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Fannie and Freddie fade into the background

Hiring in the new residential mortgage world

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Executive Summary

Few industries have seen greater changes in the past decade than the residential mortgage business. Following the easy lending environment prior to 2008, the pendulum swung in the opposite direction where regulations ruled and only top-tier borrowers could qualify for home loans. The majority of these top-tier borrowers used the post-2008 years for refinances, not purchases.

As we move into 2015, we see two large trends emerging: Number one, the lending environment will balance out making it possible for first time homebuyers to qualify for reasonably leveraged mortgages. Number two, the bulk of the refinance boom is probably over and a longer sales cycle will be necessary as borrowers shop for houses, not loans.

Accustomed to the quick turn-around in years past, many mortgage professionals in the industry are not equipped for this longer sales cycle. Companies in the residential mortgage industry must change their hiring criteria to attract the talent that understands the changes ahead.

Mortgage Rules Loosen Up

The borrowing standards at banks have been at the highest levels in more than 20 years. By 2011, the average credit score of an approved mortgage was 750, and Fannie Mae raised its minimum to 620, up from 580 in 2009. The borrowing requirements banks imposed after the crash of the housing market prevented as many as 1.2 million loans from being processed in 2012. Refinancing provided most of banking's business until the rising cost of borrowing significantly cut demand and resulted in the loss of more than 25,000 mortgage jobs.

In early 2012, 73 percent of all mortgages were straight refinances. Today, there are more purchase mortgages than refinance mortgages, and that trend will most likely continue as rules are being loosened in this new mortgage arena. In March 2013, nearly 16 percent of mortgages went to borrowers with monthly debt obligations exceeding 43 percent of their pay, up from 13.4 percent in mid-2012. In addition, more than 23 percent went to buyers with credit scores less than 720, an increase from 15.6 percent in the same period.

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Recently, Fannie and Freddie announced an expansion in the number of loans that are exempt from putback requests. Under these new rules, loans will be spared if borrowers make 34 of their first 36 payments in a timely manner. Previously they were required to avoid any delinquency for the first three years. In May 2013, the Federal Housing Administration (FHA) issued a "Blueprint for Access," designed to expand access to credit for underserved borrowers. Concurrently the department of Housing and Urban Development announced the formation of Homeowners Armed with Knowledge (HAWK), a pilot program to incorporate counseling into the process for borrowers using FHA insured financing. The nation's biggest lender, Wells Fargo, also eased its rules on lending in that same time period, cutting its minimum credit score for borrowers of Fannie and Freddie backed loans to 620 from 660. The step followed moves by smaller lenders, such as the U.S. unit of Canada's Toronto-Dominion Bank (TD), which lowered down payments to 3 percent without requiring mortgage insurance for some loans.

"Alternative Income Verification" is being used by Western Bancorp to bypass the review of tax returns and pay stubs, instead using software that turns information on bank statements into data, analyzing cash flow to vet and qualify incomes for the self-employed applicant. Currently these loans are available only to borrowers with a down payment of at least 35 percent, but that is on track to be lowered to 30 percent. In April 2013 the TD Bank unit lowered down payments on loans from 5 percent to 3 percent, and do not require private or FHA insurance. In addition, the down payment can come from gifts, governmental programs or nonprofits.

Lenders are starting to become more accommodating again on jumbo loans, approving borrowers who don't adhere to the usual standards for income documentation or credit score minimums, but who can qualify based on other criteria, such as long histories of working successfully within their industry, or significant funds in reserve. Capital gains from stocks are sometimes factored in, and counted as income, along with stock grants received as compensation by the borrower.

A More Stable Mortgage Environment

The kinds of loans made with abandon during the boom - no down payments, no documentation of income, rates that doubled in two years, etc. - are not making a reappearance, and indeed some of the largest lenders, such as JPMorgan, Bank of America and Citigroup, are not adjusting their standards at all. "The regulatory environment now is just so much stricter, there's not much you can do," said Brian Simon, chief operating officer of New Penn Financial, the lender owned by mortgage-bond pioneer Lewis Ranieri's Shellpoint Partners LLC. "It's generally not our game plan to chase volume by loosening up on quality."

Others see the relaxing of standards as a realistic readjustment of what was an over-correction. Peter Grabel, a senior loan originator with Luxury Mortgage in Stamford, Conn., sees it as more of a common-sense approach, "not wild and crazy." Lenders are "just sort of unwinding the things that might have been overly onerous," he said.

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Programs put into place, and mentioned earlier in this paper, include HAWK and the Blueprint for Access, both designed to educate and counsel buyers as they navigate the mortgage process, improving their budgeting skills and housing decisions. The HUD-approved counseling, through independent nonprofits, qualifies participants for savings on their FHA-insured loans of approximately $325 a year – nearly $9,800 over the life of their loan. Other benefits to the borrower and their lenders include a 50 basis point reduction in the upfront FHA mortgage insurance premium (MIP) and a 10 basis point reduction in the annual FHA MIP for those who complete housing counseling before signing a contract to purchase a home and complete additional pre-closing housing counseling. These initiatives are designed to provide greater clarity and transparency to FHA approved lenders and encourage lending to qualified borrowers across the credit spectrum.

There is a genuine interest in doing business with borrowers who qualify in ways other than the norm, but this time with checks and balances in place to do so responsibly for the benefit of all involved.

Increased Lending, the Changing Landscape and Talent Who Will Handle It

Mark Zandi, the chief economist for Moody's Analytics, estimates that more than 12.5 million otherwise qualified people have been shut out of the market, and they could conceivably be back in soon. Large banks are also looking at a wider range of borrowers because rising mortgage rates have affected much of their refinancing business. The Mortgage Bankers Association (MBA) expects that purchase originations will increase to $723 billion in 2014, up from $661 billion in 2013. In contrast, refinances are expected to drop to $463 billion from $1.08 trillion in 2013. And for 2015, they forecast purchase originations of $796 billion and refinance originations of $433 billion for a total of $1.2 trillion. Jay Brinkmann, MBA's chief economist and senior vice president for research and education states "We are projecting home purchase originations will increase in 2014 due largely to gains in home sales and home prices. We expect to see a decline in the share of sales paid for with cash, and higher average LTVs on purchase mortgages, due to the rise in home prices. We expect mortgage rates will increase above 5 percent in 2014 and then increase further to 5.5 percent by the end of 2015." They also state "The mortgage market will continue to undergo significant change in 2014 as banks refine loan products, underwriting requirements, and other aspects of mortgage operations to ensure compliance with the Consumer Financial Protection Bureau's new mortgage regulations. Strong compliance systems, coupled with improved efficiencies, will be key to the ability of banks to continue to meet the credit needs of their communities."

Restructuring has occurred in various sectors of the financial services industry as relates to real estate. Digital Risk LLC, a mortgage-analysis company in Florida, recently laid-off around 40 percent of its employees, though many are being reclassified as contract, temporary or part-time. In some instances total elimination of jobs would violate economic-incentive agreements with state and local governments.

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Among the many changes in the mortgage landscape, detailed by the American Banking Association in March 2014, in which this talent must operate are the CFPB's new mortgage regulations. They fundamentally change virtually all aspects of the mortgage business, establish new lending and servicing standards for all industry participants, and protect consumers. However, the new rules are extraordinarily complicated and are subject to ongoing, extensive amendments. Banks have been working to comply with the new requirements, but the volume and complexity of the rules have created uncertainty that participants are working to address. In 2014, banks that finance and service residential real estate transactions will continue to make refinement of compliance and technology systems a top priority. Areas that this talent will need to effectively address, as per the CFPB, include:

- **Ability-to-Repay and Qualified Mortgages:** CFPB regulations require creditors determine that a borrower is reasonably able to repay the loan based on verified, documented information. Minimum requirements for making these determinations and guidance on basic underwriting factors are spelled out. The CFPB has deemed Qualified Mortgage (QM) loans to be safe for consumers and so have special protections from legal challenges. The regulations surrounding Ability-to-Repay and QM are highly technical and complex because their varying levels of legal protection and certain regulatory exemptions are based on a combination of lender characteristics, product pricing, loan features and other factors. The ABA expects the CFPB to amend and clarify the Ability-to-Repay and QM rules throughout 2014.
- **Non-Qualified Mortgages:** Future lending in this space is likely to be categorized non-QM rather than prime or subprime. Non-QM lenders will have both more flexibility and more liability, but not all non-QM loans will be subprime.
- **Servicing:** No longer an operational issue, servicing is a compliance issue and is subject to regulatory enforcement. The new rules address how payments are processed, notifications of rate changes and error resolution, monthly statements and a highly detailed timeline for communicating with delinquent borrowers, and processing loss mitigation applications. The ABA expects that CFPB will issue additional servicing-related amendments and clarifications in 2014.
- **Loan Originator Compensation:** The CFPB rules build upon existing restrictions on compensation and varies based on loan terms and conditions. The rule also revises previous regulations on loan originator compensation, including payments based on a proxy for a term of a transaction and permissibility of bonuses or other profit-based compensation packages. Originators also must meet new qualification and screening standards – including character and financial responsibility reviews, criminal background checks and training requirements. The rule also prohibits mandatory arbitration for disputes related to mortgage loans and the practice of increasing loan amounts to cover credit insurance premiums.

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The "Sane Subprime": These are not the subprime loans that were a prime cause of the financial crisis, but loans made under much more careful control.

- **Second-chance Mortgages:** Second-chance Mortgages are qualified as subprime. But as only about 0.5 percent of new home loans are subprime today, according to Black Knight Financial Services, and those loans are not enough to bundle into securities for sale to investors. This means the lenders, largely financed by private investors, are for the most part keeping the loans on their books or selling them one by one, an incentive to keep the quality high.

This business will be handled and processed in an environment far different from that which preceded the collapse and the recent refinance boom of the last several years. The talent required to manage these sales and sales teams has changed, as well. Based on financial services and real estate industry publications, thought and opinion pieces, and interviews with long practicing professionals in those fields, the characteristics and skill sets of the following positions could change accordingly:

Talent needed going forward

Chief Operating Officers/VP Operations

Operations personnel must change their strategies and prepare for a longer sales cycle across most of their divisions. With longer sales cycles and more specifically targeted products, building and nurturing relationships with other professionals will be crucial. The quick refinance loans which worked for "A" borrowers during the past several years will give way to longer sales processes; this includes first time buyers who shop around for extended periods of time.

Chief Marketing Officers/Sales Managers/Sales Teams

Anyone involved in attracting new clients must broaden their group of potential clients. Advertising in the Wall Street Journal or another avenue which targeted the highest demographic and Baby Boomers will no longer be the only routes to pursue new business. According to Forbes.com article "The Recession Generation" published July 30, 2014, Millennials control $2 trillion of liquid assets and will control $7 trillion of liquid assets by 2020. How can sales reach these first-time home buyers?

Additionally, demographics which have sat out of the housing market the past half-decade will be prime to re-enter. Timid and trepid after being burnt years ago, a longer sales cycle will be needed to lure them back into the market.

And within this new paradigm, talent once found, recruited and hired, will need to have a management developed process in place to quickly and effectively on-board these employees. The purchase of a home represents an investment in building individual, family and socioeconomic wealth, upward mobility and security. Likewise, the recruiting, hiring and training of these new real estate executives must be seen as a real investment in long-term, sustainable profitability.

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