

Before that he served as senior program manager for Downey Savings & Loan.

Previous to these positions, Spencer was a senior vice president of business development for Fidelity National Financial and vice president and enterprise program manager in the IT department for First American/CoreLogic.

UTAH

SALT LAKE CITY

Primary Residential Mortgage Inc. has hired **Eun "Karen" Cohen** as a loan officer in its Columbia, Md., branch.

Prior to joining PRMI, she worked as an international business development manager in New York and also worked as a real estate agent for seven years in Maryland.

Primary Residential Mortgage Inc. has also promoted **Michael Jenkins** from sales assistant to loan officer in its Larkspur, Calif., branch.

Jenkins has nearly 27 years of experience in the financial industry working with homebuilders and lending companies.

WISCONSIN

PEWAUKEE

National mortgage lender **Waterstone Mortgage Corp.** has hired **Nathan Vlazny** as vice president, underwriting at its Pewaukee-based corporate office.

Vlazny was previously the underwriting manager for the South Atlantic region of Academy Mortgage.

He has more than 15 years of experience in underwriting; 10 of those being in underwriting and operations leadership roles. NMN

MARKETPLACE

SUBSERVICING

12 Best Cities for Homebuyer Purchasing Power

Demand for housing has continued outpacing supply, putting upward pressure on home prices and creating affordability hurdles for consumers. Rising mortgage rates are also causing greater financial challenges for potential homeowners.

Here's a look at 12 cities where median home prices are under $200,000 and the combination of local wages and interest rates offer buyers the most purchasing power.

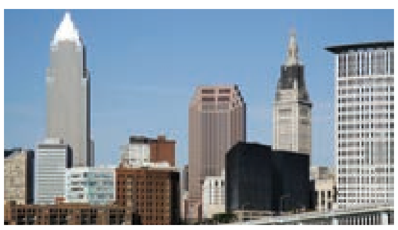
The data, from the February First American Real House Price Index, measures home price changes, taking local wages and mortgage rates into account "to better reflect consumers' purchasing power and capture the true cost of housing."

No. 5 Cincinnati, Ohio
RHPI: 63.92 (YoY 5.3%)
Median sale price: $150,000
House buying power: $341,609

No. 9 Charlotte, N.C.
RHPI: 73.7 (YoY 10.23%)
Median sale price: $198,250
House buying power: $313,738

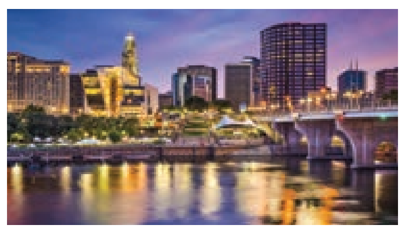
No. 6 St. Louis, Mo.
RHPI: 67.28 (YoY 2.32%)
Median sale price: $142,109
House buying power: $337,721

No. 10 Atlanta, Ga.
RHPI: 74.83 (YoY 6.88%)
Median sale price: $200,000
House buying power: $366,109

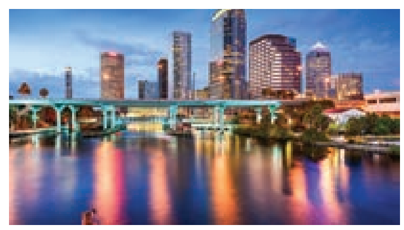


No. 1 Cleveland, Ohio
RHPI: 48.2 (YoY 6.27%)
Median sale price: $135,000
House buying power: $317,428

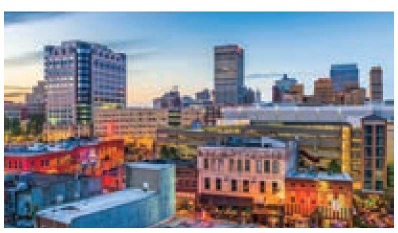
No. 3 Columbus, Ohio
RHPI: 60.62 (YoY 9.12%)
Median sale price: $174,900
House buying power: $344,488



No. 7 Hartford, Conn.
RHPI: 70.77 (YoY 0.82%)
Median sale price: $194,900
House buying power: $455,014

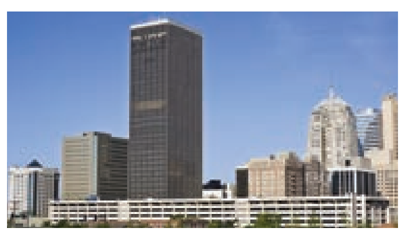


No. 11 Tampa, Fla.
RHPI: 74.9 (YoY 8.95%)
Median sale price: $190,000
House buying power: $301,361



No. 2 Memphis, Tenn.
RHPI: 54.67 (YoY 0.99%)
Median sale price: $148,000
House buying power: $299,869

No. 4 Pittsburgh, Pa.
RHPI: 63.55 (YoY -3.38%)
Median sale price: $150,500
House buying power: $328,155



No. 8 Oklahoma City, Okla.
RHPI: 71.55 (YoY 1.78%)
Median sale price: $160,000
House buying power: $304,799

No. 12 Detroit, Mich.
RHPI: 80.39 (YoY 4.9%)
Median sale price: $149,956
House buying power: $333,231