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Automation Is the Answer

Automated underwriting systems keep loans moving despite changing requirements

Since the 1990s, Fannie Mae's Desktop Underwriter (DU) and Freddie Mac's Loan Prospector (LP) have provided mortgage professionals with a quick and convenient way to qualify borrowers. Over time, these two automated underwriting systems (AUSs) have established themselves as industry standards, with private investors adopting their decisions as requirements for loan approval. But these only answer part of the loan-eligibility question.

Despite automation, origination costs have increased 20 percent in the past year, while average profit per loan decreased by more than 40 percent, according to the Mortgage Bankers Association. This is partly because private investors — to which many independent bankers sell their loans — have their own requirements, which then must be met in addition to DU or LP results. This process adds to the time and manpower necessary to successfully originate a loan that investors will purchase.

There are, however, AUS engines that can be coordinated with investor requirements, which makes for more-efficient underwriting. Mortgage bankers and originators who understand the value of these engines can increase their business and minimize their costs.

Keeping up with requirements

Private investors have their own requirements for loan approval. These eligibility rules, known as overlays, are layered on top of a DU or LP decision and ultimately determine whether a loan can actually be sold. Overlays can be small enhancements to Fannie Mae or Freddie Mac requirements, like slight increases to minimum

credit scores. They also can be more complex and nuanced, like bankruptcy or debt-to-income rules that are designed to mitigate specific credit-risk profiles.

As a result, lenders must spend time making sure that their loans, even the ones that are Fannie Mae- and Freddie Mac-eligible, meet the requirements of their investors. And it's worth it for them to be vigilant. If an investor overlay is not caught early, lenders may have to break a rate lock and find an alternate investor at a worse price. Not only do lenders take a hit on the price difference, but they lower their pull-through rate with investors and risk being placed in a worse pricing tier.

In a more extreme situation, if lenders miss an overlay after a loan has been funded, their losses could potentially multiply. Finding an alternate investor means the loan must be completely re-underwritten, repackaged and redelivered, which can take 10 to 14 days. The additional costs reduce the profitability of that loan. Also, warehouse funds are unavailable for an extended period of time, which reduces their lending capacity.

If an alternate investor cannot be found, lenders find themselves trapped in a difficult dilemma. They either portfolio the loan themselves and pay back warehouse lenders with their own funds, or they sell the loan to the scratch-and-dent market, at a potential value of 85 cents to 90 cents on the dollar. On a \$200,000 loan, that equates to a \$20,000 to \$30,000 loss.

Getting help

Staying on top of investor overlays obviously is essential to a lender's overall

profitability, but investors change their overlays regularly, as often as 15 to 20 times a month. If a lender is selling to multiple investors, the amount of resources needed to ensure that overlay changes aren't missed is high.

Some lenders will even create a help desk — a full-time position dedicated to tracking overlay changes and helping others understand whether a loan is investor-eligible or not. This speaks to how difficult it is to monitor changes and keep everyone throughout the organization informed.

Many lenders accept this as the cost of doing business. They manually check every loan that hits their pipeline for investor overlays, but what they must understand is that automation is the key to optimizing their performance. They need technology that can check for investor eligibility in the same way that DU or LP checks for Fannie and Freddie eligibility. They want a virtual help desk that can assist originators directly at the point of sale so they can free up operational resources and streamline originations.

Fortunately, the newest breed of automated underwriting systems is specifically designed to handle investor guidelines and overlays. These AUS engines analyze loan-application and credit-report data to produce highly accurate decisions on investor eligibility. These systems can even aggregate multiple investors and provide originators with a comprehensive decision that offers maximum flexibility. Changes to investor overlays are managed on behalf of the lender and occur without its involvement. Add to this a loan-pricing engine and you've got a powerful tool that impacts a lender's performance across many levels.

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Originators then become instant experts on loan products without any effort because the AUS automatically applies investor overlays for them. The fact that their loans are prescreened for investor overlays means that processor and underwriter pipelines are more concentrated with loans that have a higher probability of closing. As a result, operational resources are better utilized and turnaround times are decreased. Lenders can mitigate the risks of broken rate locks and poor pull-through rates, and they avoid situations where loans are underwritten multiple times or sold to the scratch-and-dent market.

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Automated underwriting technology has evolved beyond just DU and LP; it's bringing about a fundamental change in the way lenders run their business. By making AUS technology a central component of their originations, lenders can resolve investor overlay issues and bring fundable loans into sharp focus earlier, eliminating wasted resources and mitigating the risk of a complex and constantly changing underwriting environment. Mortgage bankers and originators can take advantage of this technology to ensure their loans move smoothly and quickly through underwriting. ●