Cutler Consulting, Inc.

Strategic Mortgage Partners

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Who Wants to Be a Millionaire?

Most of us won't have an opportunity to win a million dollars on the popular game show. However, Cutler Consulting can offer a proven strategy to increase your company's income by $1,000,000. In this issue, we examine the financial benefits of selling loans mandatory as opposed to best efforts. If you are currently selling your loans best efforts, pull your early morning investor pricing sheets for April 7th. Compare your investor's "all-in" price for 4.75% to 101.75. The difference is the additional money that you can make selling your loans mandatory. In today's market, the difference between a best efforts delivery and a mandatory delivery is at least 50 basis points. On $25,000,000 per month in production, that equates to $125,000 in additional monthly income, or over $1 million annually.

Inside this issue:

Mandatory vs. Best Efforts Base Pricing Comparison

Examine the chart below which provides a comparison of the base pricing for different types of loan deliveries. On the left hand side are the 30 year fixed rates, starting with 4.625% and ending with 5.250%. The next column contains the actual market price, which is the price at which a loan can be sold directly to a broker or dealer. The remaining columns list mandatory and best efforts pricing from April 7th for a large aggregator and one of the agencies. Lenders who sell loans using MBS securities execute their sales at the market price. Other lenders must obtain pricing from the agencies or the aggregators.

30 Year Fixed Rate Base Pricing (SRP not included)

Rate	Market Price	Agency Mandatory	Agency Best Efforts	Aggregator Mandatory	Aggregator Best Efforts
4.625%	100.14	100.06	99.560	99.510	98.014
4.750%	100.53	100.48	99.980	99.850	98.360
4.875%	100.56	100.89	100.39	100.04	98.569
5.000%	101.16	101.26	100.74	100.35	98.892
5.125%	101.76	101.60	101.10	100.59	99.138
5.250%	102.15	101.95	101.45	100.74	99.290

Prices are based on 60 day delivery and assume identical loan characteristics.

Mandatory Pricing

For purposes of this comparison, pricing will be examined and discussed for only one rate. On April 7th, the actual market price for a 4.750% loan was 100.53. The Agency Mandatory price was 100.48 (at the market price allowing for timing difference). *The Agency pricing referred to in this chart is available only for lenders selling directly to the agency, not to an agency designated third party.*

Aggregator Mandatory pricing is 68 basis points lower than the actual Market Price. This is largely because rates are at a historic low, putting pressure on servicing values. Most aggregators adjust their base pricing downward during periods of declining servicing values, instead of adjusting their servicing released premiums.

Best Efforts Pricing

Generally, Agency and Aggregator Best Efforts Pricing is 35 to 50 basis points lower than their respective mandatory pricing. In the example above, the Agency Best Efforts Pricing is 50 basis points worse than its mandatory pricing. The Aggregator Best Efforts Pricing is 150 basis points lower than its mandatory pricing and 200 plus basis points lower than the actual market price.

Best Execution

The base pricing only tells part of the story. To determine the best execution for the lender, the total or "all-in" price must be examined. This price includes the base price plus the servicing released premium, or SRP.

Servicing Released Options

Aggregator Best Efforts – Base pricing and SRP subject to market conditions and individual investor guidelines and adjustments.

Agency Best Efforts – net coupon whole loan sold directly to the agency. Servicing sold to a third party.

Aggregator Mandatory – loans and servicing sold loan by loan or in block commitments.

Agency Mandatory – net coupon whole loan sales loan by loan or in blocks sold directly to the agency. Servicing sold to third party.

AOT – lender executes MBS trade, assigns the trade to aggregator, notifies dealer of the assignment, and delivers loans against the assigned trade to the aggregator. The aggregator pools the loans and makes the actual delivery against the assigned trade to the dealer.

Co-issue – lender executes MBS trade, pools the loans, makes delivery against the trade and simultaneously assigns servicing to an aggregator.

Private Investor – best efforts or mandatory delivery to bank. conduit, insurance company or pension fund.

Best Execution Analysis

Assume the lender will sell 25 basis points of servicing simultaneously with the sale of the loan. The servicing values in the chart below are based on actual values obtained on April 7th. On this date, the lender could sell the loan to the agency via Best Efforts or Mandatory delivery and sell the servicing at 1.25. The lender also has the option to sell the loan to the aggregator via Best Efforts or Mandatory delivery and sell the servicing at 1.90. By combining the base prices from the previous chart and the associated SRPs, we arrive at the total (all-in) pricing shown below.

Note Rate	Agency 30 Year Fixed Rate Pricing						Aggregator 30 Year Fixed Rate Pricing					
	Mandatory			Best Efforts			Mandatory			Best Efforts		
	Base Price	SRP	Total Price	Base Price	SRP	Total Price	Base Price	SRP	Total Price	Base Price	SRP	Total Price
4.625%	100.060	1.25	101.310	99.560	1.25	100.810	99.510	1.90	101.410	98.014	1.90	99.914
4.750%	100.480	1.25	101.730	99.980	1.25	101.230	99.850	1.90	101.750	98.360	1.90	100.260
4.875%	100.890	1.25	102.140	100.390	1.25	101.640	100.040	1.90	101.940	98.569	1.90	100.469
5.000%	101.260	1.25	102.510	100.740	1.25	101.990	100.350	1.90	102.250	98.892	1.90	100.792
5.125%	101.600	1.25	102.850	101.100	1.25	102.350	100.590	1.90	102.490	99.138	1.90	101.038
5.250%	101.950	1.25	103.200	101.450	1.25	102.700	100.740	1.90	102.640	99.290	1.90	101.190

The total price for each delivery method is compiled in the chart below. A best execution analysis is then performed by comparing the total price for each delivery method. The best execution for each note rate is highlighted in bold print and noted under the Best Execution column.

Note that the price for Agency Mandatory Delivery and Aggregator Mandatory are about the same. The aggregator's lower base price is offset by its higher servicing released premium.

Agency Best Efforts is superior to Aggregator Best Efforts. This reflects the severity of the Aggregator base price reduction.

Aggregator Best Efforts Total Price is 100-150 basis points worse than the other executions.

This chart provides pricing for one day only, but is representative of the increased profitability that can be generated by selling loans via mandatory delivery. Mandatory delivery execution has been substantially better than best efforts execution since late last year. This trend is expected to continue.

The threshold to switch from best efforts to mandatory delivery is generally pegged at $15-$20 million in sustainable conventional 30 year agency business per month. Other requirements include:

- Fallout Tracking.
- Discipline and Attention to detail.
- Working knowledge of pipeline behavior.
- Customer knowledge.
- Pipeline management reports.
- Management tolerance for fluctuations in gain on sale in volatile markets.
- Warehouse capacity to hold closed loans for a period of time to obtain a best execution price.

30 Year Fixed Rate Total Pricing (Base + SRP)					
Note Rate	Agency Mandatory	Agency Best Efforts	Aggregator Mandatory	Aggregator Best Efforts	Best Execution
4.625%	101.310	100.810	**101.410**	99.914	101.410
4.750%	101.730	101.230	**101.750**	100.260	101.750
4.875%	**102.140**	101.640	101.940	100.469	102.140
5.000%	**102.510**	101.990	102.250	100.792	102.510
5.125%	**102.850**	102.350	102.490	101.038	102.850
5.250%	**103.200**	102.700	102.640	101.190	103.200

Fallout

Successfully predicting pipeline fallout is critical to hedging a mortgage pipeline via mandatory commitments. Fallout is calculated by isolating and tracking all loans locked in a given month until their last expiration date or 60 days from the last day of the month, whichever comes first.

Lenders should have a minimum of 3 months of historical fallout information prior to deploying a mandatory selling strategy. Correspondent scorecards may provide a short-term alternative if the lender is selling the majority of its business to one aggregator.

Don't Be Afraid - You Can Do This

On the next page, we examine some of the perceptions and fears regarding mandatory delivery and provide real world solutions.

Perception versus Reality

Business is great! I don't have time to switch delivery methods.	The refinance boom won't last forever. Switching to mandatory delivery will allow you to remain competitive and permanently increase profitability.
Why switch? I am making 75 -100 basis points gain on sale on every loan now.	Based on current pricing, implementing a mandatory delivery strategy gives you an opportunity to make 150 -200 basis points gain on sale on every loan.
We do not understand selling loans mandatory. We would have to hire experts to hedge the pipeline.	Additional personnel may not be required. Current personnel may only need training that can be provided by an experienced consultant.
I am having a hard time predicting my fallout. If rates continue to go down, my fallout will increase and I will not have enough loans to fill my mandatory commitments.	Experienced production managers and lock in specialists generally understand their pull through rates under different interest rate scenarios. They only lack the structure and training needed to successfully hedge the pipeline using mandatory commitments.
We do not have any money in the budget to hire consultants.	Selling loans mandatory is a proven method to increasing mortgage company profitability. The temporary expense incurred to hire consultants would be more than offset by the increased profit margin.
My bank would not be comfortable taking on the additional interest rate risks.	Selling loans mandatory involves additional risks. These risks can be effectively managed through proper pipeline reporting and oversight. A consultant can prepare a risk rewards presentation for the CEO and Board of Directors that clearly states the benefits of switching to mandatory delivery.

Do you need a lifeline…?

Cutler Consulting is a multifaceted financial services consulting company specializing in the mortgage and housing markets. As a strategic mortgage partner, we offer our clients senior management experience, in -depth functional knowledge and skills, and an expansive network of industry resources. We work in close partnership with our clients to deliver solutions designed to increase profitability, improve performance, and gain competitive advantage. In this rapidly changing mortgage lending environment, Cutler Consulting assists its clients with the critical decisions and tasks impacting the direction and success of their businesses.

The Final Answer

Sell Mandatory and Watch your Profits Grow

Best Efforts is a hedging strategy - an expensive one. If you want to be a millionaire, you have to beat the competition. Putting yourself in position to take advantage of the best available secondary marketing execution can be critical to your success. If your competitors sell their loans mandatory and you do not, they will have a pricing advantage every day for the rest of your mortgage life. Cutler Consulting has the expertise to assist you in determining if switching to mandatory delivery is the right plan strategy for your company. Contact us to set up a consultative meeting to discuss improving your profitability via mandatory delivery. Learn how to sell your loans mandatory and this strategy will be your BEST FRIEND FOREVER.

-Professor Mort Gage

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