MIAC®
Analytical Solutions for the Financial Industry
OPEN BOX TECHNOLOGY®

Spring/Summer Edition 2014

MIAC Perspectives

Whole Loan Market Overview- The Regulation Dichotomy

Anjali Kumar, VP, Whole Loan Sales/Trader

January 10th, 2014, brought about significant change to the mortgage industry nationwide with the Consumer Financial Protection Bureau's implementation of QM & QRM Regulation. The new QM and QRM rules and guidelines, imposed upon the entire lending industry, were designed to prevent lenders from providing high risk mortgage loans to borrowers.

Commercial Servicing Market Update

Dan Thomas, Managing Director, Client Solutions Group

All is well in Commercial Servicing Land. Underlying property values are increasing in most sectors, delinquencies are dropping and commercial servicers continue to add a significant amount of high quality, low note rate, high servicing fee commercial mortgage servicing rights (CMSRs) to their balance sheets. These new, low interest rate CMSRs are projected to be around for many years and will help stabilize the financials of the large and mid-sized commercial mortgage servicers during the eventual slow down in origination income.

The Need to Conduct a Data Quality Review on Bulk MSR Purchases

Kent Loehrke, Managing Director MDS, Mortgage Delivery Specialists - Part of the MIAC Group

It has never been more important for buyers of Mortgage Servicing Rights (MSRs) to conduct a formal due diligence of each portfolio they purchase. Over the last several months more and more Mortgage Servicing Rights have exchanged hands. MSR transaction volume has been steadily increasing due to strong demand and increasing prices. Mortgage companies, some who only recently decided to retain MSRs, have been forced to sell a portion of their MSR portfolios to generate revenue. As these non-traditional sellers enter the arena and new buyers enter the marketplace, a due diligence program is necessary.

Marketplace Lending: An Online Alternative to Traditional Banking

Brian Kearon Analyst, Borrower Analytics, Capital Markets Group
Jeffrey Fromer Sales Associate, Business Development
Eli Clark-Davis, Analyst, Business Development

Marketplace lending, formerly peer-to-peer (P2P) lending, has just turned a corner. The recent name change accurately describes the evolution of the industry over the past year. Renaud Laplanche, CEO of Lending Club, the world's largest marketplace lending platform, formally suggested calling the industry "marketplace lending" at the LendIt 2014 conference in May. Ron Suber, President of Prosper Marketplace, the second largest platform, was recently quoted in the NY Times saying a suitable name for the industry is "online consumer finance." Notice neither has the term "peer" in it.

Whole Loan Market Overview- The Regulation Dichotomy

January 10th, 2014, brought about significant change to the mortgage industry nationwide with the Consumer Financial Protection Bureau's implementation of QM & QRM Regulation. The new QM and QRM rules and guidelines, imposed upon the entire lending industry, were designed to prevent lenders from providing high risk mortgage loans to borrowers. While there is some gray area in the interpretation of some of these guidelines, the driving factor is clear: to protect the consumer from future default and foreclosure and subsequently avoiding another national housing meltdown.

Industry feedback surrounding these new rulings has been mixed and twofold. On one hand, lenders are being squeezed by the ongoing and seemingly endless rounds of regulations being imposed upon them since the significant housing downturn that started approximately six or seven years ago – and has yet to be fully corrected. Lenders have been subjected to legislation stemming from the Dodd-Frank rulings, the Consumer Protection Act, and tightening of compliance and RESPA rulings. With the increasing restrictions imposed on lenders, various product offerings have been discontinued or completely prohibited; origination volumes have decreased even more than the already declining numbers due to the lack of new purchase loans and reduced number of refinanced loans. Overall revenues are down and margins are tighter as lenders are being squeezed within the primary and secondary loan markets. Additionally, the MBS markets have been consistently sluggish over the past few years, powered by trepidation within our political and socio-economic environment. Some might say that there is too much 'government' and not enough lender encouragement to promote growth and optimism.

Another view is that these regulations are long overdue and include certain key stipulations that should have been intact ten or more years ago so as to avoid the credit crisis or at least the level at which it occurred. QM/QRM present lenders with guidelines, which, if followed correctly, should provide for healthy originations for creditworthy borrowers. Lender wins, borrower wins, government wins. While there will always be the exception and the loan that will walk the fine line of the Ability-To-Repay (ATR) rule, gone are the days of the no-doc and NINA loans (no income, no asset verification loans). We now have a much more grounded approach toward residential lending. By eliminating high risk underwriting factors, and by having a more disciplined approach to lending, we have a better chance of avoiding another catastrophic industry crash in the future.

Involuntary Non-QM Fallout Loans

Regardless of which viewpoint you defer to, the first quarter of 2014 has provided clear insight into the short term and potentially longer term consequences of the QM/QRM legislation. For much of 2013, lenders were wary of how QM/QRM rules would impact their business. At the outset, it was clear that many lenders were going to be forced to discontinue certain product offerings, such as the interest only loan and balloon note. Various underwriting factors were abolished as well, such as 40/30 loans (negative amortization loans), or any loan term greater than 30 years. Prepayment penalties were deemed non-QM qualifying as were loans with DTI greater than 43%. Because of the human component of underwriting, we fallout in terms of non-qualifying mortgages that, post closing, may not be sold to an aggregator or GSE. Lenders would be forced to hold these loans in house and on their balance sheets, or sell via the Scratch and Dent market for a discount.

We have not encountered a significant amount of these 'QM Fallout Loans' - at least not any more fallout than the Scratch and Dent market (S&D) evidenced prior to January 10th, 2014. The reasons for this are twofold: First, many lenders were in preparation mode for many months prior to the implementation of new legislation, making weekly announcements regarding changes to their underwriting and product offerings as the deadline approached. Second, lenders utilizing agency underwriting guidelines are, by default, already adhering to many of the QM stipulations as the two overlap in many ways. Pricing is also not affected by whether a loan is a 'QM Fallout loan' or if it is a standard investor overlay or 'near miss loan.' For example, prior to the new QM rulings, a loan being sold in the S&D markets due to higher than acceptable DTI or higher than acceptable points and fees would result in the same S&D pricing post QM implementation. This is for the simple fact that if a loan is unsecuritizable it will trade in the Scratch & Dent market sub 90s pricing regardless of the issue at hand. If a Scratch and Dent loan is potentially securitizable, it will trade north of 90 but it must adhere to the new QM stips.

Since our last review in January 2014, **Scratch and Dent** pricing has held constant in the 90s to 100 range for loans that are able to be cured and subsequently securitized. Pricing may reach low premiums as well depending on the product type. For loans that are more dented and not able to be securitized, pricing is sub 90, mostly in the mid to high 80s range, unless there are severe underwriting, property value or compliance issues, all of which may subject a loan's pricing to the high 70s to low 80s range.

From late 2013 into Q2 2014, we have seen Scratch and Dent pricing increase slightly, due in part to supply and demand. With origination volumes lower in general, demand is naturally on the upswing for secondary buyers looking for yield. This, coupled with a rising interest rate environment, has produced a whole new group of Scratch and Dent buyers emerging in the market. We have been encouraged by these new bidders who have competitive pricing in the face of an ever changing industry fueled by massive regulation. Large institutional banks, hedge funds, and even REITs are adventuring into the Scratch & Dent arena, some of which is seemingly complimentary to their already existing distressed asset holdings in the re-performing and non-performing markets.

Voluntary Non-QM Originations

As a result of the QM/QRM implementation, lenders have been disallowed from originating certain types of loans entirely and have been prohibited from originating loans with certain CFPB denoted risk components. If you are a lender who sees the cup as half full, or, depending on how you view things, as half empty, you may be one of the handful of originators that already has or is soon to roll out a non-QM loan program to fill this void in our industry. There have been rumblings about the 'subprime' mortgage coming back but it looks instead like it is the new 'Non-Agency' sector that is sprouting this Spring and showing signs of life.

There are a smattering of banks and mortgage companies that are currently originating non-QM qualifying mortgages. These loan categories run the gamut from the predominantly clean, albeit non-prime Jumbo loan to the slightly more questionable conventional mortgage characterized with a sub 600 FICO or spotty pay history. Regardless of the lender or loan program, the common thread here is that these borrowers, for the most part, have only one obstacle or adverse factor in their credit history preventing them from obtaining an agency eligible mortgage loan. While these new non-QM lenders have cultivated guidelines that are slightly wider than agency guidelines in terms of FICO, LTV, DTI and a few other loan stipulations, the quality of the borrower appears stronger than what we saw pre-crisis. These loans are catered toward borrowers who have the income, the reserves, the job history and security, or are solid self-employed borrowers – but for one reason or another, cannot obtain agency financing. We are not witnessing a return of the true subprime loan - inclusive of several risky underwriting factors in aggregate. The era of the 90LTV, 580 FICO, 63 DTI, 2nd home, condo property in Florida is gone. At least we hope so.

A typical non-QM loan today could have a 740 FICO, a 65 LTV, and a 46 DTI and more than two times the loan amount in reserves for a primary single-family residence. Not a bad loan but not a QM qualifying loan and not an agency eligible loan either – due to DTI in this case. There are also loans out there for the borrower with a 38 DTI, 70 LTV, and a 620 FICO. Many single family, primary residence properties are attracting the borrower with sufficient income, reserves, and a predominantly clean credit history. These are often first time home buyers but we are also seeing second time home buyers who were forced out of their homes due to loss of job and income, or property value issues on a previous home. A borrower who suffered during the credit crisis may still be building back credit and this appears to be more the norm today than not. Our country is full of the borrower who has not been able to obtain financing for a number of years until today. These borrowers may not be able to obtain agency financing but they are by no means a subprime borrower either; they fall somewhere in between.

This scenario is reminiscent of the days of the non-agency ALT – A loan. When ALT –A loans were introduced to the market, the reaction was mixed and twofold, questionable at best about this new and unknown mortgage product. For those old enough to remember, there was a day prior to the ALT – A loan too, so I am told, where there was a different, yet comparable product, the common denominator being that these were all non-agency products filling a gap in the market for borrowers that fell short of agency eligibility.

Market pricing for these non-QM (non-agency) loans has been surprisingly strong, well into the low premium range, 101-00 to nearly 103-00. These loans have note rates anywhere between 5% and 9%, garnering strong demand and therefore strong pricing. We should point out that a high note rate will not singularly attract premium pricing. The way the market perceives and looks at these loans is on a 'make sense' basis. Certain key factors must be in check, going back to our discussion above about these borrowers having one hiccup in their credit profile and history and not an entire array of risky characteristics. Buyers of this product are banks, hedge funds, and other financial institutions that are looking to add yield and generate income.

With rates higher than the industry norm today for a standard agency loan, one might bring up the topic of prepayment risk. If a borrower obtains financing at 7.5% on a non-prime, non-QM qualifying jumbo ARM today, what will prevent him or her from trying to refinance in 6 months to a year? Buyers of these non-QM loans have been requesting extended reps and warrants for EPO/EPD/and PPP. Some lenders have been incorporating prepayment penalties as part of their loan programs and because these loans are not QM qualifying to begin with, adding the prohibited prepayment penalty should be an easy solution, but not so in the eyes of the CFPB. The CFPB will be monitoring all loans, QM and the non-QM loans that are being brought to the market. Lenders are under scrutiny from all sides and must not lose sight of the primary concern of the CFPB which is to protect the borrower from financing that may not be optimal for the long term. If a non-QM loan has too many adverse and unattractive factors, you bet the CFPB will come knocking. There is a fine line that lenders face in originating these loans; the gray area allows for lender judgment but the key fact remains: burden on lender, not borrower.

Bank and Credit Union Regulation

In another area of regulation, with regard to banks and credit unions, we have witnessed pressure on these institutions over and above other originators to some extent. Besides the CFPB, the Fed, OCC, HUD - and all the regulations that trickle downward within these main governances, banks have to contend with the ever evolving and changing Basel rules, year after year, as well as any state and local regulations. Credit Unions, while exempt from many of these origination regulations, have been feeling pressured and squeezed by their own federal constituents forcing change upon them as well. The NCUA has been applying change ever so slowly to Credit Unions so as to have better control over members and stronger policies to protect them.

Continuing from 2013 into 2014, we have been presented with many bank originators looking to sell one form or another of residential loan products on their balance sheets. Oftentimes, these are moderately or heavily seasoned residential conventional and jumbo loans that were originated to be held in portfolio and were underwritten to non-agency guides. But remember, a bank's originations and underwriting are usually so conservative and clean - they tend to mimic agency underwriting. The theme we have seen is that banks are looking to sell loans not because they necessarily want to, but rather, because they are being forced to for one reason or another. Regulations surrounding the type of loans that may be held on balance sheet and the longevity of these loans sitting on the balance sheet are the primary reasons for banks looking to sell assets. Some banks are looking to raise capital by selling a section of their balance, and as we are in a rising interest rate environment, replenishing the balance sheet with equivalent or higher yielding originations is not a challenging feat. Many banks are looking to raise capital in order to expand lending capacity and introduce new products.

Credit Unions have been faced with similar constraints today in the face of regulatory overkill. While Credit Unions did not actively partake in the activities and lending that our new rulings are looking to prohibit, they are being equally scrutinized and must succumb to new federal compliance and lending rules that will affect membership.

Credit Unions, due to the nature of their business, have not historically originated high risk loans. They exist to serve their members, but typically adhere to stricter rules and governing factors than banks. Because of new legislation imposed on credit unions, they will likely face lowered volumes in the coming months and years as we have seen with the mortgage company and bank lenders. Credit union borrowers and members will not be exempt from these lending laws and may be forced into the non-QM world of lending.

On one hand, while credit unions are facing similar tightening with regard to lending and balance sheet management, they are exempt from certain QM legislation allowing them to hold on their balance sheets various non-QM qualifying loans. It is not easy to predict what credit unions will do in the face of these rulings and the non-QM lending strategy. Will they originate a new product that fits the non-QM product described above to attract new business or will they put the reigns on lending and membership benefits? To be continued.

Jumbo and Conventional Loan Pricing:

Bank and Credit Union trading has been active, both financial institution types showing interest as sellers and buyers, a continuing theme from 2013. The pendulum swings heavier toward buyers rather than sellers today, regardless of product and loan type. Simple supply and demand economics here: lowered production volumes overall mean buyers are hungry for paper and looking toward anything that provides yield, whether it be seasoned non-agency loans or non-QM loans.

We have seen prime jumbo ARMs trading well above 101 into the 102/102.75 range (servicing released) depending on loan characteristics. For very clean sub 70 LTV, sub 43 DTI and mid/high 700 FICOs, this is particularly true. For Fixed Rate Jumbos of comparable quality, demand is not as great but it is growing from what we have seen between Q4 2013 into Q2 2014. Pricing is approximately 50 – 80 basis points back from ARMs pricing. Geographic concentration and a few other loan characteristics drive pricing on fixed jumbos more than on ARMs.

On the servicing retained side, there has been an influx of originators looking for outlets for jumbo fixed-rate flow pricing and minimal buyers of this paper. This is an area to watch for growth in terms of originations and flow and bulk buyers. Pricing of Fixed Rate Retained Servicing loans is anywhere from 100.25 to the high 101 range depending on note rate. Pricing of Retained Servicing ARMs is between 100.50 and 102 for the bulk of market ARM rates today on 5/1 ARMs. All of this pricing is general and is based on a combination of note rate, loan type, occupancy, loan purpose and other key loan characteristics like DTI/LTV/FICO.

Q2 2014 Residential Whole Loan Pricing Matrix

Loan Type	Price Range	Guidance
Scratch & Dent Loans – Agency Eligible	$90.00 - $100.00	Securitizable Loans Only
Scratch & Dent Loans – Agency Ineligible	$76.00 - $90.00	Unsecuritizable Loans
Jumbo Adjustable Rate Loans – Servicing Released	$101.00 - $102.75	Bank Quality Clean Notes (note 1)
Jumbo Adjustable Rate Loans – Servicing Retained	$100.50 - $102.00	Bank Quality Clean Notes (note 1)
Jumbo Fixed Rate Loans – Servicing Released	$100.50 - $102.00	Bank Quality Clean Notes (note 1)
Jumbo Fixed Rate Loans – Servicing Retained	$100.00 - $101.50	Bank Quality Clean Notes (note 1)
Non-QM/Non-Agency Jumbo ARMs – Servicing Released	$101.00 - $102.75	Clean 'Non-Agency' Notes (note 2)
Non-QM/ Non-Agency Jumbo Fixed – Servicing Released	$100.00 - $102.50	Clean 'Non-Agency' Notes (note 2)

*All pricing is hypothetical and based upon market fluctuations, loan quality, pool size, and market demand.

Note 1: Price indications based on clean bank quality residential loans (low LTV, low DTI, high FICO loans with other stipulations)

Note 2: Price indications based on clean non-agency loans (i.e. Loans have one characteristic deeming them ineligible to the GSEs, one credit component causing borrowers to seek alternative financing)

By: Anjali Kumar VP, Whole Loan Sales/Trader
Business & Development
Anjali.Kumar@miacanalytics.com

Commercial Servicing Market Update

All is well in Commercial Servicing Land. Underlying property values are increasing in most sectors, delinquencies are dropping and commercial servicers continue to add a significant amount of high quality, low note rate, high servicing fee commercial mortgage servicing rights (CMSRs) to their balance sheets. These new, low interest rate CMSRs are projected to be around for many years and will help stabilize the financials of the large and mid-sized commercial mortgage servicers during the eventual slow down in origination income. Delinquency rate levels in the CMBS, GSE and Bank & Thrift sectors all have seen steady improvement with rates at or close to their five year lows. The Mortgage Bankers Association recently reported in their Q4 2013 Commercial Delinquency Report that overall CMBS delinquency rates (30+ days delinquent and REO) have decreased from 8.55% at the end of March 2013 to 6.97% at year end. Delinquencies for the other investor sectors have been steadily dropping for the last several quarters. At March end, the 60+ days and REO delinquency rates were the following: Life Companies (.05%), Fannie Mae (.10%), Freddie Mac (.09%) and the 90+ days and in non-accrual rates for Bank & Thrifts (1.70%). These modest levels are even lower than those than reported at year-end 2013.

Commercial Servicing Supply

As has been the case for the past several years, commercial servicing that was available in the marketplace over the past several quarters is very light, with the only real volume coming from new CMBS and Freddie Mac CME securitizations. Total servicing supply in 2013 was approximately $87.5 B, with the vast majority of the volume going exclusively to the large CMBS servicers. The consolidation of commercial servicing continued this past quarter, albeit at a slower pace than last year when several mega deals were announced, most notable of which was the KeyBank RE Capital / Bank of America / Berkadia Commercial Mortgage deal. Since our last Perspectives a couple more commercial servicers have merged or been acquired. Centerline Capital Group, part of Centerline Holdings, merged with Hunt Capital Partners, Inc. Centerline services approx. $12.2 billion of Fannie Mae, Freddie Mac, Ginnie Mae and FHA. The merger was completed in Q4 2013.

Pillar Multifamily, LLC, (“Pillar”), an affiliate of Pillar Financial, LLC, (“Pillar Financial”) and Guggenheim Partners, LLC, (“Guggenheim”) purchased Columbia National Real Estate Finance, LLC, and Freddie Mac Program Plus license and their $500 million MSR portfolio in Jan 2014.

Cantor Commercial Real Estate (CCRE) has agreed to purchase Berkeley Point Capital, LLC, which services over $28 billion of Fannie Mae, Freddie Mac, Ginnie Mae multifamily servicing.

Market Demand

As has been the case for several years, market demand continues to remain strong among the top commercial servicers, especially for CMBS and Freddie Mac CME loans. This continued strength is driven by three factors: a lack of new commercial servicing supply available to market participants, existing portfolio run off, and a strong desire by servicers to maintain their economies of scale costs. M&A activity in the Commercial Sector has been very active. The general theme has been Seller/Servicers positioning themselves for growth by adding a GSE investor outlet or strong capital partners with CMBS expertise purchasing existing GSE origination and servicing operations.

The Outlook for CMSRs in 2014

Market values for Commercial MSRs should be relatively flat for the remainder of 2014.

Below are a few items that may have an impact on commercial servicing values over the next several years:

- Increasing interest rates will take away the refinance option for borrowers and will slow voluntary prepayments resulting in a increase in CMSR values

- Decreasing default rates will reduce involuntary prepayments and reduce servicing costs resulting in a increase in CMSR values

- The CMBS sector has sizable amounts of loans maturing over the next several years. The jury is still split on whether or not these loans will have refinance options in the Capital Market or increase the default rate and special servicing opportunities.

- If the GSE component of Commercial Finance continues to lose loan volume to life companies and banks the ability of small, mid-sized and to a lesser degree, large servicers, to replenish their portfolio runoff will be greatly diminished. If it becomes a zero sum game then more consolidation of the commercial servicing industry is inevitable.

- Longer Term: Basel III capital limitations for MSRs may reduce the demand for CMSRs by the bank-owned mega-servicers? Reduction in demand by these mega-servicers could eventually shift ownership of the asset class to non-bank servicers owned by hedge funds or private equity (PE) firms. PE firms have higher yield requirements and do not utilize the float balances as efficiently as banks, the result being a decrease of CMSR market values.

By: Dan Thomas, Managing Director
Client Solutions Group
Dan.Thomas@miacanalytics.com

The Need to Conduct a Data Quality Review on Bulk MSR Purchases

Introduction

It has never been more important for buyers of Mortgage Servicing Rights (MSRs) to conduct a formal due diligence of each portfolio they purchase. Over the last several months more and more Mortgage Servicing Rights have exchanged hands. MSR transaction volume has been steadily increasing due to strong demand and increasing prices. Mortgage companies, some who only recently decided to retain MSRs, have been forced to sell a portion of their MSR portfolios to generate revenue. As these non-traditional sellers enter the arena and new buyers enter the marketplace, a due diligence program is necessary. This article will provide an overview of why we feel due diligence is important, point out some of the areas that merit special attention and show you how MIAC can help you with your due diligence needs through our newly acquired division, Mortgage Delivery Specialists (MDS).

Acquisition Plan

Buyers should have an acquisition plan that contains formal policies and procedures that guide acquisition activities for all mortgage assets and consistently documents each acquisition. Ideally, this plan provides proper communication for all areas impacted by the acquisition and a means for review and approval of key assumptions and judgments. This documentation can be used by independent parties such as internal audit, independent accountants, CFPB and other regulatory examiners.

What are the Risks?

Prepayment speeds and default risks are normal risks factored in to the purchase price of the MSR portfolio. We will focus this article on other aspects of a transaction that can pose additional risk to the buyer.

Counterparty Risk

The first risk that needs to be assessed is Counterparty Risk (i.e. the seller of the assets). The purchase and sale agreement the buyer signs with the seller is only as good as the strength of the seller itself. Depending on the size of the purchase, the buyer may want to have a full Counterparty review done by an outside firm that specializes in this type of work. At a minimum, a financial review should be conducted, taking into account the net worth of the seller, as well as current recent operating results and servicing audit results from Freddie, Fannie or HUD.

Operational Risk

An operational risk assessment should be part of your Acquisition Plan. The scope of the operational review will depend on the make-up and complexity of the portfolio. This review should ensure that no operational issues that may currently exist will be inherited. Areas of focus would include reviews of investor reporting, escrow administration, compliance, and collections/loss mitigation, if applicable. Some buyers will go as far as conducting a full servicing operations review and origination process review. MDS can assist with all operational review aspects of your Acquisition Plan.

Underwriting/Compliance Risk

It is recommended that a full re-underwrite and compliance review be conducted on a sampling of loans in the portfolio. There are several reasons why this is important:

1) Determine if data was properly input into DU or LP – (Potential put-back)

2) Determine if loans truly meet Agency guidelines – (Potential put-back)

3) Determine if loans are truly QM – (Potential put-back or foreclosure issues)

4) Determine if loans meet state and federal regulatory compliance rules – (Potential legal action/put-back/difficulty in foreclosure)

5) Determine completeness and presence of documentation including credit documents, legal documents and proper disclosures – (Potential put-back/operational issues)

6) Detection of fraud

7) Determine the completeness/accuracy of Servicing Data (comparing review data to servicing data)

Data Integrity Risk

Data integrity continues to be a huge issue for mortgage servicers and it can impact the entire operation. Incomplete/inaccurate data:

- Reduces efficiencies
- Creates unnecessary re-work
- Increases customer service calls
- Creates liability for the servicer
- Impacts third-party MSR and whole-loan fair-market valuations
- Has become a hot point for CFPB and HUD

The CFPB has chimed in on this issue too. CFPB Director Steven Antonakes recently stated in a speech that "… continued sloppiness by servicers is difficult to comprehend and is not acceptable… technical issues should simply be identified and corrected". He said the CFPB will be paying "exceptionally close attention to servicing transfers, looking to see if all information and documents are transferred as required." This scrutiny puts added pressure on servicers to focus on data integrity.

Modification data and data related to loss mitigation efforts are two primary culprits. It is not uncommon for pertinent modification data such as the modification type, date modified, modified balance and modified first payment date to be incomplete or missing and not be available for the electronic transfer to the new servicer. Incomplete modification data can lead not only to servicing errors, but can also have a huge impact on MIAC's MSR valuation of your portfolio.

It is very important the buyer of MSRs takes a proactive approach regarding data integrity by making an assessment of the data completeness as part of the Acquisition Plan. This assessment should include a full analysis of the servicing data BEFORE the transaction closes.

MDS has a solution that assists buyers in determining the completeness of the servicing data. Using our DataAuditor™ product, which uses MIAC's DataRaptor™ technology, MDS can quickly analyze the servicing data of the target portfolio and provide the buyer an Edit Summary of the data issues found, along with loan level detail behind the Edit Summary. Ideally, this analysis is done before the due diligence is conducted so that the buyer's operational due diligence team can use the results of the analysis to focus on any target issues uncovered. MDS can usually analyze a servicing portfolio in three business days from receipt of all necessary servicing data required for the analysis.

This data analysis is invaluable for the data conversion team as well, as they are now able to anticipate data issues as well as unique loan features that may not have been disclosed as part of the bid package. Many users of this product require the seller to correct invalid and incomplete data prior to the transfer by providing to them the Edit Summary detail produced by MDS through this analysis. This helps reduce the overall cost of data clean up to the buyer.

Conclusion

Mortgage Servicing Rights when valued properly and scrutinized carefully can be a valuable asset for your organization. Coming up with a detailed Acquisition Plan and executing it for all of your purchases is vital to minimize the risk that comes along with the asset.

Buyers must look at MSRs as more than just an IO strip. They can also contain hidden risks that can be uncovered before the purchase is consummated through the use of MDS's services. Mortgage Delivery Specialists can help you have the confidence to make a sound purchasing decision.

By: Kent Loehrke, Managing Director MDS,
Mortgage Delivery Specialists - Part of the MIAC Group
kent.loehrke@mds.miacanalytics.com

Marketplace Lending: An Online Alternative to Traditional Banking

Marketplace lending, formerly peer-to-peer (P2P) lending, has just turned a corner. The recent name change accurately describes the evolution of the industry over the past year. Renaud Laplanche, CEO of Lending Club, the world's largest marketplace lending platform, formally suggested calling the industry "marketplace lending" at the LendIt 2014 conference in May. Ron Suber, President of Prosper Marketplace, the second largest platform, was recently quoted in the NY Times saying a suitable name for the industry is "online consumer finance." Notice neither has the term "peer" in it.

Peers, or individual investors, are playing a diminished role in the industry, as large institutions, including hedge funds and banks themselves, dominate the investor demand. Some of this is the result of banks partnering with platforms, and some is just the result of the volume of institutional money, the power of their credit-analyzing algorithms, and the number of their analysts.

The industry was built around connecting borrowers with lenders online, at agreed terms, without involving a bank or credit card company. By cutting out the highly regulated and often inefficient process of applying to a bank for loans, borrowers benefit from lower rates, and investors benefit with higher returns.

Institutions noticed the outsized returns investors could earn on these marketplace lending platforms, and decided they wanted a piece of the action. They got involved in a number of ways: by agreeing to fund large amounts of loans; partnering with platforms to share leads on potential borrowers; and even bringing their own borrowers and capital to the marketplace to facilitate loans to their customers, utilizing the efficiency of the online model.

[1] Foundation Capital, Lending Club, Liberum

Some examples include direct partnerships between Union Bank, Titan Bank and Congressional Bank with Lending Club, and Banco Santander establishing relationships with both Lending Club and Funding Circle. This increase in institutional money has spurred platforms to offer investors whole loans, in addition to the fractional loans that the industry grew upon.

Originally centered on a few platforms offering unsecured consumer credit loans, the industry has expanded to hundreds of platforms offering access to a variety of products. These include small business loans, student loans, real estate secured loans, and going as far as loans to secure financing for mining projects.

As the industry has expanded to include new asset classes, the volume of loans issued continues to show rapid growth. Lending Club and Prosper issued a combined $2.4B in 2013, increasing 175% year-over-year from $871MM in 2012. As risk managers ourselves, MIAC is impressed at how much of that volume is amortizing into investors pockets – 92% of investors in Lending Club have earned 6-18% annual yields since its inception.[1]

Building upon the idea of an increasingly diverse marketplace, a big buzz during the 2014 LendIt Conference in San Francisco was the growth of real estate secured peer-to-peer platforms. It is important to note that many of the secured loans funded through these kind of platforms technically fall under the crowd-funding category, as it aims to reach a funding goal by aggregating many small investors and, often times, includes additional benefits such as debt, equity, and/or rewards. 2014 saw the first attempt to crowd-fund a US hotel online, according to Realty Mogul, the Beverly Hills-based tech company behind the campaign.

Through crowd-funding and Realty Mogul's online investment platform, the Hard Rock Hotel Palm

Springs plans to raise at least $1.5MM for improvements and additions. Individual investors in the hotel will receive a portion of the rental income from the hotel through quarterly payments (debt), capital appreciation of the hotel when it is sold (equity) as well as special VIP treatment at the hotel (reward).

Other real estate secured marketplace lending platforms include Patch of Land, which focuses on crowd-funding residential properties for improvement and resale, and LendInvest, a UK based firm dedicated to providing funding for both residential and commercial mortgages. MIAC believes real estate secured marketplace lending has a large and untapped market opportunity and we expect to see this sector grow in 2014.

The US is not the only country that is seeing rapid growth and innovation in the space. Although still dominated by the “big three” platforms, which include Zopa, RateSetter, and Funding Circle, today, there are nearly 30 active platforms in the United Kingdom.[2] Marketplace lending is also a large part of China's active shadow banking sector - the financial system that operates alongside the traditional banking system. Loans issued through China’s platforms reached 68.03 billion yuan ($11B) in 2013, about three times the 22.86 billion yuan in 2012. Marketplace lending platforms are also forming and growing in countries such as South Africa (RainFin), Australia (SocietyOne), India (i-lend), and Brazil (Fairplace). Moreover, platforms are expanding across national borders. One such company is Funding Circle, the UK-based platform that lets individuals and institutions loan money to small businesses. In October 2013, Funding Circle merged with San Francisco-based Endurance Lending Network, which was rebranded as Funding Circle USA. In addition to globalization and innovation within the industry, lending platforms have also taken new strides in developing new metrics for credit risk underwriting.

[2] iResearch

Upstart, a platform that allows investors and borrowers to enter into Income Sharing Agreements (ISAs), where a borrower repays investors with a percentage of their future monthly income, targets young borrowers with minimal credit history. They enrich a borrower’s profile with education-related variables to predict their earning potential, employability, and propensity to repay the loan. Such variables include schools attended, area of study, academic performance, and work history.

According to Upstart’s website, as of April 2014, Upstart backers have made 2,192 offers to borrowers totaling approximately $3.5MM, without a single repayment default over a span of 14 months. If Upstart’s methods are proven to hold true, lenders across the finance spectrum could benefit from a non-traditional, data-enriched credit underwriting approach, building upon the widely used FICO-driven methodology. This, in turn, could bring credit to a previously underserved population.

The Future of Marketplace Lending

Early on, marketplace loans were largely for consolidating pre-existing (usually credit card) debt, which seemed like good news for everyone. However, as marketplace lending continues to grow and branch out into new asset types, and maybe riskier loans, you can be sure the regulators are watching closely. Currently, all US-based marketplace lending platforms are regulated by the SEC. What is unknown, however, is if US regulators plan to crack down further on platforms as outstanding loan balances continue to increase across all asset types. Regulators exist for many reasons, but in this case their role is primarily to protect the little guy, the borrower, from getting in over his head in debt.

As an example, let’s look at the US market for student loan debt. In the US in Q1 2014, outstanding student loan balances reported on credit reports increased by $31B to a total of $1.11 trillion. The increase since this time last year was $125B. With mortgage originations, credit card balances and auto loan originations all decreasing in Q1 2014, student loan was the only type of debt to increase significantly. Serving this portion of the market are SoFi and CommonBond, the two biggest US platforms when it comes to student loans. Both offer borrowers a chance at new loans or to refinance existing loans, and both utilize some form of community to further connect borrower and investor. [3]

On December 3, 2013, The Consumer Finance Protection Bureau (CFPB) issued a rule that allows it to "supervise certain nonbank student loan servicers." While this rule focuses on servicers, it is very open ended and difficult to understand where their authority begins and ends. Most importantly, "in their annual report by the Bureau's Student Loan Ombudsman, the CFPB identified a broad range of concerns voiced by student loan borrowers in complaints to the CFPB."[4] With this being a popular political issue, we wouldn't be surprised to see the CFPB expand their supervision in this area, and possibly take a look at marketplace student loan platforms in the near future.

LendIt 2014 awarded its first annual Innovator of the Year award to Jon Barlow, Founder, CEO & CIO of Eaglewood Capital Management, for his firm's work in creating the first ever securitization of marketplace loans. Eaglewood's initial deal was a $53MM securitization of strictly Lending Club notes, completed in September 2013.

On May 8, 2014 they closed on an additional $47MM of loans, bringing the combined transaction to $100MM worth of Lending Club notes. While this first deal was not rated by any agency, Eaglewood was still able to sell the majority to a large insurance company, unidentified by the fund.

[3] All statistics in this paragraph from NY Fed Quarterly Report (Q1 2014) on Household Debt and Credit, May 2014.
[4] CFPB
[5] Lending Club

With Eaglewood agreeing to take up to $13MM in losses on the original $53MM deal (approximately 25%), it is looking to show it has skin in the game, as opposed to many pre-2008 securitizations that were completely unloaded off the books of the securitizing firm.

SoFi went a step further, engaging Toronto based DBRS to rate the second of marketplace loan securitizations, which consists of a $152MM pool of student loans originated on the SoFi platform, which received an A rating. The fact that SoFi was able to get a rating from the world's fourth largest rating agency legitimizes, in the eyes of some wary investors, the idea of marketplace lending, and also opens the door to many more investors.

MIAC believes the marketplace lending industry is securitizing in a prudent manner today, and these deals involve high-quality borrowers and responsible underwriters. If any future securitizations receive ratings from Moody's, S&P or Fitch, there's no telling how much the industry can grow. But as long as 2008 is still fresh in people's minds, investors around the world will be wary of securitizations of new asset classes. The fate of these first few deals will go a long way in determining the future of securitization in the industry.

As presented above, growth is strong in the marketplace lending industry. Year-to-date, the market has seen numerous partnerships, acquisitions, and further financing rounds (offered) to platforms of all asset classes. Additionally, investors show confidence by reinvesting the returns back into the products.[5] The second half of 2014 also promises to be big for marketplace lending, as Lending Club is expected to go public.

MIAC likes how the industry has evolved thus far and believes in marketplace lending's chances of adapting to increased regulation, developing best practices for the industry, building secondary markets and strengthening customer acquisition. We look forward to playing an important role in the industry's maturation process.

By: Brian Kearon Analyst, Borrower Analytics
Capital Markets Group
Brian.Kearon@miacanalytics.com

Jeffrey Fromer Sales Associate,
Business Development
Jeffrey.Fromer@miacanalytics.com

Eli Clark-Davis, Analyst
Business Development
eli.clark-davis@miacanalytics.com