Secondary Marketing Resources

Secondary Marketing Solutions For Credit Unions

November 13, 2014

Presented to Florida CUREN

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Agenda

- Rate Setting/Pricing Challenges
- Interest Rate Hedging Challenges
- Secondary Market Challenges

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Setting Rates

- Determine rates based on primary investor
  - Used for products for portfolio and intended for sale
- Increased focus on market competitors
  - Not necessarily local, competitors members may use
- Most credit unions publish rates daily
  - More have processes to update rates later in the day
- Margins have moderated since the first quarter 2013
  - Still above levels prior to 2008
  - Average margins currently 100-120 bps

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Servicing Value Component

- Critical factor in pricing is valuing servicing
  - As much as 50% of income in servicing value
- Servicing value on new production around 100 bps
  - Will vary based on amount, term (product), cost
- Servicing value calculation: $100,000 30 year loan
  - $250 - $50 = $200 * 5 years = $1,000 (100 bps)
- Servicing value considerations in pricing
  - Impact on current servicing asset
  - Value of servicing for alternative products
    - No cost loans, premium rates

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Handling LLPAs

- Adjusting rate/points to reflect has been challenge
  - Many credit unions have been passing through as points
- Seen three different methods for incorporating
  - Divide LLPA point cost by 3/add result to rate
  - Use premium grids with rebate in 1/8ths over 0 point rate
  - Provide wholesale pricing type grid
- New POS/LOS providers have simplified
  - Avista/MortgageBot and Mortgage Cadence handle and allow simplified pricing
  - Facilitate including in points or rate

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Rate Sheets Are Evolving

- Rate sheets are changing to adapt to new originators
  - More credit unions are hiring experienced sales staff
  - Rate sheets are adapting to reflect this change
- More detailed pricing options are available
  - Moving from standard 0, 1, 2 point rates to market priced
  - Providing premium pricing by product – 3 or 4 rate tiers with rebate prices
  - Rebates are provided on portfolio and saleable loans
- Decreased Product Choices Since 2008
  - Primary new product has been 5/5 ARM

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Hedging Strategies

- More credit unions moving to selling on flow basis
  - Alternative is selling from portfolio
  - Results in interest rate risk, product risk, underwriting risk
- Mandatory delivery versus best efforts delivery
  - Best efforts minimizes fall out risk
  - Pricing can be significantly inferior to mandatory
  - Requires credit union to meet standard pull through ratios
- Effective mandatory sales requires fall out detail
  - Tools to measure fallout include overall, financial cost, loan characteristic fall out

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Portfolio Management

- Credit unions balance income needs with ALM
  - Very few earning assets besides mortgages
  - Mortgages have high interest rate/duration extension risks
- More credit unions using secondary to manage risk
  - Turning on and off sales of loans (15/20 year fixed)
  - Using secondary marketing to sell recent portfolio loans
  - Designating on a loan by loan basis to sell/retain
- Increased challenges to using to manage portfolio
  - Agencies require loans be sold within one year to qualify as current production
  - 120 day sale window regarding appraisal

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Expanding Investors

- Most clients are approved by Fannie and Freddie
  - Still differences: 10 year fixed/jumbo conforming pricing
  - Underwriting differences exist as well: 85% cash out
  - Freddie Mac pricing problems through refinance boom
- Ginnie Mae direct loan sales increasing
  - Outlet for FHA/VA/RD loans
  - Pricing better than conforming (0.25% or more to rate)
- More credit unions adding FHLB to list of investors
  - Allows credit unions increase income on lower credit risk loans
  - Limited recourse with higher loan premium

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Mortgage Lending Future

- In spite of short term changes, rates are going up
  - Fed Reserve anxious to end QE and increase rates
  - Employment growth will begin to drive wage increases
  - Stock market adjustment may result in lower rates in ST
- Will see tighter margins in the mortgage lending
  - Margins are still wide in a longer term perspective
  - Maintaining margins the result of aggressive cost cutting
- With higher rates, significantly less refinances
  - Purchase money loans will higher % of loans
  - Increase in first time homebuyer products

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Secondary Market Evolves

- Differentiate the credit and delivery functions
  - Ginnie Mae model: FHA manages credit risk
  - Credit risk in conforming include multiple players
    - Freddie Mac and Fannie Mae, expanding to include other players
- Common securitization platform in development
  - Security liquidity critical factor in execution
  - Goal to eventually begin offering single security
    - These would be backed by multiple credit enhancement providers
- Impact on smaller lenders critical
  - Most use cash execution
  - Securitization entity may offer options

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Questions and Discussion

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