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WHAT YOU SHOULD KNOW ABOUT RATES AND THE MARKETS

Dave Hershman

OriginationPro

DAVE HERSHMAN

- Produced almost 600 transactions in his first 18 months in the industry—including closing 60 in his 12th month;
- Run sales forces for large production organizations;
- Directed the sales force for the largest mortgage technology organization;

- Written seven books in the areas of finance, management, sales & marketing—including two best-sellers published by the MBA;
- Helped found a Federal Bank, serving as a board of director;
- Been a keynote speaker at hundreds of industry events

www.OriginationPro.com

OUR GOALS TODAY

- Why this topic Is Important
- The history of the market
- A perspective on the crisis
- What is a commodity and IRDI
- Understanding spreads
- Servicing & warehouse lines
- Points and fees
- Newsletters—Economic Commentary

And Coaching —Q&A on any topic

LATEST NEWS ON THE HOUSING FRONT

- Several States setting up programs to allow first time buyers to obtain their tax credit up-front
- Home Valuation Code of Conduct scheduled to go into effect May 1st. No word on lobbying efforts. NAR and NAMB are lobbying for a delay in effective date.
- Administration about to announce changes to their Loan Mod solution and HOPE for Homeowners centered around buying second mortgages which has been a major obstacle.
- Congress is considering regulating YSPs. NAMB is supporting so far. Latest news, mark-up on this bill has been postponed and hearing may be held. Key issues..
  - Will bankers also be required to disclose?
  - What will the restrictions be? Does not look to be a total ban but limiting putting someone into a higher cost program because YSPs. How do they do this? It will be hard! Great example: Margins on Option ARMs.
- National licensing is coming for loan officers—including minimum credit score and net worth—SAFE Act Update next week
- Ginnie Mae working on a warehouse solution for the industry.

THE BIG RATE ISSUE

- Fed has lowered short-term rates close to zero and this has many beneficial effects upon the economy. The most beneficial on the housing market? ARM adjustments have eased. This was the first domino in the housing crisis.
- The economy is depressed and that means the Fed's lowering of short-term rates has been accompanied by lower long-term rates (it is not always).
- The administration is helping bring mortgage rates down by purchasing mortgages to support the secondary market. The spreads between 30 year mortgages and 10 year Treasuries have narrowed as the 10 year has gone up in the past two months--
  - In early 2007, spread approximately 1.5%
  - In 2008, spread moved over 2.5% (approximately)
  - Today, the spread is 1.9% (approximately)
  - Spread even wider for jumbo loans and those with poor—even good credit.
- Caution: The administration is also spending billions on stimulus and that is forcing long-term rates up because of inflation fears--even as they purchase Treasuries to lower rates.
- We go into the summer with all these factors in place. Any economic recovery will be accompanied by higher long-term rates BUT will not necessarily be accompanied by higher mortgage rates if the spreads continue to narrow.
- The real solution is confidence in the secondary markets, i.e., real estate not going down in value so investors will purchase mortgages. Want more wholesalers in the market? Want more wholesalers purchasing from brokers? Want more yield spread? Want shorter underwriting times?
- Caution: What is going to happen when the government has to unload these mortgages?

REFI PLUS PRICE ADJUSTERS

Refi Plus™ Mortgages ONLY

Table 4: Refi Plus Mortgages with Subordinate Financing (2)

LTV Range	CLTV Range	LLPA Credit Score < 720	LLPA Credit Score ≥ 720	SFC
65.01% – 75.00%	90.01% – 95.00%	0.500%	0.250%	339
75.01% – 95.00%	90.01% – 95.00%	0.500%	0.250%	338
75.01% – 90.00%	76.01% – 90.00%	0.250%	0.000%	187
Any	>95.00%	1.500%		

Table 5: Expanded Approval – DU Refi Plus Only

Product Feature	LLPAs by LTV Range These LLPAs are *in addition to* (and NOT in lieu of) the standard Credit Score/LTV LLPAs under Table 2 (note that the LLPAs below also apply to mortgages with terms less than 15 years).								
Representative Credit Scores	≤ 60.00%	60.01 – 70.00%	70.01 – 75.00%	75.01 – 80.00%	80.01 – 85.00%	85.01 – 90.00%	90.01 – 95.00%	95.01 – 97.00%	97.01 – 105%	SFC
≥ 740	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%	0.000%	0.500%	0.500%	716
720 – 739	0.250%	0.250%	0.250%	0.250%	0.250%	0.250%	0.250%	0.750%	0.750%	716
700 – 719	0.250%	0.250%	0.250%	0.250%	0.250%	0.250%	0.250%	0.750%	0.750%	716
680 – 699	0.500%	0.500%	0.500%	0.500%	0.500%	0.500%	0.500%	1.000%	1.000%	716
660 – 679	0.500%	0.500%	0.500%	0.500%	0.500%	0.500%	0.500%	1.000%	1.000%	716
640 – 659	0.750%	0.750%	0.750%	0.750%	0.750%	0.750%	0.750%	1.250%	1.250%	716
620 – 639	0.750%	0.750%	0.750%	0.750%	0.750%	0.750%	0.750%	1.250%	1.250%	716
< 620	1.250%	1.250%	1.250%	1.250%	1.250%	1.250%	1.250%	1.750%	1.750%	716

(2) If the subordinate financing is a Community Seconds® loan, these LLPAs do not apply and the lender must use SFC 118.

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Velma/MyMortgageCommunity Trial Members: Welcome

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- Ten webinars including today's. There is a choice of at least three webinars for the tenth webinar.
- Includes three part planning/advisor course.
- Schedule on www.certifiedmortgageadvisor.biz
- Six months to attend all 10 courses (15 hours of training)--**must attend LIVE!**
- Certification page posted on site (above) with list of class dates so you can track. **It is your responsibility to track!**
- Continuing education---CMA Case Studies—We don't want you to stop learning
- Must be a NewsletterPro Marketing System subscriber for six months
- Test is issued. Passing score gives you CMA certification
- Marketing materials coming as well..Logo, seminars and more!
- New: Webinar registrations, slides and audio all on home page of newsletter system.

THE BASICS

What is the secondary market?

What is the primary market?

WHY THIS TOPIC IS IMPORTANT

- We are subject to many cycles in this industry—and mortgage rates are the leading factor in determining cycles and what your income will be.
- The secondary market to a great extent has been responsible for today's mortgage crisis (as well as the preceding real estate boom)
- If you want to be an expert in this industry—you must understand where your product comes from and what affects changes in this product
- Everyone and his uncle will ask you what is going to happen to rates. You must know what to say.
- You need to be able to advise your clients regarding the risks of locking a rate and the risks of floating a rate.
- You will differentiate yourself from the competition by becoming an expert in this topic because the average loan officer and Realtor does not understand.

THE HISTORY OF THE SECONDARY MARKET

- Goes back to the great depression
- One of the causes? The dust bowl put the nation in jeopardy
- Also a housing and financial/banking crisis
- Through the depression was born the commodities market
- The purpose of the commodities market? Minimize risk
- Ability to sell commodities "in the future" (example corn), or hedging
- Why located in Chicago?
- Two other advantages of the commodities market…product development and liquidity (makes funds available and lowers rates)—especially through standardization (underwriting guidelines)
- Also the depression brought us FHA and Fannie Mae—the first "participants" of the secondary market for mortgages

PERSPECTIVE ON THE CRISIS

- The Savings and Loan Crisis
  - Dominant in real estate lending—portfolio lending
- Bond market collapse—1987.
  - Right after a real estate boom
  - Real estate collapsed—both commercial and residential
- The solution? De-emphasize portfolio lending.
- Loans had to be sold. "Mark-to-Market" Regulations
- As the market recovered during the 1990s—the secondary market exploded.
- It brought new products. These products were not tested during a down times.
- There was a "disconnect" between standards and purchasers
- These new products (loose lending), people fleeing the stock market and abnormally low rates caused the real estate boom and a bubble.
- This caused the mortgage broker explosion—not enough regulation
- We all know what happened—and especially valuation of bad assets, back to mark-to-market—and the subsequent change.

WHAT IS A MORTGAGE COMMODITY?

- You should know what a mortgage is…
- After it is made it can be sold/traded like gold or oil or the dollar
- It is an “interest rate denominated instrument” like corporate bonds or Treasuries
- The value of the instrument will go up or down depending upon the direction of rates: 6.0% mortgage goes up in value when rates fall and down in value when rates go up (bond market is “up” means that rates are falling). Why?
- Value of a mortgage at 6.0%---when you sell it

  101.00 Over Par (you get more than the value)

  100.00 Par (you get face value)

  99.00 Under Par (you get less than the value of the mortgage)

If a lender has a pipeline of loans and they are not hedged (locked in the future), the risk is great. $100 million and 2 point move is a $2 million loss.

- It is just as much a risk if the loans are locked and hedged—but not closed and rates go down!

WHAT AFFECTS THE RATE OF AN IRDI?

- The three "R's"
- Risk of Inflation
  - As inflation is higher, your money is worth less (lend 100K at 10% inflation)
  - You can't predict inflation—that is why bond trading is as risky as trading stocks.
  - This is why long-term rates are higher than short-term rates, or a "positive yield spread"—usually. And why Fed can raise rates & mortgage rates can go down.
  - What happens in an inverted yield spread—25% inflation
- Risk of Prepayment.
  - When the loan is prepaid you must re-invest at today's rates
  - Risk of prepayment goes up as rates go down (inverse of inflation risk)
- Risk of Default.
  - Why "B" credit costs more than "A" credit.
  - The driving force behind today's market—Treasuries vs. Mortgages

MAJOR POINT

- You can't predict the future of interest rates
- Don't let the gurus fool you! They can't tell you when to lock or float (unless it has already happened)
- What did Freddie Mac say earlier last year? Rates will go up by the end of the year!
- Don't even try it—especially floating loans consumers think are locked. That is illegal and stupid.
- In 1987 rates when up almost 2.0% in one week—that is in rate!
- Don't advise people to lock or float—there is just as much risk in locking as opposed to floating

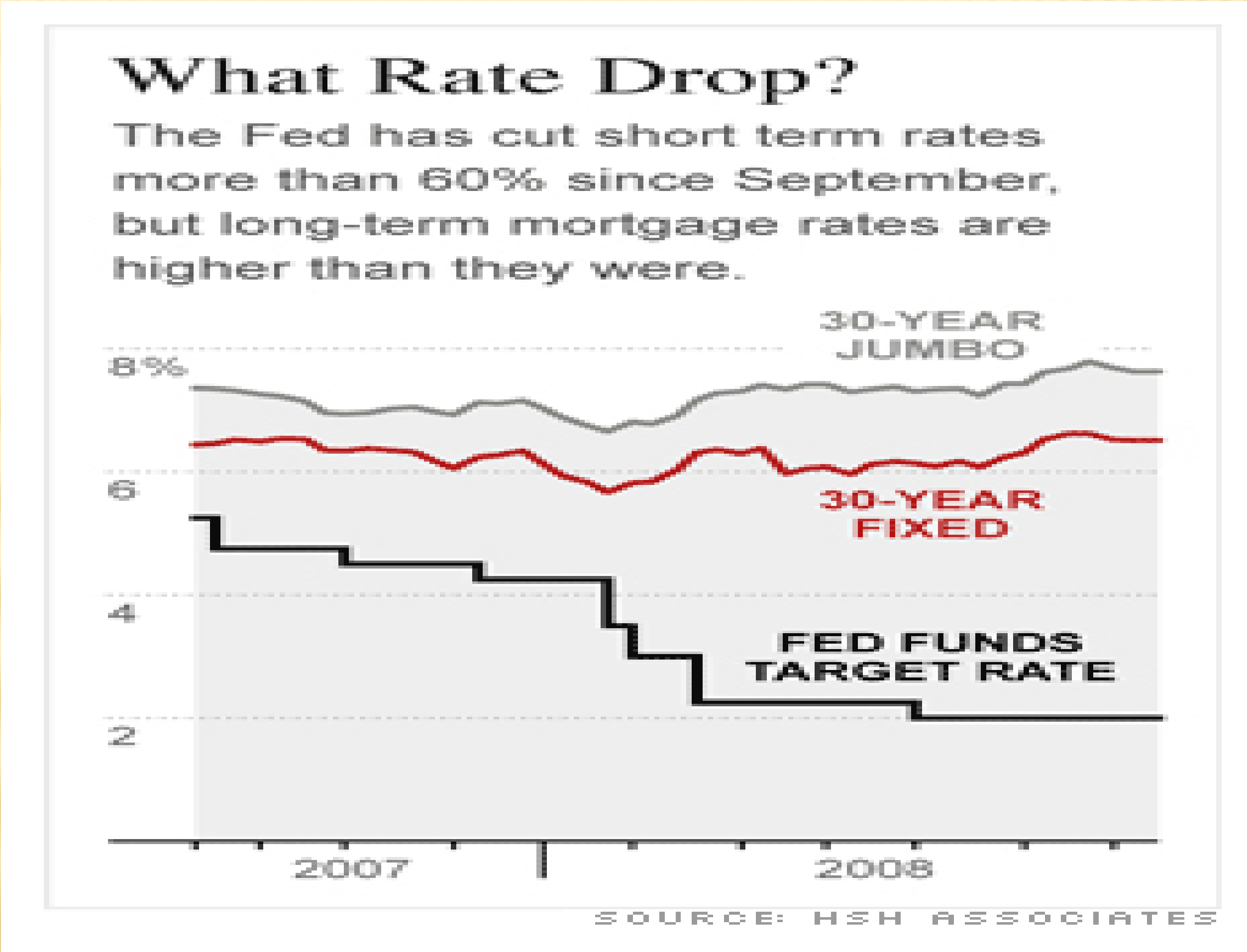
WHAT IS HAPPENING TODAY?

- The economy is tanking—rates go down because there is no danger of inflation. The government forces short-term rates down to record levels to combat the recession.
- The government is borrowing hundreds of billions to keep the economy afloat—that provides competition to borrowing money—long-term rates up.
- Default rates are up and real estate values are going down—the rates on mortgages are higher than Treasuries—spreads are up. Especially for those with lower credit scores—*Risk based rates*
- The government is talking about purchasing loans at 4.0%. That keeps people on the fence. It also speaks to the fact that the government is going to support mortgages—putting downward pressure on rates
- The government is talking about loan modifications---that gives investors less confidence to purchase mortgages because the government can change the rules (example, cram-downs on bankruptcies).
- If rates do go down—volume and prepayment rates go up. This lowers the value of servicing. And lenders increase pricing because of limited capacity. Or eliminate brokered loans (less options for brokers)
- Conflicting forces can only mean one thing—more volatility

UNDERSTANDING SPREADS

- Essential to understanding rates and advise your customers
- There are many spreads….
  - Why are conforming loans less costly than jumbo loans? Now we know!
  - Long vs. short-term rates Adjustables vs. fixed rates.
  - Mortgage rates vs. other instruments (big cause of crisis)
  - 30 year vs 15 year
  - 15 day vs 60 day
  - Servicing spreads (more about that later)
  - "A" credit vs "B" credit (became artificially narrow)
- Crisis Today
  - Spread between mortgages and Treasuries became wider
  - Spread between fixed rates and adjustables actually inverted (even though the Fed lowered rates). Should have lowered short-term rates—
  - Spread between conforming and non-conforming became wider

UNDERSTANDING SPREADS



OOOPS I LIED…SERVICING

- I told you that we create a commodity we can sell when we make a mortgage.
- Actually it is two commodities..
  - The loan itself
  - The right to service the loan
- The value of servicing is a separate commodity that affects the rate of your loans. First, what is the value.
  - If the “spread” is 25 basis points (6.00% mortgage with a .25% servicing spread would be a 6.25% mortgage to the consumer),
  - Then the “income” it generates would be $250 annually for every $100,000 of the mortgage.
- What kind of value is that? Well, a servicing spread might bring anywhere from no value to close to 2.00 points when sold separately from the loan itself.

WHY WOULD SERVICING HAVE VALUE?

First, what does the servicer do for $250?

- Collects payments
- Sets up escrows
- Pays escrow bills when due
- Sends principal to owner of mortgage
- Sends out reports (investor reporting)
- Forms for the IRS-1098
- Gives out payment information
- General customer service
- Escrow analysis at the end of the year
- Collections
- If that does not work foreclosure
- And more…

WOULD YOU DO THAT FOR $250?

- Of course not!
- Then how can it be value?
- Originations is a labor intensive business—what does it take to close one loan?
- Servicing is a technology based business.
- It is more conducive to volume.
  - One $300,000 loan $750 annually
  - 100 loans $75,000 annually
  - 1,000 loans $750,000 annually
  - 1,000,000 loans $750 million annually
- Anything less than several thousand loans is too small for a servicer to be profitable.

WHY IS SERVICING VALUE IMPORTANT?

- What affects the value of servicing affects the value of the loan…
  - Loan Size (same as origination)
  - Fixed vs. adjustable
  - B credit vs. A credit—Rate of default (**major issue today**)
  - Higher rate as compared to market (7.0% no-closing cost vs. 6.0% and two points). Higher rate more likely to prepay
    - While you hedge loans against rate going up---you would need to hedge a servicing portfolio against rates going down.
  - VA loans vs FHA loans
- If you are brokering loans, the lender's rate sheet reflects the value of the loan and servicing—and the variations often are due to variation in servicing value

WHAT HAPPENS WHEN A LOAN IS CLOSED?

- $100,000 loan. 6.0%. Price is 99.00%.
- Broker wants to make 2 points.
- Applicant (or seller) must bring 3 points to settlement.
- Lender sends $99,000 to table (net funding) from their warehouse line
- Other two points go to broker
- When loan is sold (hopefully for at least $99,000), the money in the warehouse line is replaced.

WHAT IS A WAREHOUSE LINE?

- It is a line of credit secured by the closing instruments
- Short term lending (lender must pay interest) because loans are sold so quickly.
- Lender keeps interest paid until loan is sold.
- If lender collects 6.0% and warehouse line cost is 4.0%, there is a positive warehouse spread.
- This is profit. $20 million average balance over the year, at 2.0% is $400,000 profit
- There are risks
  - If short-term rates are higher than long-term rates—the spread becomes negative (lenders don't like funding option ARMs)
  - What if loan is not bought? Perhaps mistake made in closing. Must sell in the secondary market—scratch and dent sale.
  - That is why every lender has a quality control plan.

THE DEAL ON POINTS

What is the difference between an Origination Fee and a Discount Point?

- Traditionally—Origination Fee pays for the origination of the loan (processing, commission)
- Discount Point—buys down the rate.
- Even IRS had a distinction
- Now—with no point loans, every point buys down the rate
- No distinction---each is deductible
- Some state laws still specify and even antiquated FHA rules
- But in reality, the only difference is that there are separate lines on the GFE and HUD-1 and we usually collect Origination Fee first.

THE DEAL ON FEES

The industry has been built partially on the acquisition of revenue through fees..

- Pass throughs—appraisal, tax service
- Some are pass throughs by others in the process (Lender underwriting fee to a broker)
- Then there are junk fees , which are a bad idea—
  - They smell of bait and switch
  - The make the closing process complex-HUD-1
  - They can't be deducted while points can be---so it costs our customers more.

LONG-TERM VALUE…

Are you taking the long-term view or looking only at what your clients mean for you today?

This is exactly the way that the media portrays us as an industry!

A long term view would have us improving our prospects' financial position—so that they can get a lower rate, afford their home or purchase in the future

Now you can deliver credit repair, debt reduction and budgeting advice with NO WORK FROM YOU, in the most affordable package.

Basically put your clients In better position financially—AND

You Get To Set Up A Monthly Income Stream

FINANCIAL DESTINATION

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And getting transactions to happen

- Professional credit restoration improvement—not a bandaid
- Debt reduction plan
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- Even better—you can chose—just refer deals in without joining. Or when you join as a rep—you get $20 monthly for each client that participates! (rep cost a one time fee in addition to joining as a member)
- More information: www.hershmanfinancialgroup.com
- 24/7 Webinar: http://fdi.originationpro.com/
- Live Webinar tomorrow (Thursday). www.originationpro.com

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- Expertise. Portray you as an expert —no handy homeowner hints— but economic commentary
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- Relevant up-to-date news they can use today
- Easy—it can't take your time to write, personalize or send
- Flexible—different pieces for different segment of your sphere—some targets are more important than others.

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- Response. Designed to make the phone ring with more than one piece available. You are not Proctor and Gamble.
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  (even 1 to 4 page)
- Leverage. Consumer pieces to give to Realtors to send to their consumers.

WHY NEWSLETTERPRO?

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  - Sales and real estate/finance article
  - Bonus flyers and letters
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- The cost is $39 monthly for both NewsletterPro & the CMA training program.
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- Need mail or email fulfillment system? You can upgrade to MyMortgageCommunity and the VELMA personal marketing assistant—cost $69 monthly

WHY NEWSLETTERPRO?

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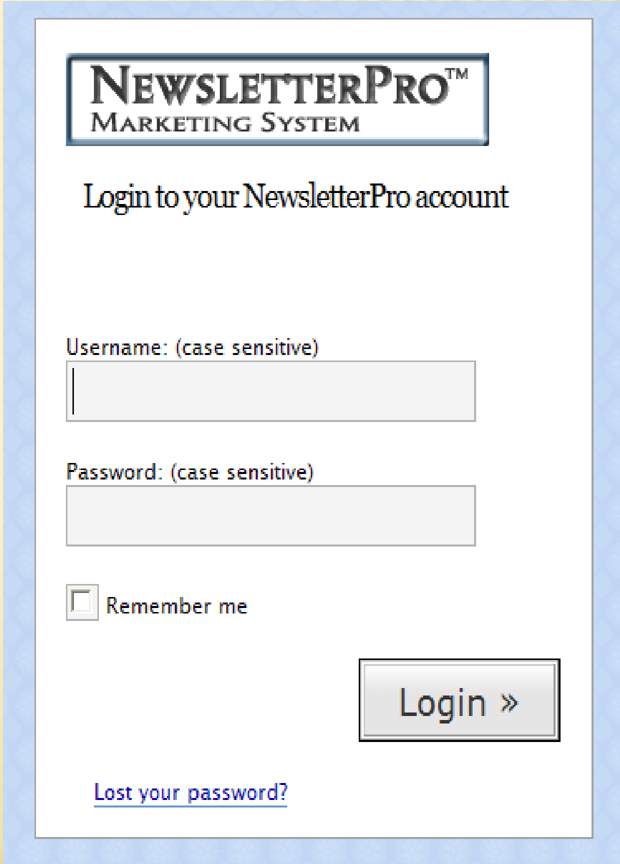
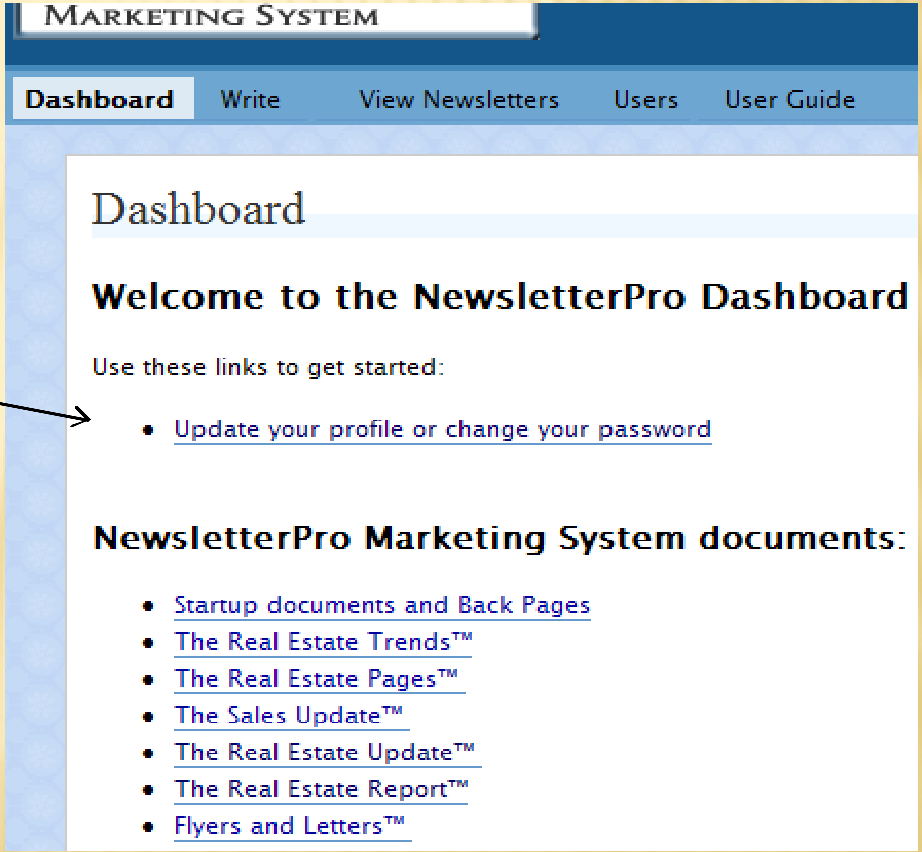


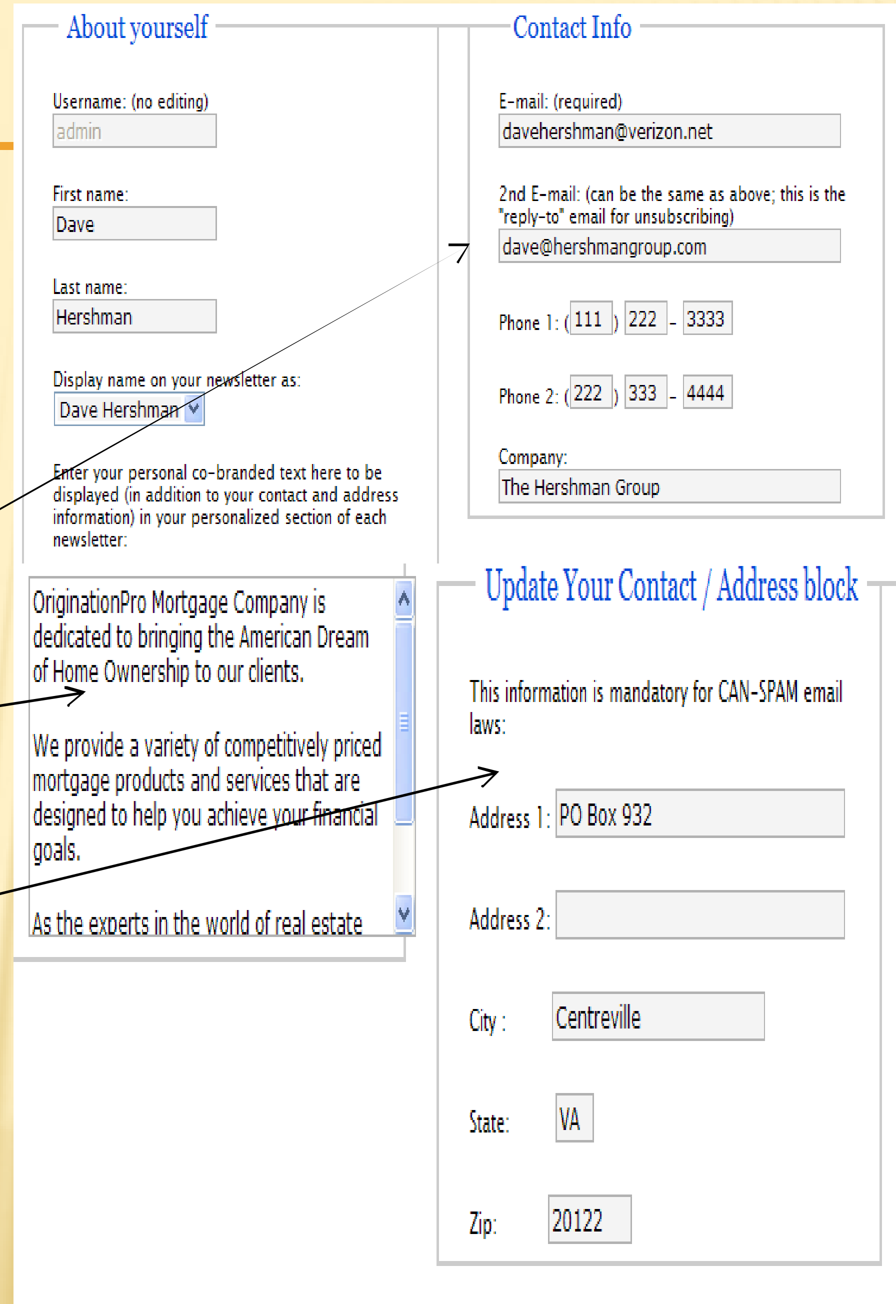
THEN..

Go to Update Profile



STEP ONE

Update Your
- Name
- Contact Info
- Personal Paragraph
- Address Block

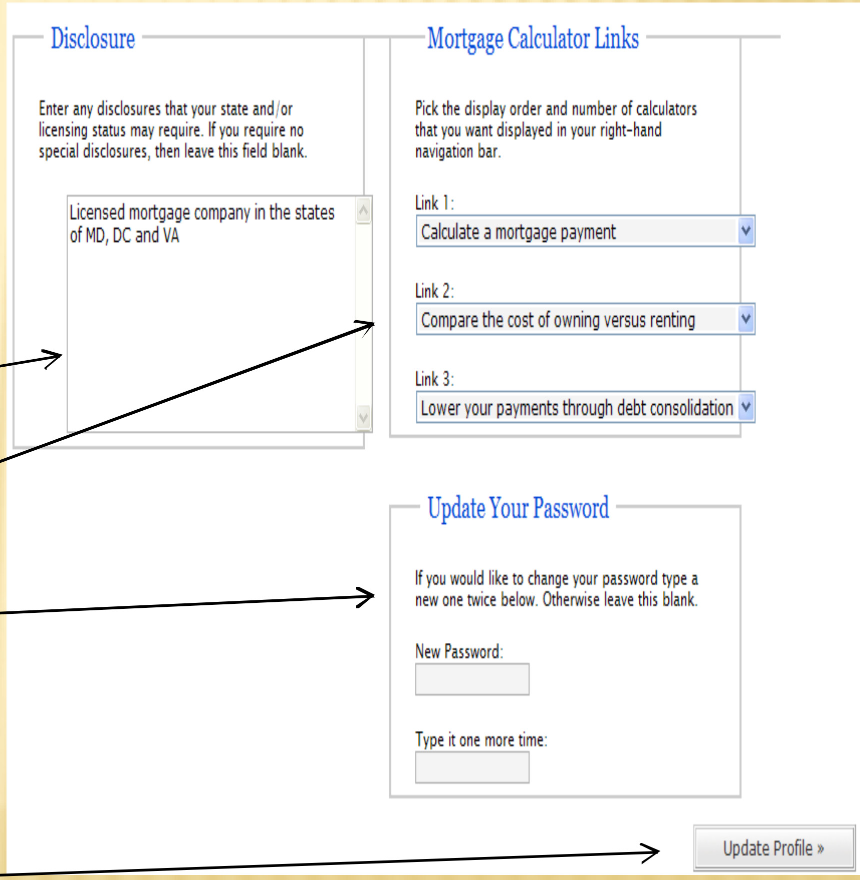


STEP ONE—PART TWO

On same page you can update your

- Disclosure
- Choose calculator links
- Change your password

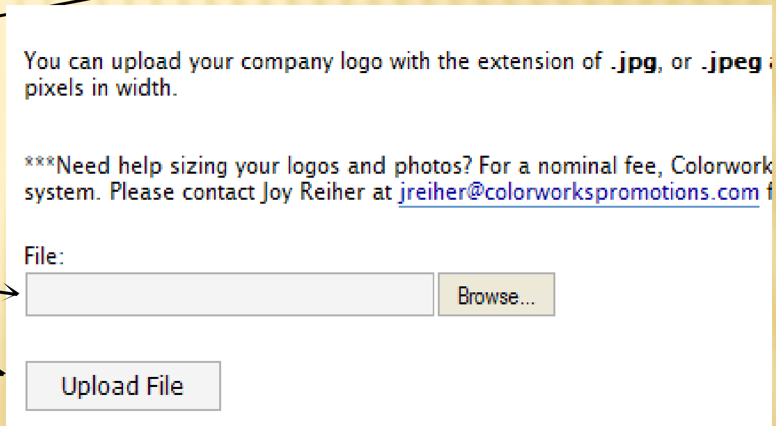
Don't Forget To Hit "Update Profile" Button



STEP TWO

After you update your profile, you can then download your company logo—

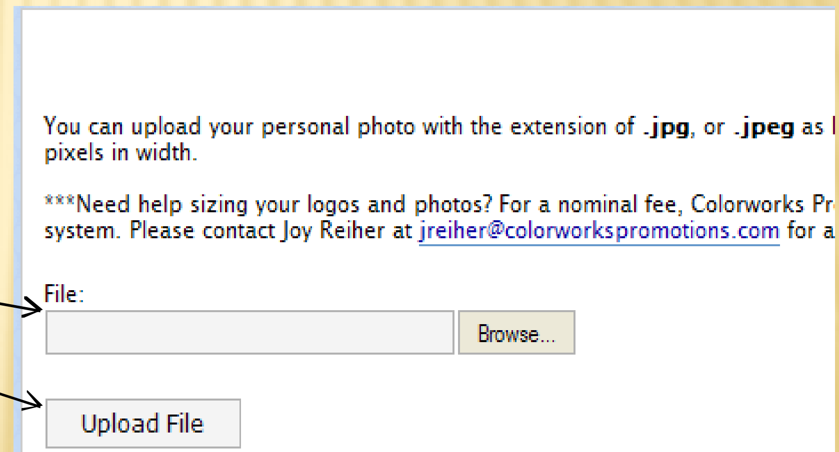
- Click on “Company Logo” on profile page
- Locate your logo on your hard drive to upload
- Click “Upload File”
- Make sure the logo no larger than the size specified



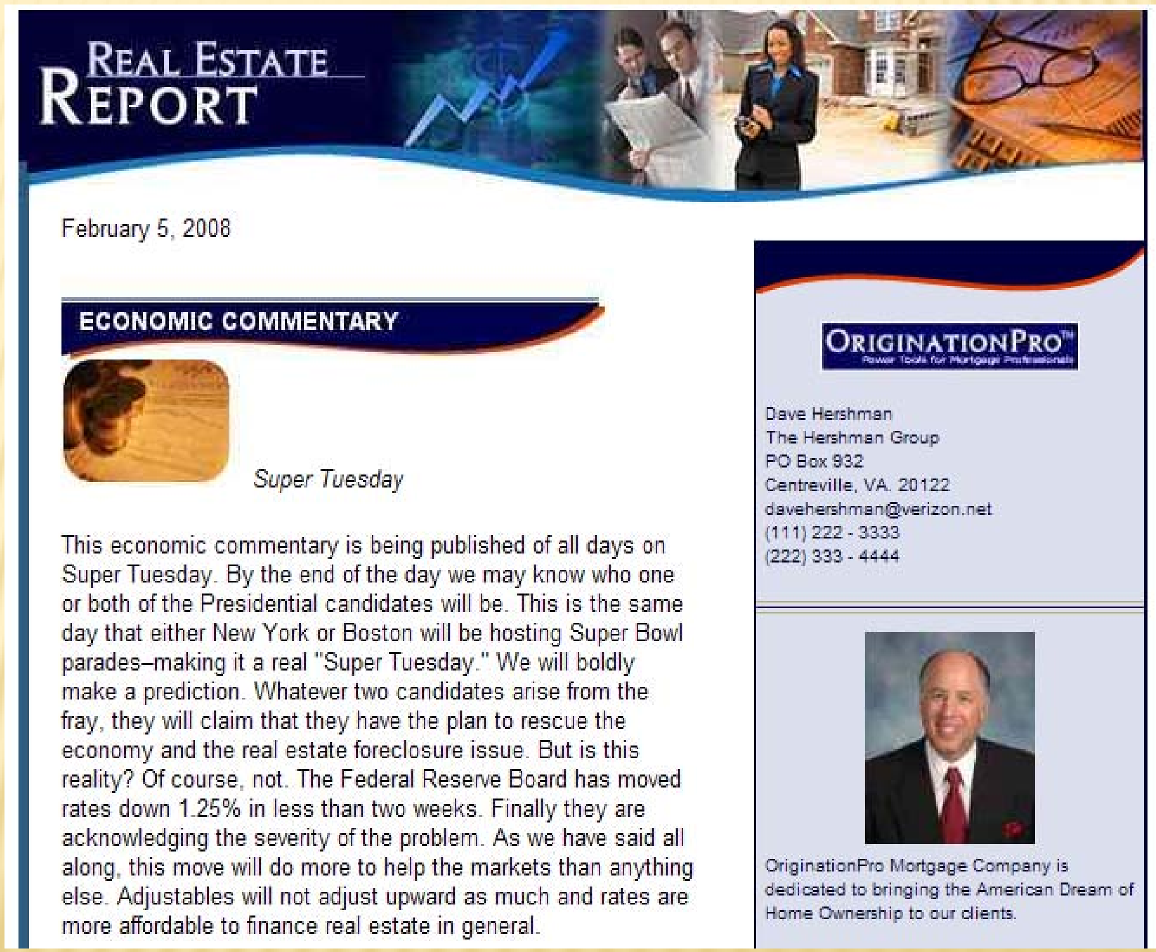
STEP THREE

Back to the Profile Page you can now download your picture

- Click on “Personal Photo”
- Locate the photo on your hard drive
- Click on “Upload File”
- Make sure the photo is no larger than the size specified



AS EASY AS 1-2-3: YOU ARE SET UP



REAL ESTATE REPORT

February 5, 2008

ECONOMIC COMMENTARY

Super Tuesday

This economic commentary is being published of all days on Super Tuesday. By the end of the day we may know who one or both of the Presidential candidates will be. This is the same day that either New York or Boston will be hosting Super Bowl parades–making it a real "Super Tuesday." We will boldly make a prediction. Whatever two candidates arise from the fray, they will claim that they have the plan to rescue the economy and the real estate foreclosure issue. But is this reality? Of course, not. The Federal Reserve Board has moved rates down 1.25% in less than two weeks. Finally they are acknowledging the severity of the problem. As we have said all along, this move will do more to help the markets than anything else. Adjustables will not adjust upward as much and rates are more affordable to finance real estate in general.

ORIGINATIONPRO™
Power Tools for Mortgage Professionals

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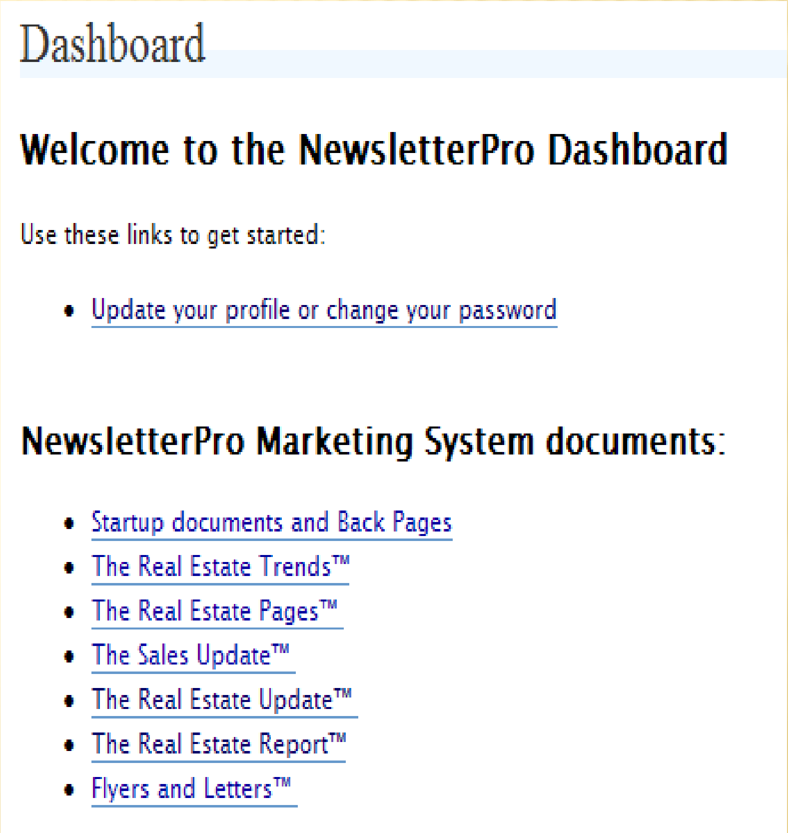
OriginationPro Mortgage Company is dedicated to bringing the American Dream of Home Ownership to our clients.

BUT THAT IS NOT ALL…

- The main page/dashboard also gives you access to all print materials, including archives
- Each document has a version in Microsoft Publisher. If you have that program (part of Office Professional)—you can edit in any way. These then can be turned into PDFs or included in an email.
- Each document also has a “PDF” version which allows you to add your name in the box. The PDF version can be mailed or emailed as an attachment.



START-UP DOCUMENTS

The start-up documents include—

- A sample welcome letter to your newsletter prospects;
- Instructions to add a banner to your Outlook Signature so that those you email can sign up;
- Back Pages. These help turn the one-page documents into self-mailers.

Start-up documents:

Welcome Letter For Real Estate Newsletter

Letter To Prospect

Outlook Signature File and Installation Instructions
(These documents allow you to configure your email signature in Outlook and O
encouraging additional opt-ins to your program)

Back Pages:

Back Page #1 for Letter Size Newsletters

Back Page #1 for Letter Size Newsletters - Publisher Version

Back Page #2 for Letter Size Newsletters

Back Page #2 for Letter Size Newsletter Publisher Version

Back Page #1 for Legal Size Newsletters

Back Page #1 for Legal Size Newsletters Publisher Version

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- Four page document
- Traditional self-mailer newsletter
- For all parts of your sphere
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- Includes finance article

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- Designed as great sales meeting material for presentations

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- Consumer articles on finance and real estate topics
- Can be used for prospect conversions when topic is right (archives become important)
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- Can use as response mechanisms


THE REAL ESTATE PAGE

April 2008

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- Why the secondary market is Important
- The financial crisis
- Commodities
- Servicing
- Warehouse spreads
- Points and fees
- Newsletters and FDI

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