



Mandatory Commitments:

How, Why and Best Practices

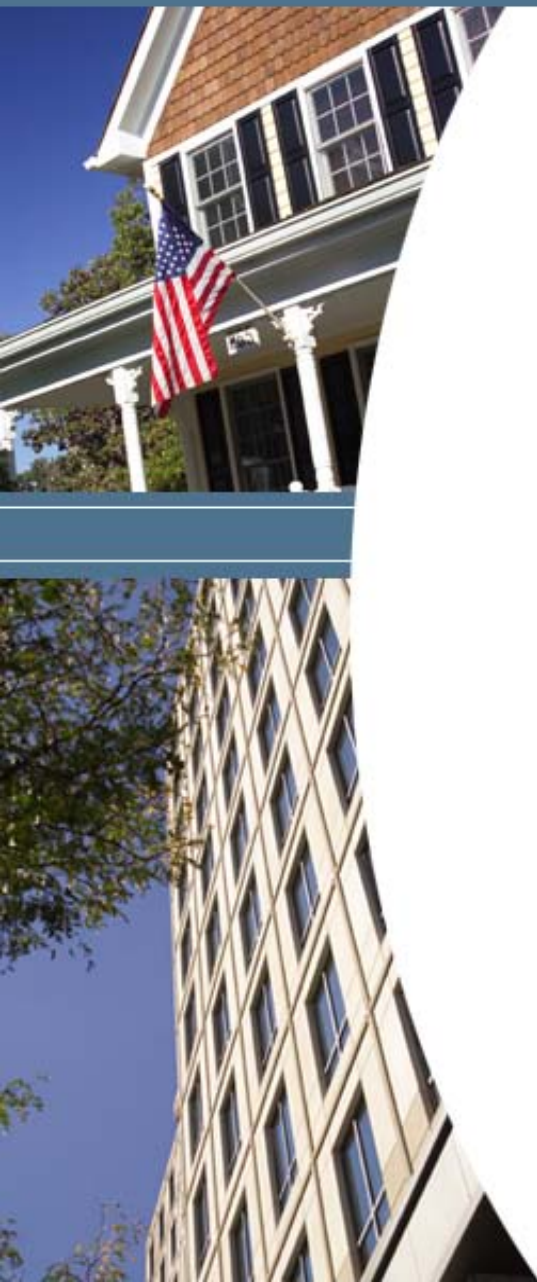
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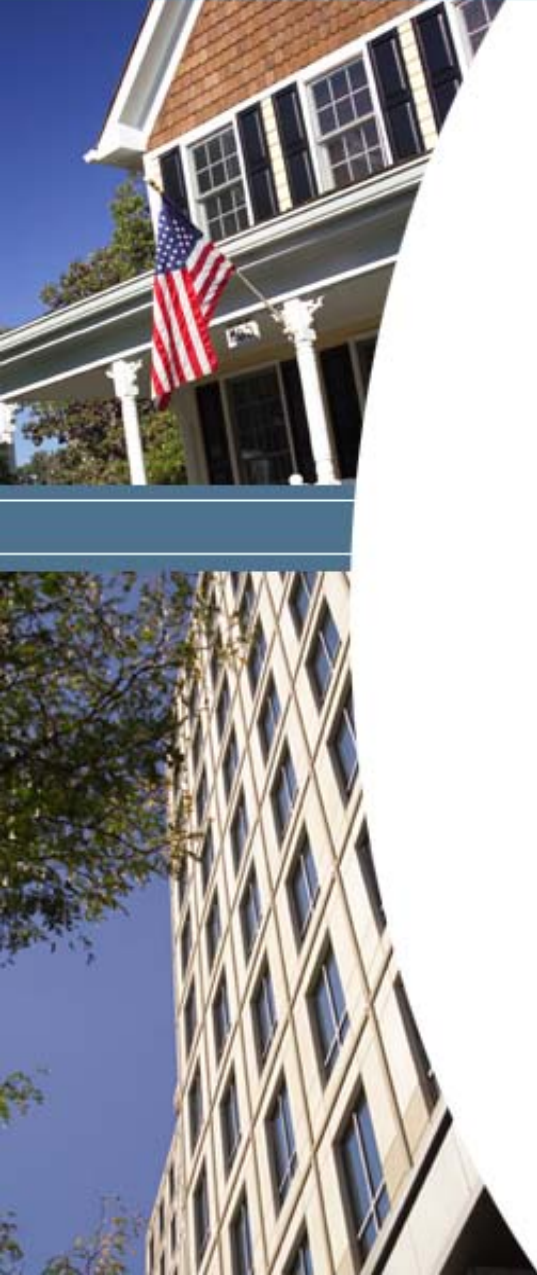




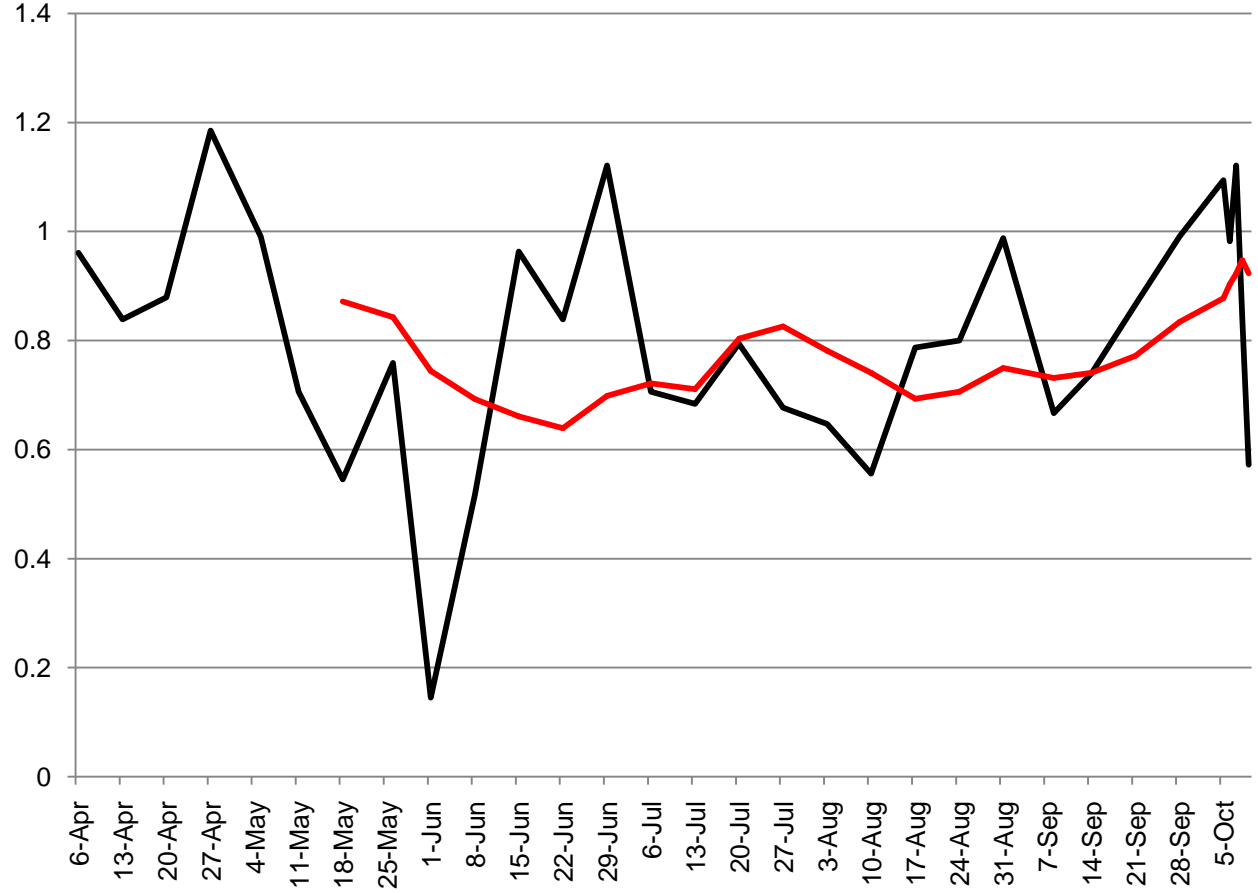
The Opportunity

Why Sell Mandatory

- Increase Revenue
- Take Control of Your Destiny
- Move Beyond Best Efforts to More Strategic and Profitable Mandatory Commitment Strategies
- Increase Operational Efficiency

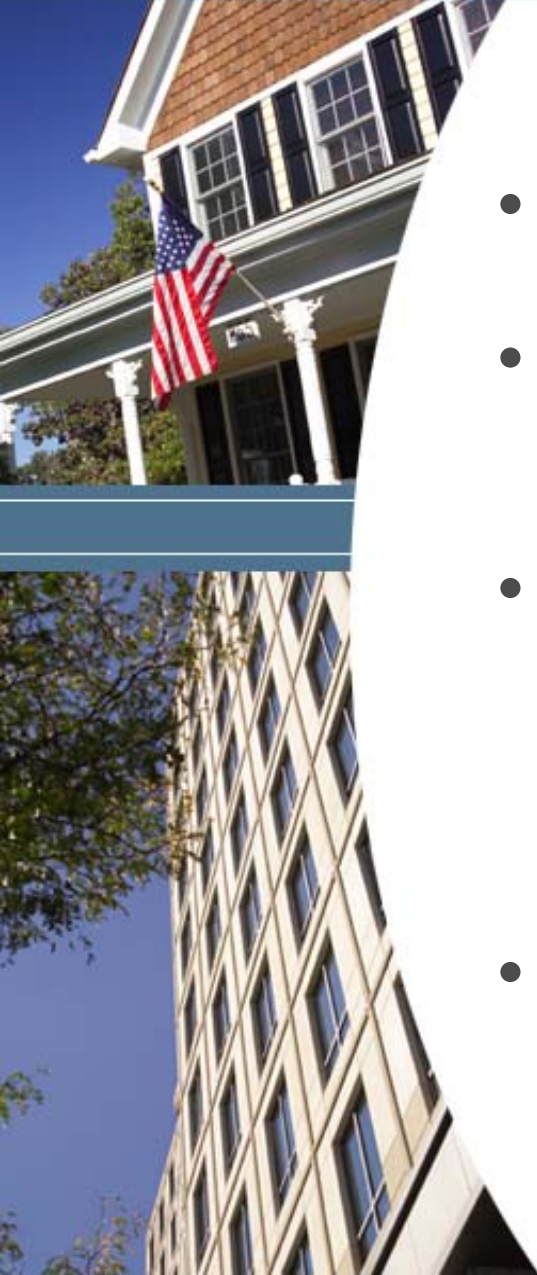


Best Efforts-Mandatory Pricing Spread

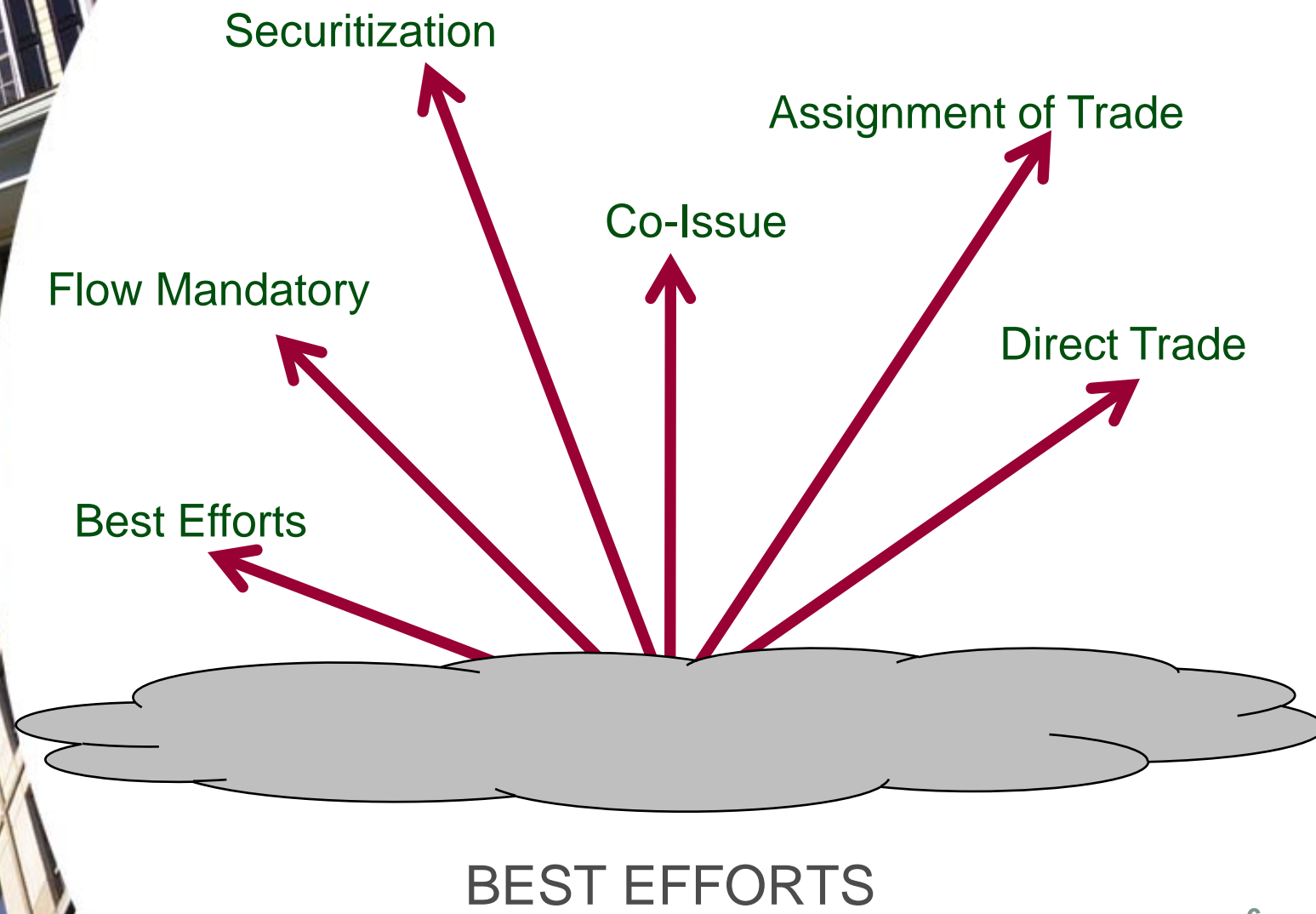
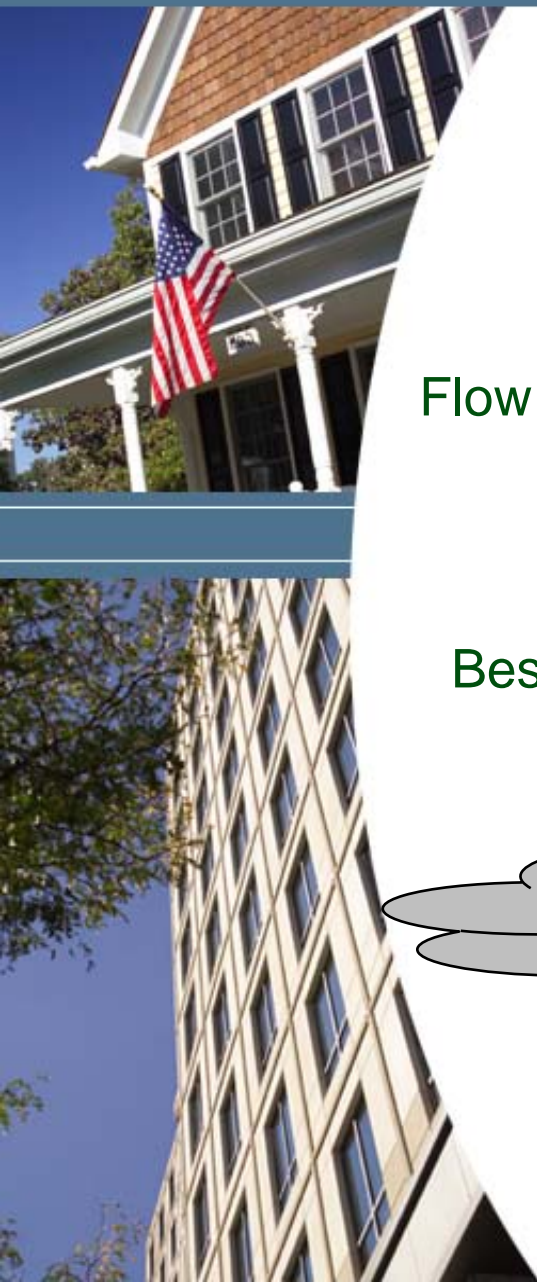


Pricing derived from Wells Fargo Funding comparing the unadjusted price of a 30-year conventional loan on a 30-day best efforts lock versus a 30-day mandatory lock from the AOT indications.

More Than Just the “Spreads”

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- Receive the mandatory pricing benefit
 - Arbitrage investors pricing opportunities
 - Improve pull-through performance
 - ✓ 100% pull through because of mandatory strategy will earn you top-tier pricing from investors
 - Capitalize on early loan delivery

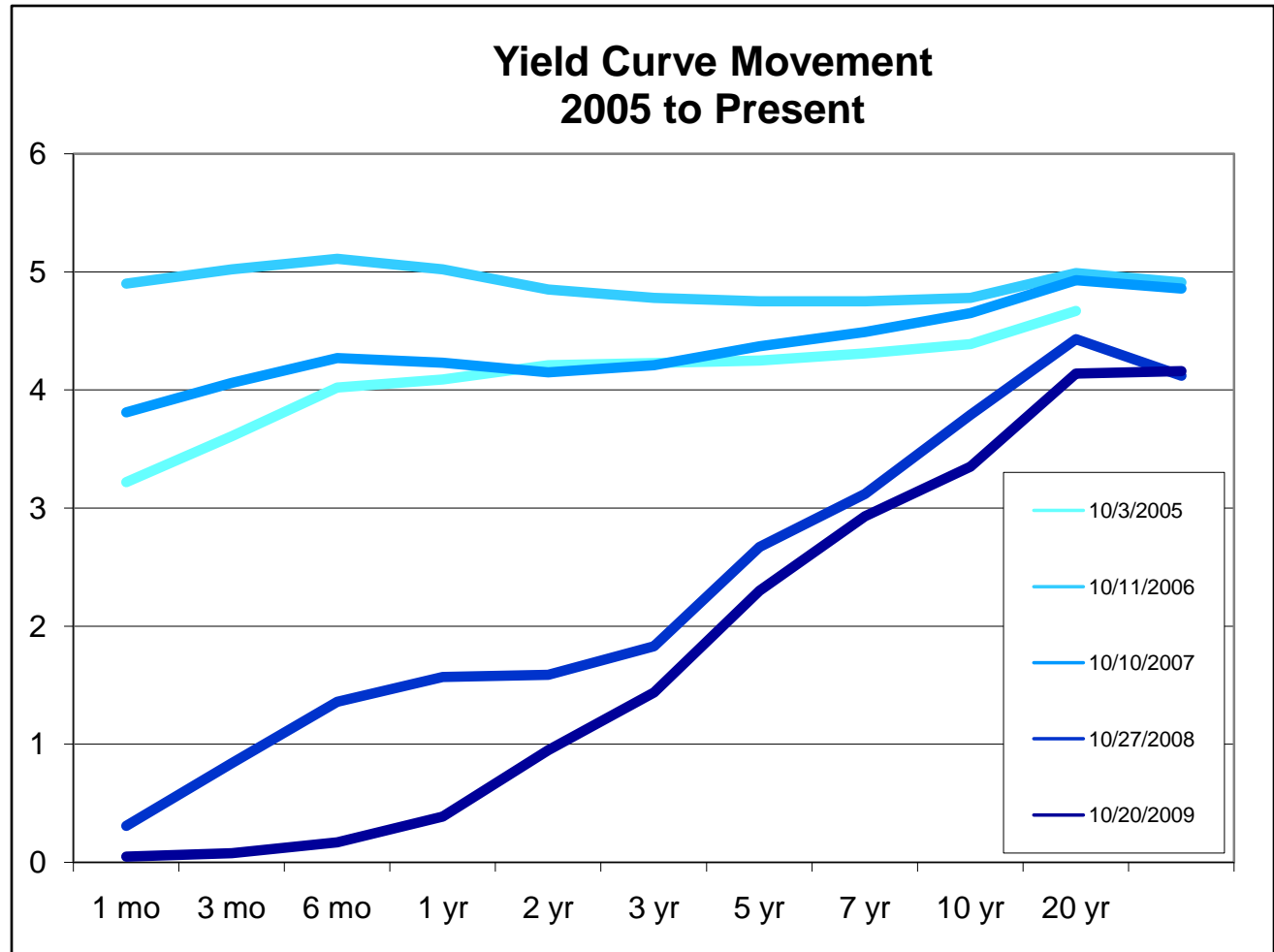
Spectrum of Commitment Options



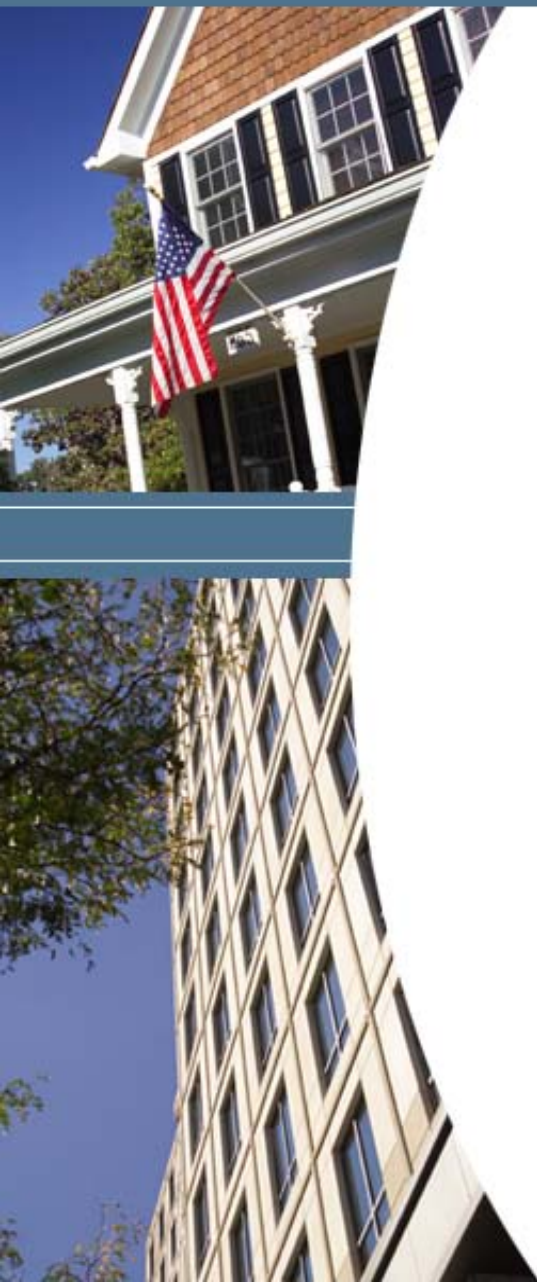
Will This Environment Persist?

- Limited number of investors
- Steeper yield curve environment
- Investors embedding pull-through management costs into pricing
- Fostering investors direct retail business

Recent Spread Between Best Efforts and Mandatory



Data derived from the U.S. Dept. of the Treasury. <http://www.treas.gov/offices/domestic-finance/debt-management/interest-rate/yield.shtml>



The Risks

The Free Put Option

- ✓ Borrower has the right, but not the obligation, to sell you the loan at a specified price
- ✓ Banker incurs risk typically without receiving any correlating compensation



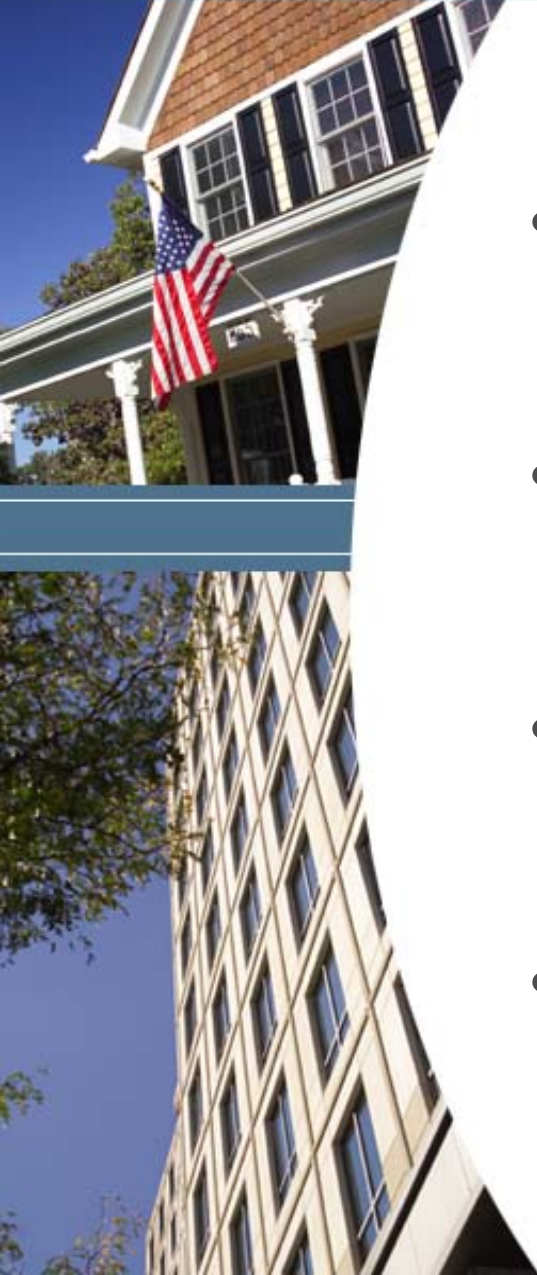
- **PRICE RISK**

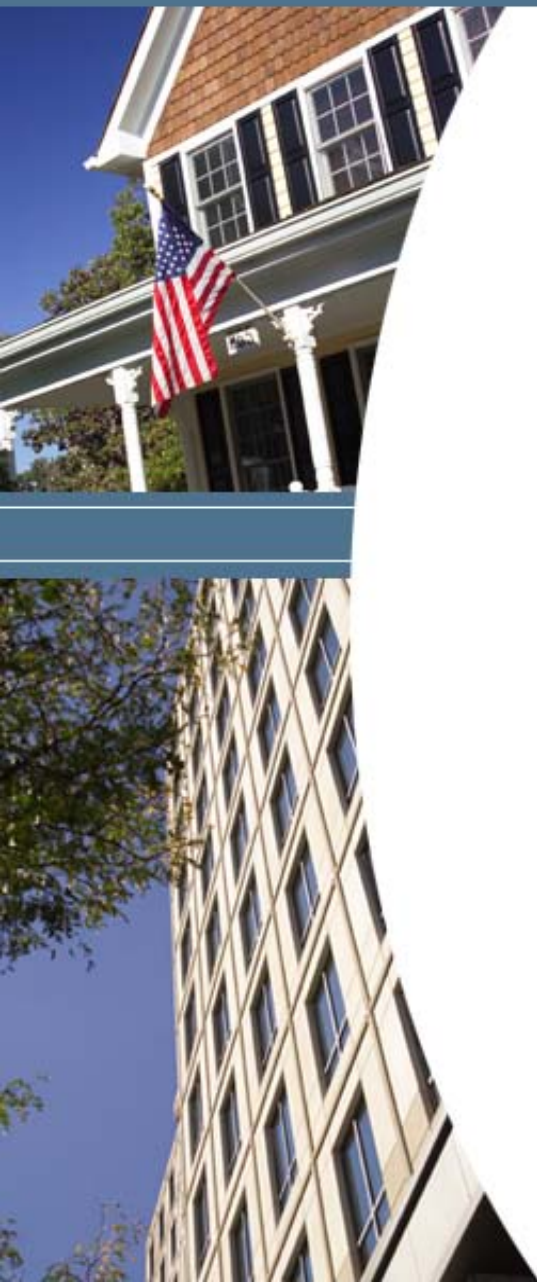
The loan price will change from time the lock commitment is provided to the borrower to the time the loan is committed to the secondary market investor.

- **FALLOUT VOLATILITY**

The loan may not close at the same rate, price, or amount as the originally lock commitment.

- ✓ Fallout depends on the type of business (retail v. Wholesale; Internet v. Standard)
- ✓ Percentage of loans that go to close is called the pull through percentage

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- **Product Risk**
 - **Pricing Correlation**
 - **Data Challenges**
 - **Operational Challenges**

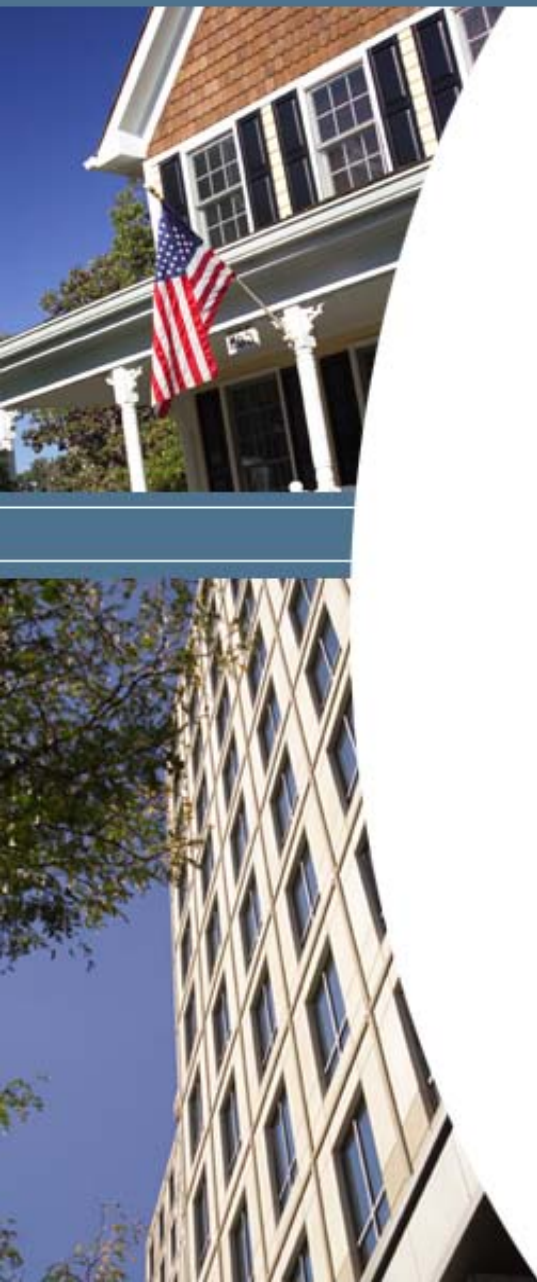


The Philosophy

- Hedge is be designed to shield the pipeline from daily market risk
- Protect the pre-determined profit margin
- Maximize the capture of the best efforts/mandatory spread offered in the market

Accentuate Existing Strengths

- **Good Data makes good hedging**
 - You can't hedge what you don't know
 - Expect perfection and eliminate avoidable inefficiencies
 - Pick up the extra bps
- **Make a good company better**
 - ✓ Build on operational foundation
 - ✓ Strong accounting practices
 - ✓ Strong operational practices
 - ✓ Effective technology

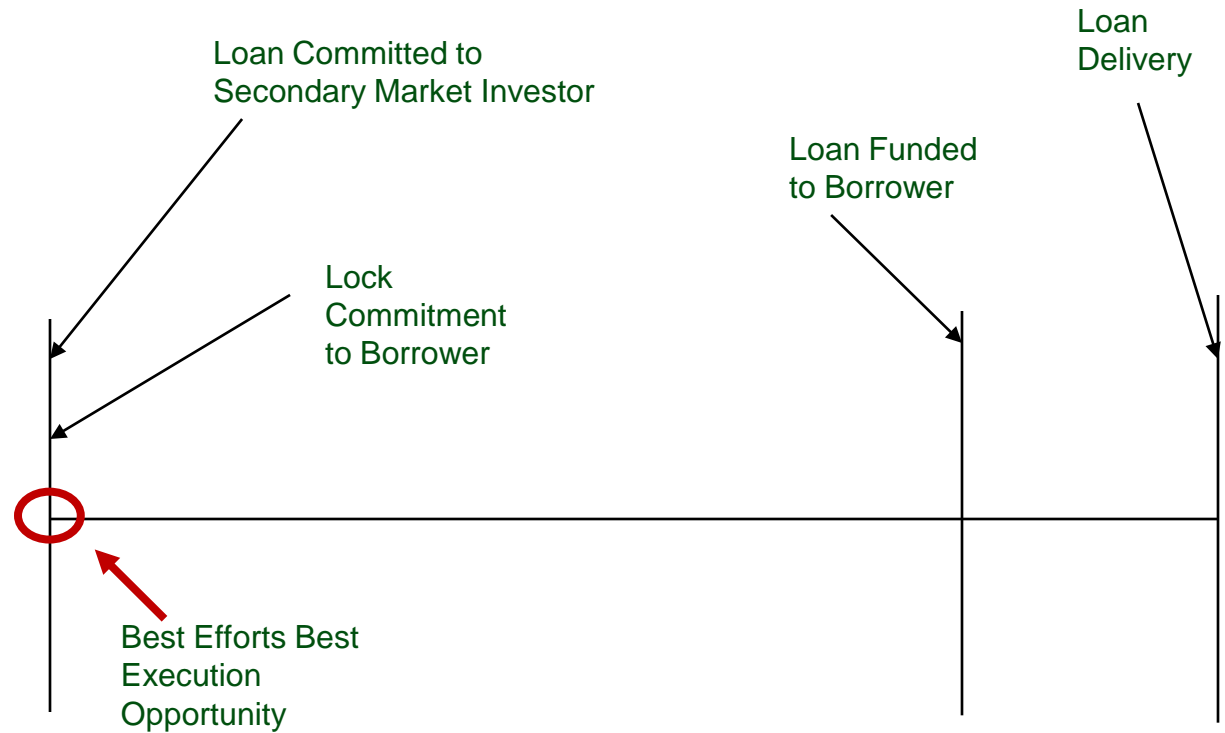
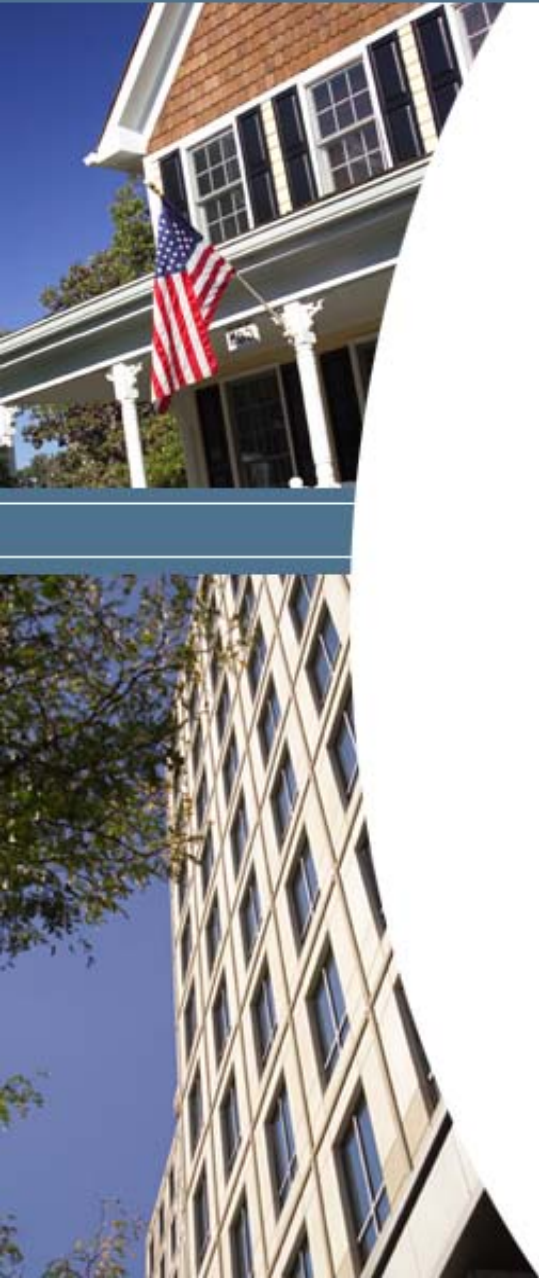


The Solutions

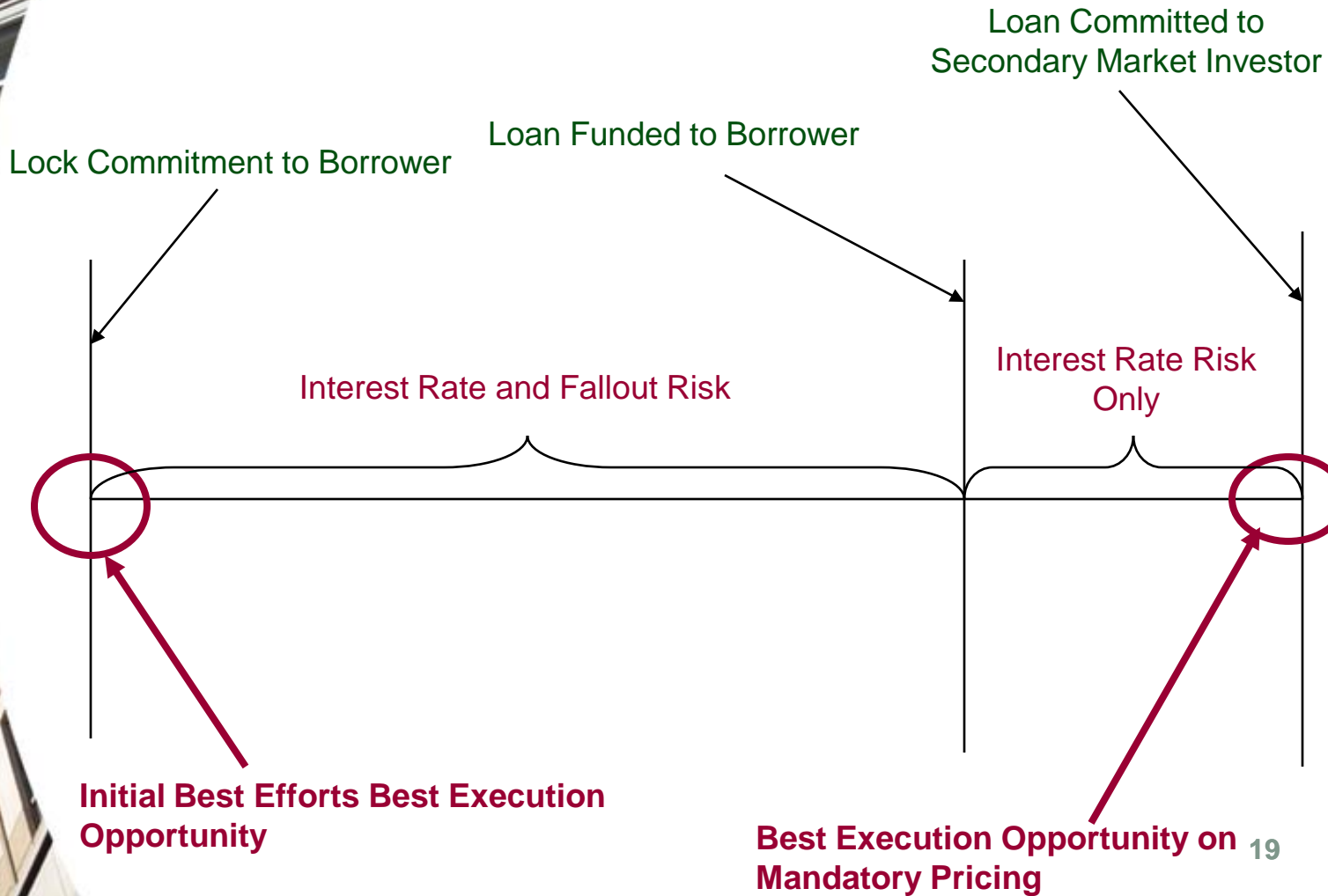
Discipline, Focus and Routine

- Regular daily routine
- Neutralize daily market movement with forward sales of Mortgage Backed Securities (“TBAs”)
- Structure Pull-through strategy based on business practices and historical pipeline research
- Use securities with high correlations
- Analyze data on a timely basis

Best Efforts Time Frame



Mandatory Time Frame





Day One Production

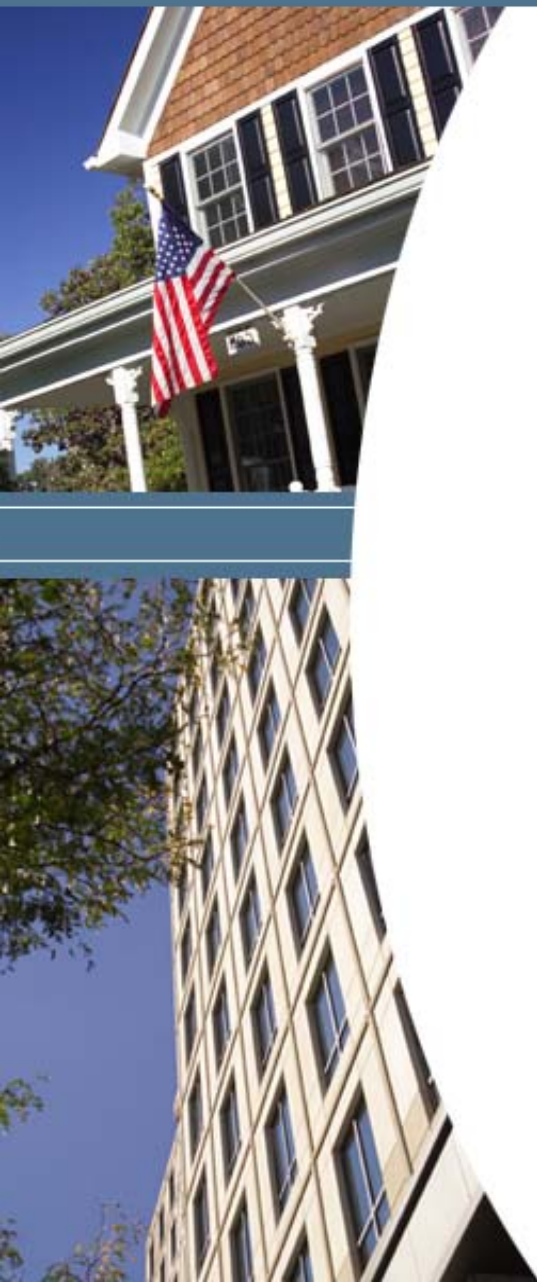
- Lock \$1,000,000 of 5.0% Loans at Par

Adding Coverage

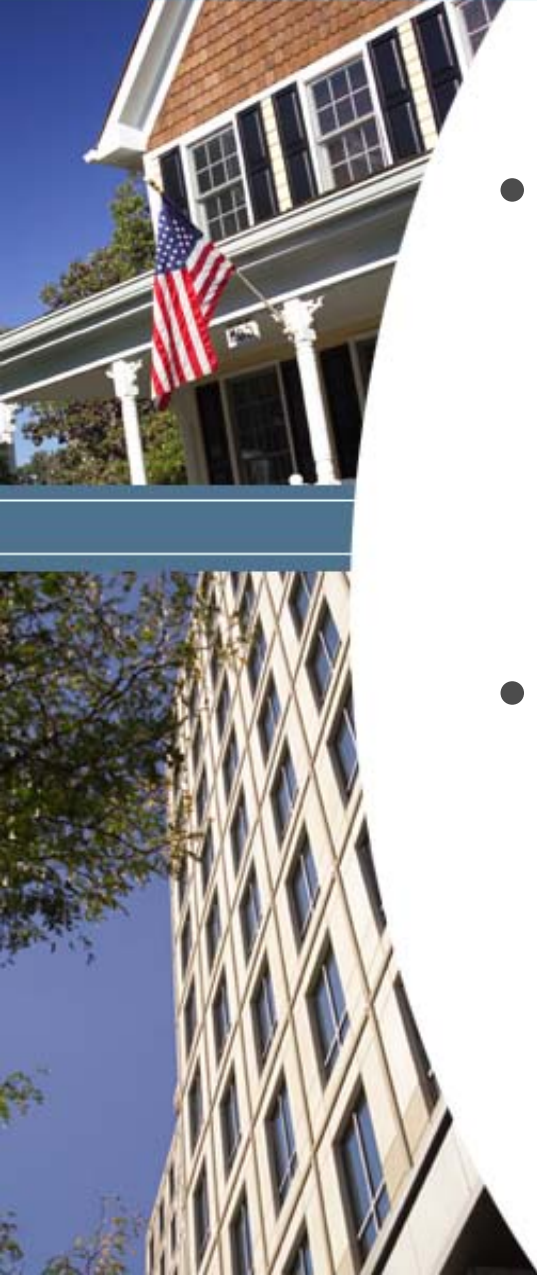
- Sell forward 4.5% coupon TBAs
- Coupon maturity date corresponds with lock expiration date
- Quantity of forward sales discounted by estimated pull-through

Adjust hedge daily based on cumulative change in pipeline

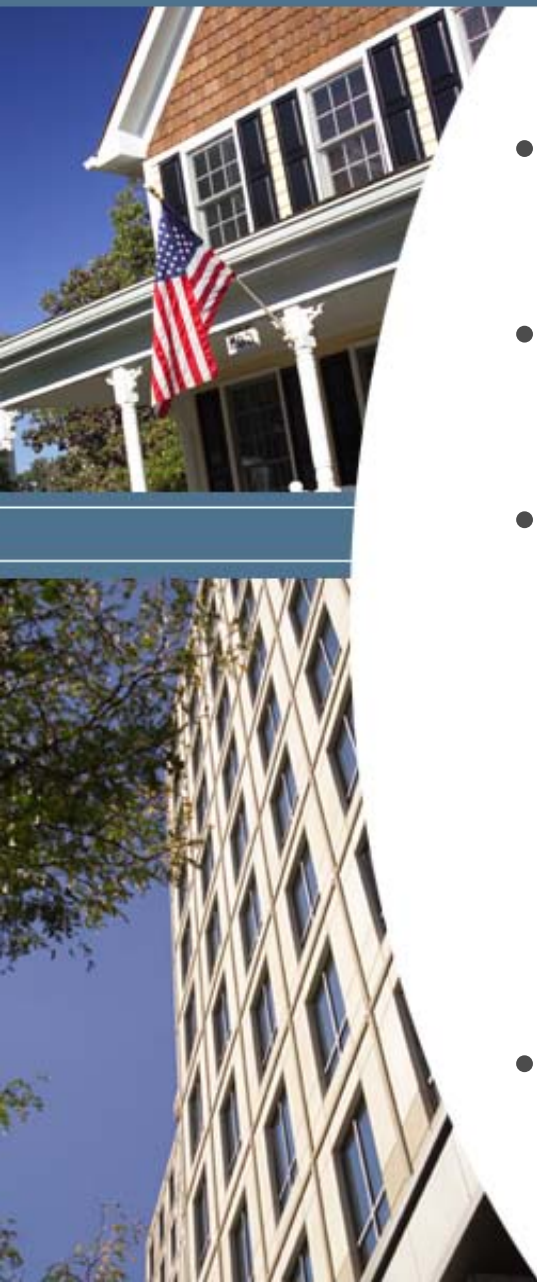
- New Loans minus new fallout minus new commitments



- Forward sales originated to protect agricultural producers
- 100 bushels of wheat harvestable in two months
- Current market price is acceptable
- Farmer SELLS forward for delivery in two months at current price
- Speculator on the other side takes the risk of price decline but benefits from price increase
- Farmer locks in the current price and eliminates price risk.

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- Agricultural example assumes direct trade with one speculator
 - » Trade is not liquid
 - » Trade is tied to specific collateral (i.e. specific bushels of wheat)
 - TBA is fungible futures contract on a security to be formed in the future
 - » Trade is highly liquid
 - » Trade is fungible – not tied to specific loans

Establishing Pull-Through Strategy



- Historical statistical research of past performance
- Establish base pull-through assumption
- Granularize pull-through assumption
 - » Specific data points that affect pull-through performance, i.e. status, lock duration, loan purpose, origination source, etc.
 - » Market movement
- Update statistical research periodically

\$1MM of 5.0% Locks Price at Par

\$1MM of MBS Sold Forward at Par

	Loans		MBS
Day 1	100	Sold	100
Day 45	<u>101</u>	Buy	<u>101</u>
	+1		-1
	+Mandatory/BE Pick-Up		

\$1MM of 5.0% Locks Price at Par

\$1MM of MBS Sold Forward at Par

	Loans		MBS
Day 1	100	Sold	100
Day 45	<u>99</u>	Buy	<u>99</u>
	-1		+1
	+Mandatory/BE Pick-Up		



Improving Market

Receive Check from Investor
Write Check to Broker/Dealer

**Check from Investor includes market pick-up
from lock to commitment**

Declining Market

Receive Check from Investor
Receive Check from Broker/Dealer

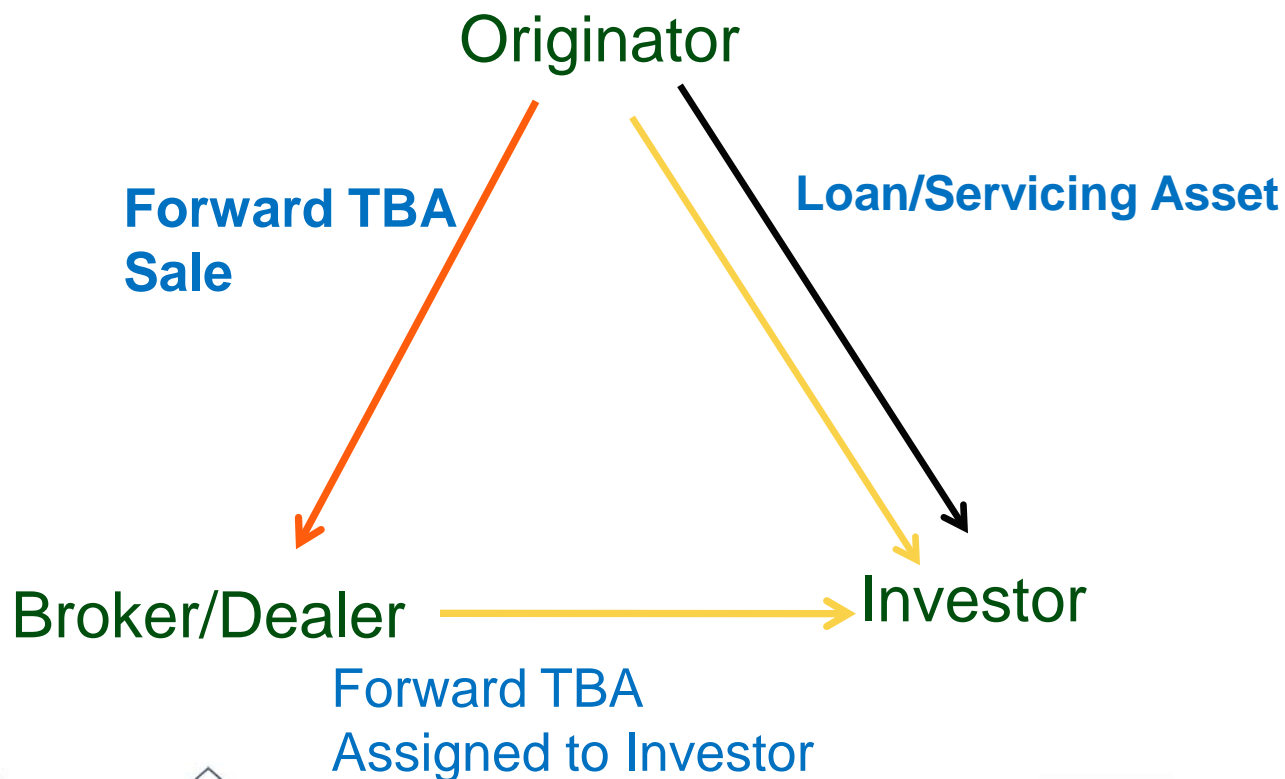
**Check from Investor Excludes Market
Deterioration Which is Made Up for by
Broker/Dealer Check.**

Flow or direct trade strategy causes to imbalanced cash flow

- MBS trades are organized by coupon, settlement month and class (FNMA, Freddie, GNMA I, GNMA II)
- Each class has a separate settlement date each month
- Pay or owe the broker/dealer on settlement day
- MBS Cash flow will be different than loan sale cash flow from investors

Assignment of Trade

- Resolves disjointed cash flow
 - » Avoid MBS pair out
 - » Paid based on MBS trade price
- Likely to improve revenue performance





Daily Mark to Market

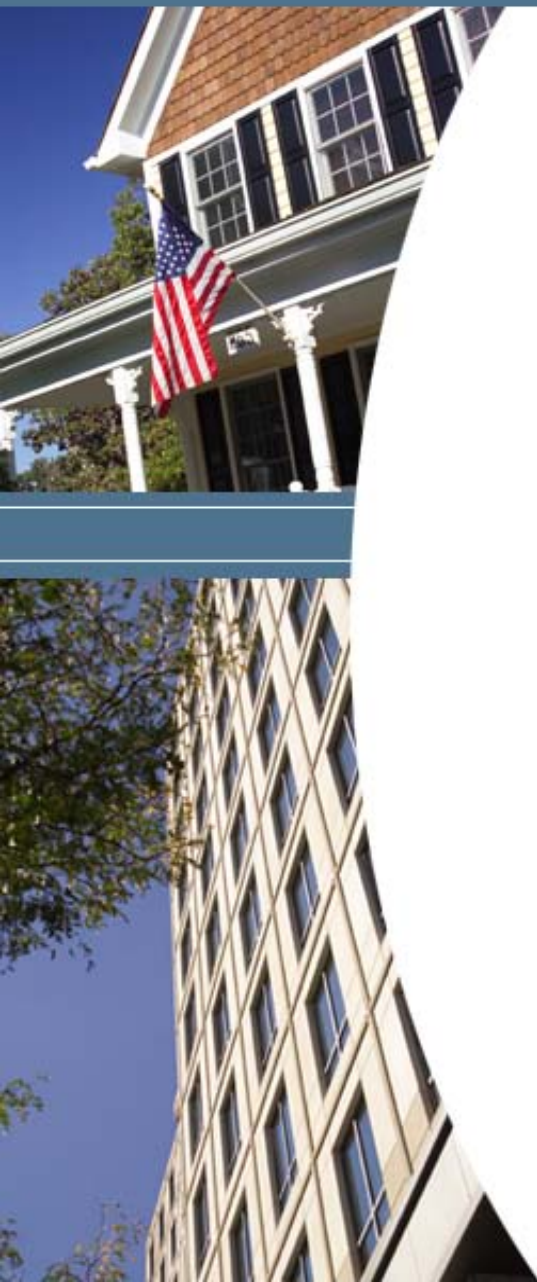
- Quantification of loan and trade values
- Broken down in open, committed and closed categories
- Enables clear understanding of financial position at all times

Daily Shock Analysis

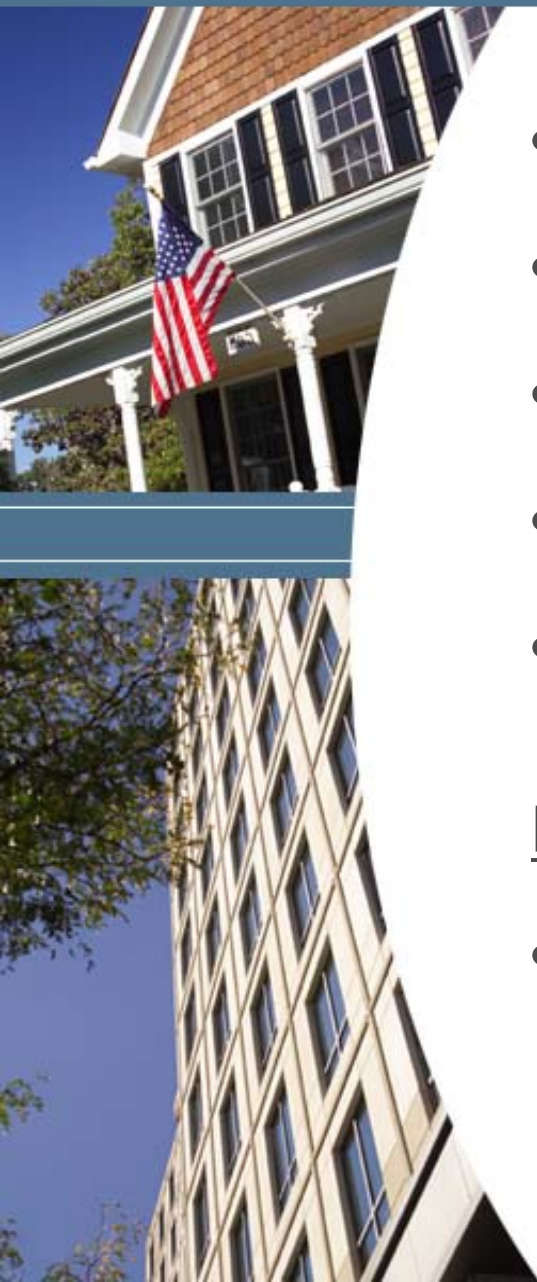
- Graphically displays current market risk position

Daily Cash Flow Reporting

- Clear understanding of upcoming cash flow events including both loans and trades



The Transition

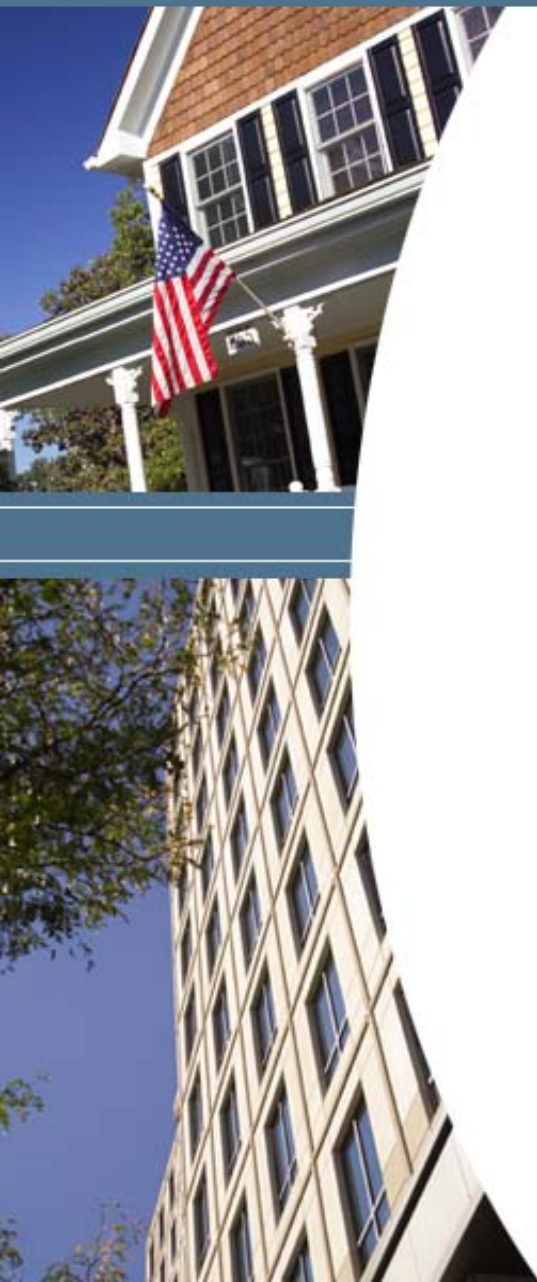
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- **Centralized lock desk**
 - **Established pricing policy**
 - **Stable data recording & tracking system**
 - **\$1.5MM net worth**
 - **Internal staff to manage lock desk**

Not Necessarily Required

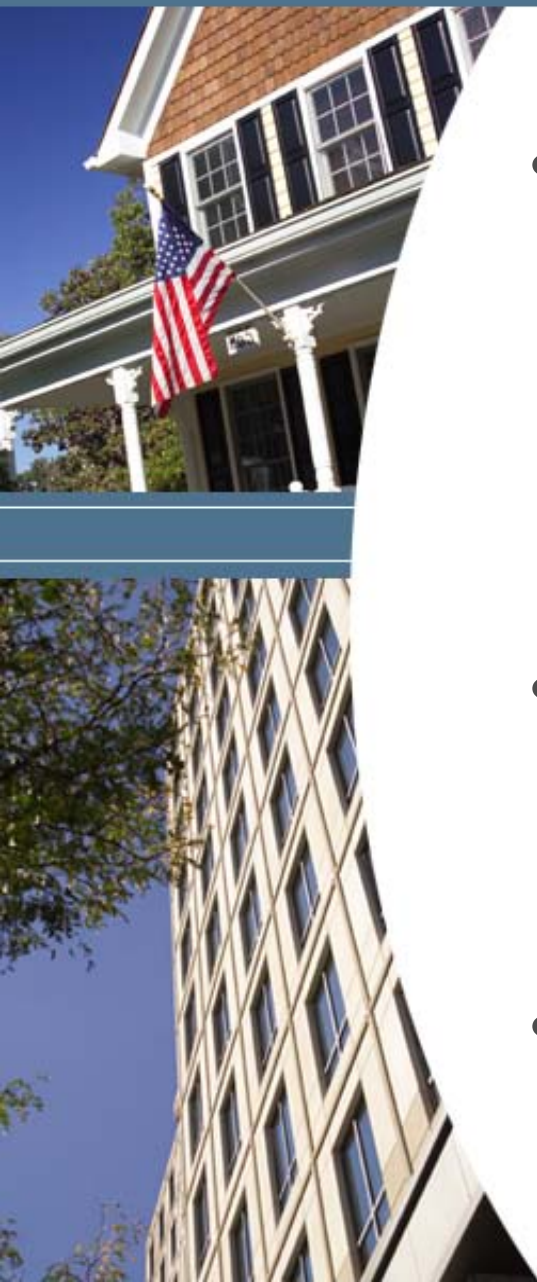
- **Experienced internal secondary marketing personnel**

Preparing for Success

- Establish Relationships with Broker-dealers
- Warehouse bankers approvals
- Obtain investor approvals
- Establish policies
 - » Board level
 - » Operational level
- Pull-through modeling
- Review product eligibility
- Data transmission and mapping
- Key leaders and staff education



The Innovations

- 
- **Data integration**
 - ✓ Maximize intra-system communications
 - ✓ Reduce time delays
 - ✓ Minimize data entry and opportunities for errors
 - **Web-based Applications**
 - ✓ Transparency
 - ✓ Accessibility
 - **Best Execution Automation**

Questions

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