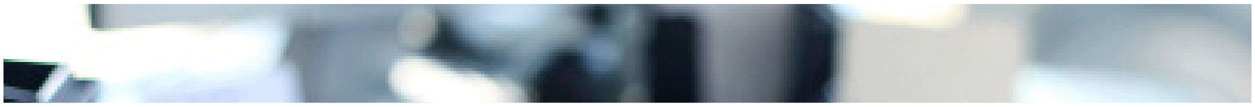
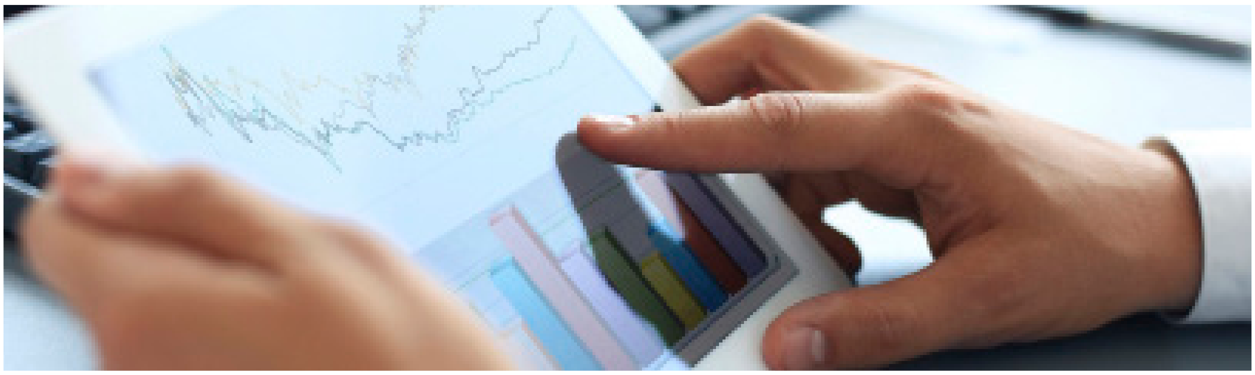


Q4 2017 | ARMCO Mortgage QC Industry Trends



"The distribution of critical defects shifted significantly from CY 2016 to CY 2017, again confirming the degree to which current data and analytics can elevate efficiency and effectiveness in any risk-focused quality control review process." - Phil McCall, President, ARMCO

ARMCO's Mortgage QC Industry Trends Report represents an analysis of nationwide quality control findings based on data derived from the ACES Analytics benchmarking software.

Executive Summary

This report represents an analysis of post-closing quality control data derived from loan files analyzed by the ACES Analytics benchmarking system, during fourth quarter 2017 (Q4 2017) and the calendar year 2017 (CY 2017).

Findings for the Q4 Trends Report were based on post-closing quality control data from over 90,000 unique loans. All reviews and defect data that were evaluated for this report were based on loan audits selected by lenders for full file reviews.

Defects are categorized using the Fannie Mae loan defect taxonomy. Data for any given calendar quarter is analyzed no earlier than 90 days after the end of the quarter, which allows sufficient time for lenders to complete the post-closing quality control cycle. Hence, ARMCO releases analyses for Q4 2017 and CY 2017 in Q2 2018.

Summary of Findings

The leading critical defect categories for Q4 2017 were (1) Income and Employment, (2) Legal / Regulatory/Compliance and (3) Assets. Purchase transactions continued to outpace refinances in Q4, comprising 55.19% of all transactions reviewed

Purchase transactions also dominated CY 2017, comprising 64.14% of all loans reviewed. Refinance transactions accounted for the remaining 35.86%. The top two leading critical defect categories for CY 2017 differed from Q4 2017. The top defect category was Borrower and Mortgage Eligibility, followed by Credit. The third highest defect category was also one of the top three in Q4 2017: Income/ Employment.

Report highlights include the following findings:

- In Q4 2017, the critical defect rate gained 0.03%, increasing from 1.65% to 1.68%.
- In Q4 2017, the percentage of purchase transactions declined for the second consecutive quarter, accounting for 55.19% of all loans reviewed.
- In Q4 2017, purchase transactions and FHA loans accounted for a disproportionately higher number of critical defects.
- In CY 2017, the critical defect rate gained 0.11% over CY 2016, increasing from 1.56% in CY 2016 to 1.67% in CY 2017—an increase of 7.00%.
- The distribution of critical defects shifted significantly from CY 2016 to CY 2017. In CY 2016, the top two defect categories, Legal/Regulatory/Compliance and Loan Package Documentation, comprised nearly 70% of loan defects identified in the benchmark. In contrast, in CY 2017, it took the top four defect categories to comprise nearly 70% of loan defects identified in the benchmark. Those categories were Borrower and Mortgage Eligibility, Credit, Income/Employment and Legal/Regulatory/Compliance.

QC Industry Trends – Overview

In Q4 2017, the critical defect rate remained relatively steady, reaching 1.68%, which represents only a nominal gain of .03% over the previous quarter's critical defect rate of 1.65%.

*NOTE: A **critical defect** is defined as a defect that would result in the loan being uninsurable or ineligible for sale. The critical defect rate reflects the percentage of loans reviewed for which at least one critical defect was identified during the post-closing quality control review and all reported defects are net defects.*

Figure 1 displays critical defect rates—the number of loans containing at least one critical defect as a percentage of the total closed loans reviewed—for the past four calendar quarters. All loans reviewed are part of a lenders' monthly random post-closing quality control review. The annualized critical defect rate for CY 2017 was 1.67%, representing a 7.00% increase over the annualized defect rate of 1.56% for CY 2016.

Critical Defect Rate by Quarter: Calendar Year 2017

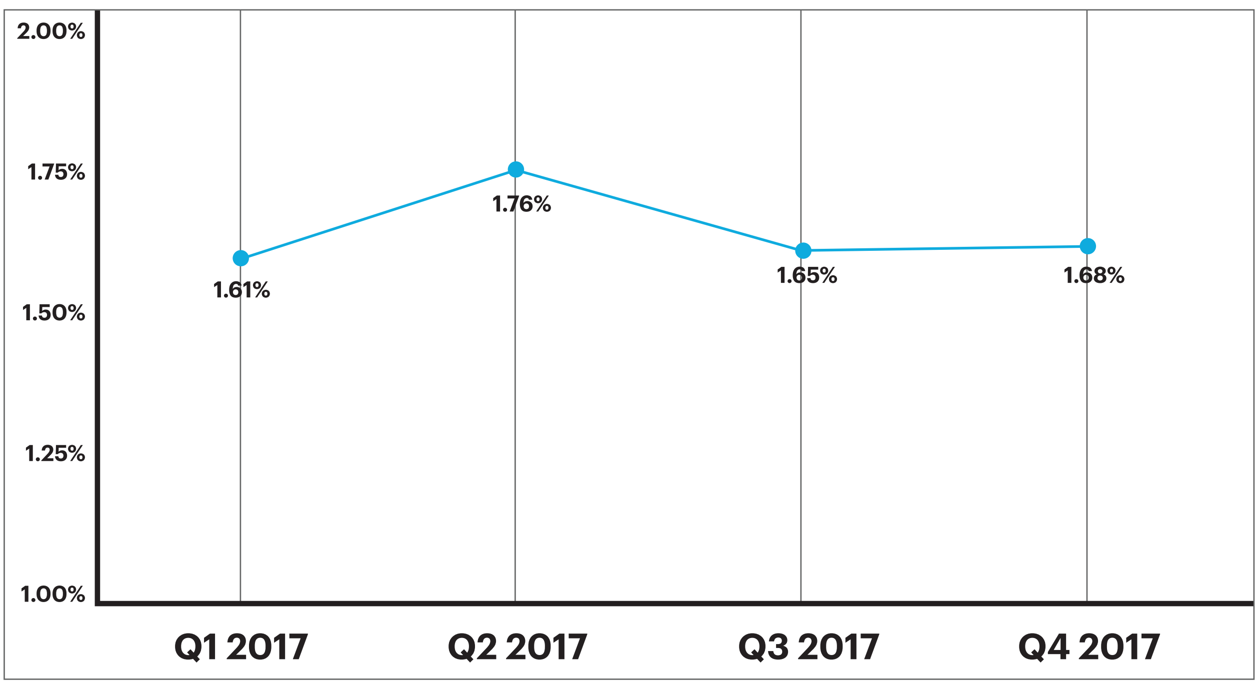


Figure 1: Percentage of loans with critical defects by quarter, Q1 2017 through Q4 2017

QC Industry Trends by Defect Category

In Q4 2017, defects classified in the Income and Employment category accounted for more defects than any other category, representing 19.90% of all critical defects in the benchmark. This category was followed by Legal /Regulatory/Compliance at 15.31% and Assets at 13.27%. The primary category outlier for Q4 2017 is Legal/Regulatory/Compliance, which rose from comprising 9.96% of all critical defects in Q3 2017 to 15.31% in Q4 2017, a 53% increase quarter over quarter.

Figure 2 shows net critical defects, sorted according to Fannie Mae defect category, for Q4 2017.

Critical Defects by Fannie Mae Category: Fourth Quarter 2017

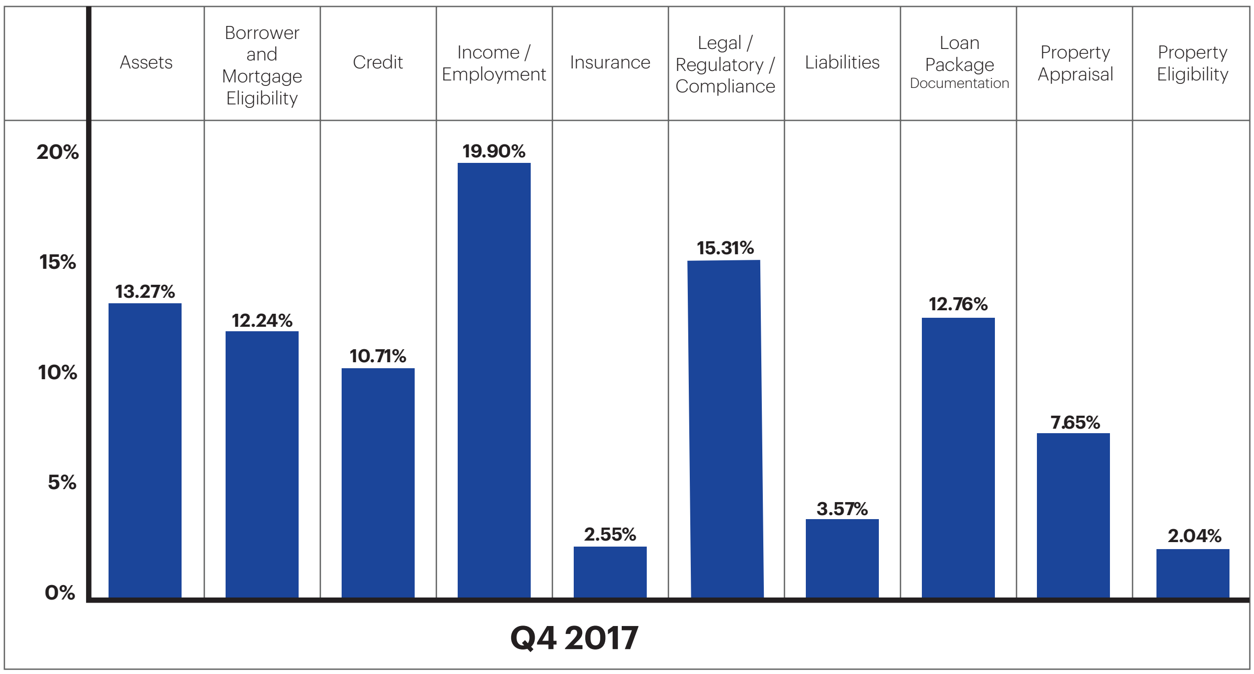


Figure 2: Q4 2017 net critical defects according to Fannie Mae defect category

The distribution of critical defects shifted significantly from CY 2016 to CY 2017. In CY 2017, the distribution of critical defects was marked by a heavy concentration of defects associated with core underwriting and eligibility issues. Three defect categories comprised roughly 55% of loan defects identified in the benchmark: Borrower and Mortgage Eligibility, at 20.33% of all critical defects; Credit at 19.06%, and Income/Employment at 17.00%.

In contrast, in CY 2016, two different defect categories comprised nearly 70% of loan defects identified in the benchmark: Legal/Regulatory/Compliance comprised 39.89%, while Loan Package Documentation accounted for 28.27%.

While the top three defect categories in CY 2017 accounted for approximately 55% of defects identified in the benchmark, those same three categories accounted for only about 18% in CY 2016 – an indication of two primary changes within the industry.

First, the industry has come to terms with TRID and has taken the needed corrective action to reduce the Legal/Regulatory/Compliance defects that dominated CY 2016 down to a more historically normal percentage in CY 2017. Second, the spike in the three defect categories that dominated CY 2017 correlates to the industry's shift to a purchase-driven market, along with the added complexity that comes with the purchase loan origination process, when compared to the relatively simpler process associated with the refinance loans that dominated the market in CY 2016.

Figure 3 shows net critical defects, sorted according to Fannie Mae defect category, for CY 2017.

Critical Defects by Fannie Mae Category: Calendar Year 2017

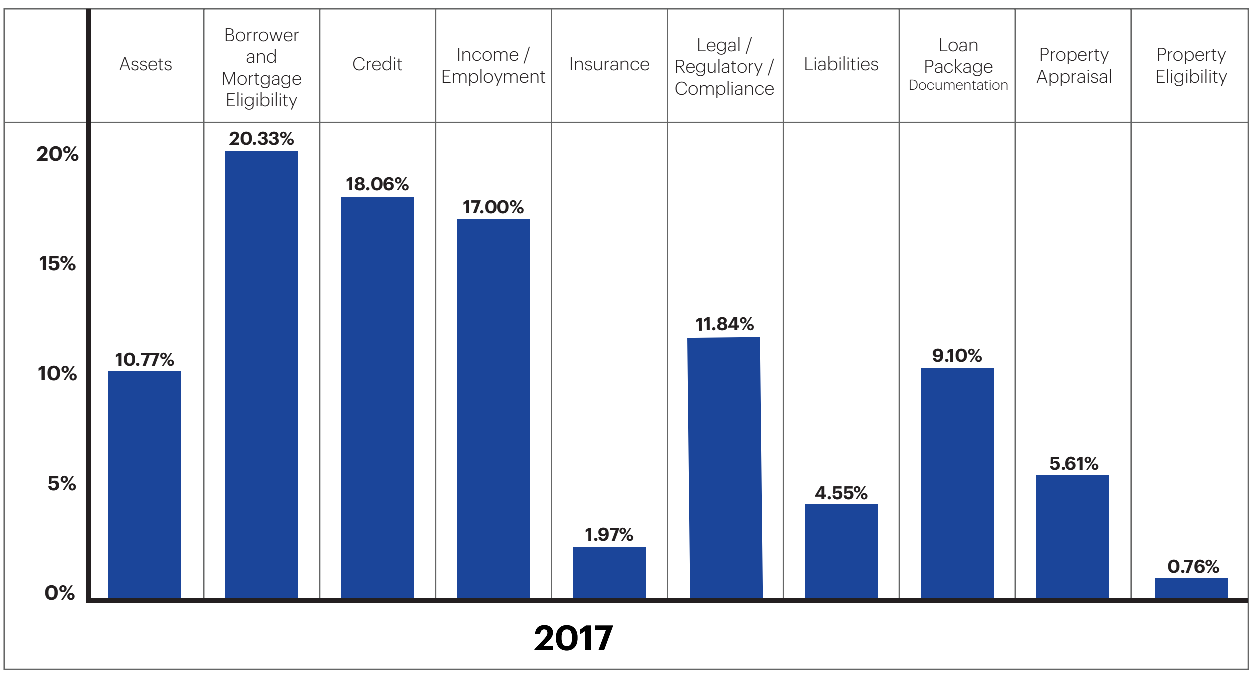


Figure 3: CY 2017 net critical defects according to Fannie Mae defect category

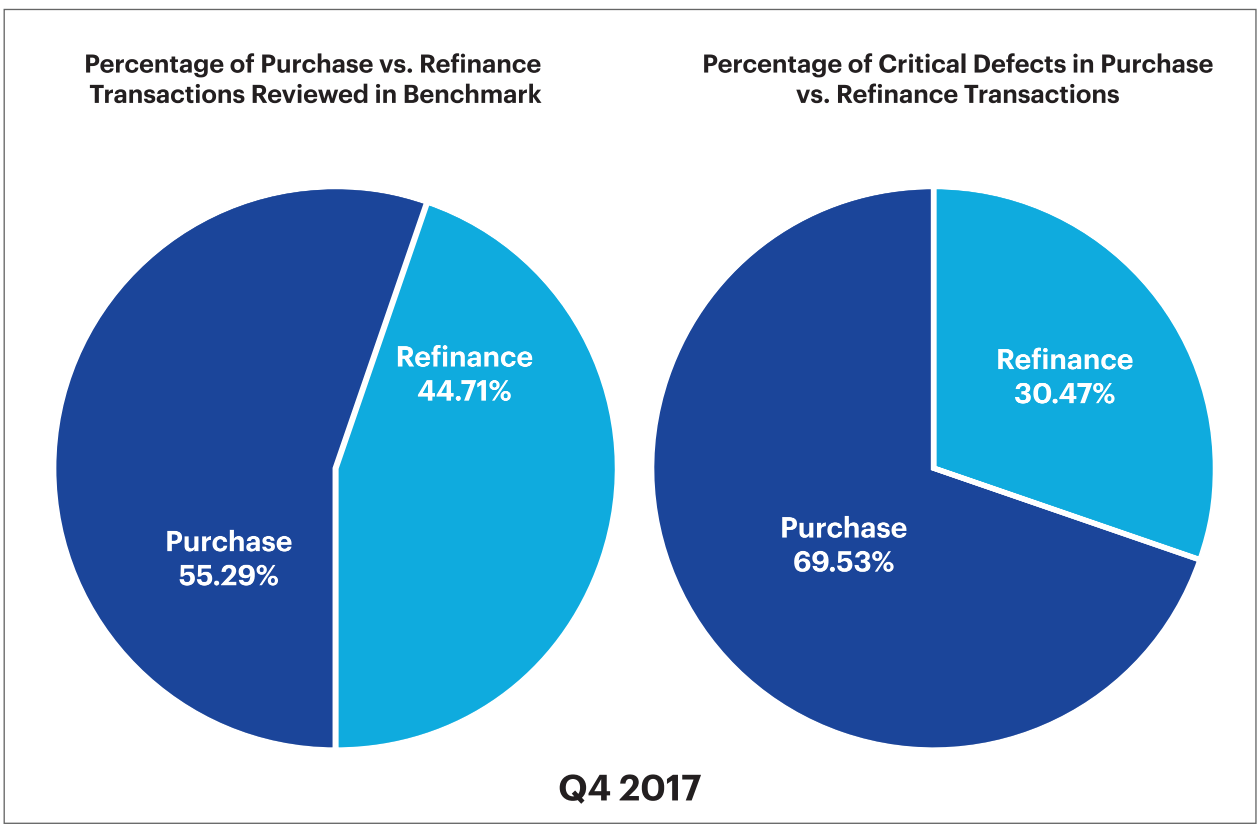
QC Industry Trends by Loan Purpose

In Q4 2017, while purchase transactions represented roughly 55% of all reviewed loans, they accounted for nearly 70% of all reported critical defects. This imbalance—the percentage of critical defects reported in purchase transactions, versus the percentage of purchase transactions of all loans in the benchmark—indicates that more critical defects were attributed to purchases during this quarter. This finding aligns with the commonly held belief that the greater complexity associated with purchase transactions lends itself to a greater number of critical defects.

As with Q4 2017, in CY 2017, the percentage of purchase transactions with critical defects (approximately 71% of reported critical defects) exceeded the percentage of purchase loans in the benchmark (approximately 64% of reviewed loans), indicating that critical defects were attributed to more to purchases than to refinance transactions in 2017.

Figure 4 provides a comparison of all reviewed loans by loan purpose and all critical defects by loan purpose for both Q4 2017 and CY 2017.

Loans Reviewed and Critical Defects by Loan Purpose: Fourth Quarter and Calendar Year 2017



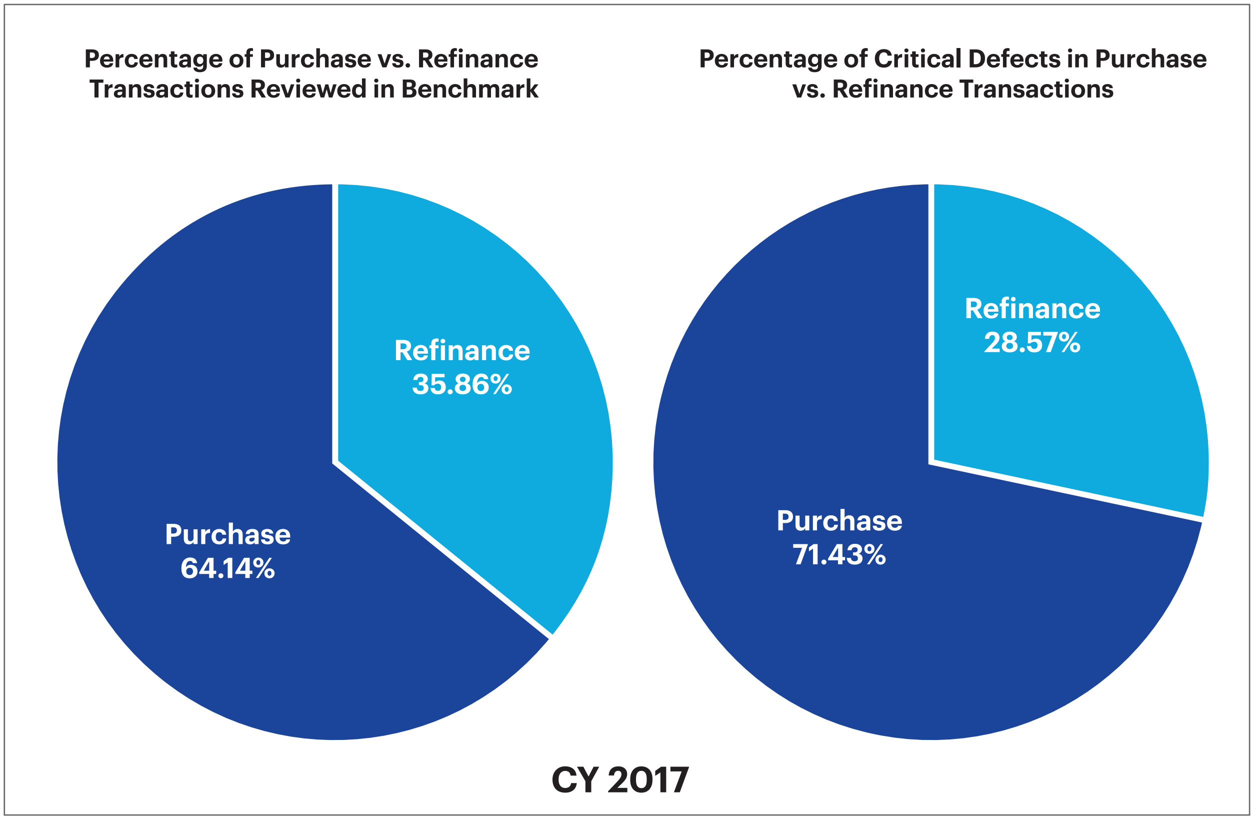


Figure 4: Q4 2017 and CY 2017 loans reviewed according to loan purpose

QC Industry Trends by Loan Type

In Q4 2017, 56.43% of all loans reviewed were conventional loans, 25.83% were FHA loans, 13.78% were VA loans, and 3.97% were USDA loans. However, the distribution of critical defects among loan types does not directly correlate to the distribution of loans reviewed. Most notably, FHA loans accounted for roughly 26% of the loans reviewed but represented approximately 38% of loans containing critical defects. In Q4, the top three critical defects reported for FHA Loans were:

1) improper calculation of income,
2) insufficient documentation and/or sourcing of assets required for closing and
3) TRID Disclosure Delivery Timing.

For CY 2017, 56.45% of reviewed loans were conventional loans, 27.16% were FHA loans, 11.79% were VA loans, and 4.61% were USDA loans. As with Q4 2017, the distribution of critical defects among loan types in CY 2017 does not directly correlate to the distribution of loans reviewed. FHA loans accounted for approximately 27% of the loans reviewed but roughly 40% of all loans containing critical defects. This disparity likely comes as little surprise to lenders, as the added complexity in FHA loan originations lends itself to a higher number of defects.

Figure 5 provides a comparison between loan types as a percentage of the benchmark and loan type as a percentage of critical defects (conventional, FHA, VA and USDA).

Loans Reviewed and Critical Defects by Loan Type: Fourth Quarter and Calendar Year 2017

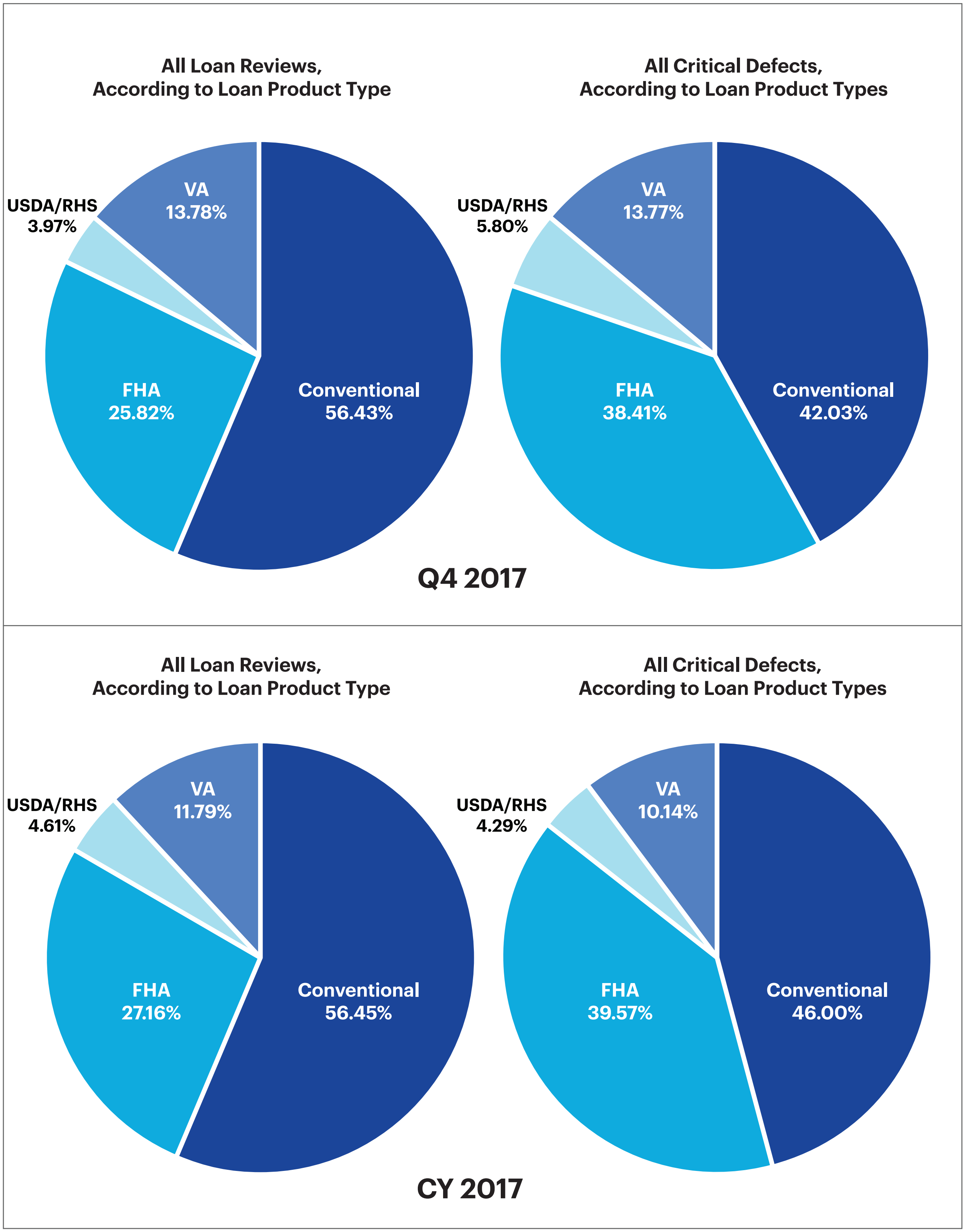


Figure 5: Q4 2017 and all of 2017 loans reviewed and critical defects by loan type

Conclusion

The purchase-to-refinance ratio began shifting in the latter half of CY 2017. While purchase transactions continued to outpace mortgage refinance originations in Q4 2017, refinance transactions gained ground as interest rates dropped and more consumers opted to refinance their existing mortgage loans.

Purchase transactions and FHA loans are inherently more prone to underwriting related defects due to the increased complexity in the origination process. In demonstration of this fact, Employment/Income, Credit, and Borrower and Mortgage Eligibility—all categories related to the activity of mortgage underwriting—accounted for the majority of defects in both Q4 2017 and CY 2017.

The disproportionately higher percentage of critical defects in purchase transitions and FHA loans demonstrates a clear need for analytics in business decision making. The ability to identify disproportionately high defect categories in turn enables lenders to focus their efforts on precise problematic areas, and conduct discretionary and/or targeted reviews on specific loans with specific qualities, rather than a random sampling. As a result, lenders can hone in on the source of the defects and implement strategies that altogether prevent—rather than merely correct—these issues.

If lenders wish to reduce the defects and risk associated with more complex transactions, they must be utilizing data and analytics to establish a more focused pre-funding quality control selection and review process.

About the ARMCO Mortgage QC Industry Trends Report

The ARMCO Mortgage QC Industry Trends Report represents a nationwide post-closing quality control analysis using data and findings derived from mortgage lenders utilizing the ACES Analytics benchmarking software.

This report provides an in-depth analysis of residential mortgage critical defects as reported during post-closing quality control audits. Data presented comprises net critical defects and is categorized in accordance with the Fannie Mae loan defect taxonomy.

About ARMCO

ARMCO – ACES Risk Management delivers web-based risk management solutions, as well as powerful data and analytics, to the nation's top mortgage lenders, servicers, investors and outsourcing professionals. A trusted partner devoted to client relationships, ARMCO offers best-in-class risk management software that provides U.S. banks, mortgage companies and service providers the technology and data needed to support loan integrity, meet regulatory requirements, reduce risk and drive positive business decisions. ARMCO's flagship product, ACES Audit Technology™, is available at any point in the mortgage loan lifecycle, to any size lender, and is user-definable. ACES standardizes audit requirements, ties pre-funding reviews to post-closing quality control audits, enables seamless trend analysis, identifies credit, compliance and process deficiencies and helps create manageable action plans. For more information, visit www.armco.us or call 1-800-858-1598.

MEDIA CONTACT:

Jeri Yoshida • Yosh Communications • jeri@yoshcomm.com • 310 651 0057