



## Current Servicing Values

Many industry participants are confused about current mortgage servicing rights (MSR) values because of the published service release premiums (SRP) they observe or receive from the larger whole loan aggregators such as Countrywide, Washington Mutual, Wells, Citi and GMAC. These aggregators offer SRP's that range from 1.5 points (%) up to 2 points for 25 basis points (bps, or .25%) of servicing value. At the high end, 2% SRP's translate into 8:1 multiples for servicing value. That multiple stands in stark contrast to multiples observed in the bulk and flow servicing market, which as of late, range from 5-6. Not surprisingly, many industry participants become confused by this substantial difference and believe that either the difference is real or seek answers to explain the difference.

In this month's Topic of the Month, we seek to provide our insight and explanation to demystify this difference. As we will see, this difference mostly evaporates when you subtract the additional value aggregators earn in their whole loan purchases.

First, consider the **guarantee fees** charged by aggregators. Some aggregators publish the guarantee fee it will charge its originators, others fold it into the price it pays or note rate level adjustments it applies. For the purpose of this example, assume the aggregator pays 1.90 % for .25 FNMA 30 year servicing and charges a guarantee fee of 20 bps to its originator. Further assume that an aggregator's actual guarantee fee to Fannie or Freddie is 10 bps. That 10 bps of guarantee fee might be worth 4.5:1 when you have to buy down the guarantee fee by that much more (45 bps) or it might be worth 2.75:1 when you have that much less guarantee fee to buy up (27.5 bps). Assuming you buy down half the time and buy up the other half, the guarantee fee advantage might be worth **31 bps** in price to the aggregator.

Next, consider the **tax advantage** realized by whole loan aggregators who are permitted to write off the whole servicing release premium at purchase as opposed to amortizing it down as the servicing stream is received (as they would in traditional flow or bulk servicing transactions). Servicing brokers seem to put that value at 5-10% of the servicing value, or using a mid-point of that range and applying it to bulk values of 1.5%, this tax advantage might be worth **11 bps**.

Next, consider the additional **interest float** earned by aggregators through their delivery cut-off schedules. Many aggregators require that whole loans must be received by the aggregator as much as 3 weeks before BMA scheduled settlement date. That compares to the one week required by lenders issuing their own security. Current drop/float value assumptions would put that value at roughly **6.5 bps**.

Finally, consider the **specified pool** opportunity that aggregators enjoy. Free to package loans from a wide lender base (even AOT deliveries are repackaged into different securities), aggregators can put together single-issue specified pools such as low loan balance, low WAC, geographic, quarter coupons, or even weighted FICO pools. This opportunity may be worth as much as **1 bps**.

If we add this all together, we have the following (all in bps):

SRP	189
Lower Gfee	-31
Tax Adv.	-11
Float Income	- 6
Specifieds	- 1



Adjusted SRP: 140 or 5.6 to 1 well within our range of 5-6:1 reported in the bulk market place.

But what about **loan fees** charged by the aggregator? Aggregators still need to QC and purchase the production they acquire as well service their customer base. For the purpose of this analysis, we would regard the lender fees charged and acquisition expenses as mostly a wash. What about the **cost to hedge** servicing? Nearly all industry participants would agree that the hedging of servicing is complicated, risky and possibly expensive. How do we adjust the value of whole loan acquisitions in order to consider the cost of hedging servicing? To this question, we have a two-part answer. The 5-6:1 bulk multiples have already priced in hedge cost assumptions and most aggregators today pass on their cost of hedging the servicing until they acquire it in the form of SRP adjustors that move as par rates move, pushing any decrease/increase in MSR value down to the originator.

Summary: Aggregators pass on a great deal of the value they realize as part of their expertise, scale and size. Although this extra value often takes the form of higher SRP's, we see that for the most part, aggregator MSR valuations are in fact in line with market levels after backing out this additional value aggregators create in their originations.