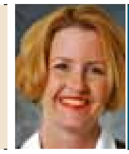

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An Introduction to Warehouse Funding

Selecting the right warehouse funding partner is critical for mortgage bankers

It's no secret that low interest rates have fueled a spike in mortgage refinancing activity. For mortgage bankers, this can present operational challenges to process, underwrite and close loans in a timely manner — and of equal importance, to have adequate access to capital to fund this activity. Whether your bank is looking to expand its funding sources or is looking for its first funding facility, selecting the right warehouse funding partner is more critical than ever.

Mortgage warehouse funding is simply a short-term funding arrangement extended — usually by a financial institution — to a mortgage originator to provide funds for its loan closings. Once closed, these loans are held in the "warehouse" until they're sold into the secondary market, typically within a couple of weeks.

Following the financial crisis in 2008, many of the financial institutions that provided mortgage warehouse facilities exited the market. Largely because of sudden scrutiny from regulators and a need to get balance sheets in order, many mortgage warehouse funding arrangements were shed in a very short period of time. Today, however, there are many new entrants to the market, providing mortgage originators with a multitude of options. Choosing the right partner can be a daunting task and often is filled with risk, however.

Understanding that all mortgage warehouse funding providers are not equal is the first step in selecting the optimal funding partner. The wrong warehouse mortgage partner can devastate your business. When a multitude of warehouse providers disappeared during the recession, it stopped many mortgage-banking businesses in their tracks. A successful mortgage-banking business needs to be able to expand and contract quickly, and in this respect, having a great warehouse funding provider is essential.

The importance of strength

When considering prospective partners, mortgage bankers and originators should know that it's important for financial institutions that provide mortgage warehouse funding to keep their balance sheets strong and maintain adequate access to liquidity. This involves maintaining a clean loan portfolio, which keeps regulators happy and allows these financial institutions to provide a stable source of funding to their clients.

It's also critically important for mortgage originators to conduct adequate research about their prospective partners. They not only should look at the financial condition of their secondary market investors, but also should consider the financial health of warehouse providers themselves.

If a prospective provider is a financial institution, its financial information is publicly available through the Federal Deposit Insurance Corporation and is updated on a quarterly basis. Alternatively, there are online tools available — such as BankTracker — that allow you to get a financial snapshot of a particular institution, as well as access information about an organization's troubled assets and how they compare to national averages.

The importance of experience

An experienced mortgage warehouse provider can provide your company with more than just the necessary capital to fund your mortgage inventory — they can provide you with a competitive advantage to take your business to the next level. Because the mortgage industry is highly specialized and in the regulatory spotlight, your mortgage warehouse provider should be strategically aligned with well-respected individuals and organizations focused on the mortgage industry. These can include a variety of companies engaged in all aspects of the mortgage business: accounting firms, law firms, quality-control companies, insurance providers and companies providing other outsourced services.

A good mortgage warehouse provider can help your company minimize the counterparty risk associated with mortgage transactions. Originators and their mortgage warehouse providers really should perceive risk management as a team effort. Risks can be mitigated by vetting agents who close the loans — for instance, title companies, closing attorneys and closing agents. You and your mortgage warehouse provider also will want to know that these agents are fulfilling their obligations to close loans correctly and disburse their funds appropriately.

Similarly, an experienced mortgage warehouse provider can assist your company in minimizing the counterparty risk associated with secondary market investors. Although

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mortgage originators can obtain the price that a potential secondary market investor is willing to pay for loans, any price advantages can be quickly wiped out if the investor's operational systems result in a lengthy purchasing process. Even worse, if the potential secondary market investor's financial picture is strained, that investor may not be able to complete the transaction at all.

Finally, an experienced mortgage warehouse provider can provide additional funding capacity if secondary market investors slow the pace at which they purchase loans, something that's often seen during spikes in loan volume.

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Although it may seem attractive to work with a mortgage warehouse provider that can teach you about this aspect of the industry, make sure that whatever institution you're working with has true expertise and doesn't do this on just a part-time basis. This is not an industry to be dabbling in.

The relationship with your mortgage warehouse provider is arguably the most crucial element in achieving success. Any potential mortgage warehouse provider will spend time getting to know you and your business, and you should take the time to evaluate and understand your warehouse provider, as well.