

OTHER PRIMARY MARKET LENDERS

KEY TERMS AND PHRASES

Application fee	National Mortgage Licensing System (NMLS)
Down payment assistance programs	Origination fee
Farm Credit Administration (FCA)	Pension funds
Farm Credit System (FCS)	Public-Private Investment Program
Foreign lenders	Real Estate Investment Trusts (REITs)
Forward commitment	Rural Development Housing and Community Facilities Programs
Fraud Enforcement and Recovery Act of 2009 (FERA)	Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE)
Immediate commitment	Servicing fee
Loan servicing	Warehouse line of credit
MDIA	Yield spread premium
Mortgage brokers	
Mortgage bankers	
Mortgage Loan Originators (MLOs)	

LEARNING OBJECTIVES

At the conclusion of this chapter, students will be able to:

- Understand the unique relationship of the mortgage companies and mortgage brokers to the real estate finance industry
- Describe the purposes of a mortgage bank and how they differ from those of a mortgage broker
- Understand the licensing and registration requirements for those engaged in making residential mortgage loans
- Explain the basics of the various methods of funding mortgage-lending activities
- Describe the principal source of income for mortgage lenders
- Describe the other primary sources of real estate mortgage financing
- Discuss the role of the various government loan programs for the direct financing of real estate

INTRODUCTION

As we saw in Chapter 3, most mortgage financing comes from regulated lenders, and the evolution of regulation has shaped the way they operate. Historically, regulated lenders dominated the mortgage industry because savings deposits were necessary to making long-term loans and federal laws encouraged such use of deposit assets. As financial institutions suffered through changes in the 1980s, secondary-market funding of mortgage loans grew, creating loan pools and selling securities backed by these pools. These new security packages opened the door to many newcomers entering the loan origination business, especially mortgage companies that specialized in sub-prime mortgages. Many of these have been forced to shutter operations over the past few years. Mortgage-backed securities were more easily sold to investors than mortgages until the financial crisis that began in late 2007. By 2011, the residential mortgage-backed securities market had been slow to recover, as without an implied or direct guarantee from the government to protect investors in the event of default, there was no demand for this investment product. While the private, mortgage-backed securities market is nowhere near recovery, one of several firms at the forefront of the toxic mortgage crisis—Goldman Sachs—issued its first post-crisis prime jumbo residential mortgage-backed securitization in November of 2014.¹

This chapter examines the mortgage companies that serve as intermediaries between lenders and borrowers. The term *mortgage companies* covers both mortgage bankers and mortgage brokers, some operating in the wholesale market and some in retail brokerage. *Mortgage companies* were a dominant source of total residential mortgages originated from the late 1980s to 2007, when they handled close to half of all loan originations each year. One effect of the recent financial crisis has been the consolidation of the mortgage banking industry and the increasingly important role of commercial banks as residential mortgage originators in the market today. At the end of 2013, commercial banks originated 54% of residential mortgage loans.² Agricultural real estate finance encompasses

¹Lane, Ben. "Goldman Sachs launches first jumbo mortgage bond since crisis." *Housing Wire*, Nov. 26, 2014. Accessed Dec. 27, 2014 at <http://www.housingwire.com/articles/32191-goldman-sachs-launches-first-jumbo-mortgage-bond-since-crisis>

²Author calculated from data from the American Bankers Association and Table F.4 Credit Market Borrowing, All Sectors, by Instrument from the Dec. 11, 2014 Federal Reserve Statistical Release.

a smaller segment of the loan market, and its primary federal regulatory has remained the same, but the structure and sources of its funding have seen extensive changes in the past 20 years. Other types of direct loans by federal and state government agencies will be reviewed later. Another portion of the loan origination market involves individuals and others who, for various reasons, participate in making mortgage loans.

MORTGAGE COMPANIES

From its origin as a brokerage-type service that arranged loans, the mortgage banking industry has grown into a major business, handling over one-quarter of the conventional loans and half of all HUD/FHA and VA loans in this country.

In the early years of the twentieth century, mortgage companies arranged for the sale of their own bonds and used these funds to make small home and farm loans. Because of the thrift-conscious nature of farmers and homeowners, mortgage loans were amazingly free of defaults and provided a steady return for the holders of mortgage bonds. Mortgage companies achieved such a good record of repayments that the small-denomination bonds they sold to the general public for mortgage financing became known as *gold bonds*.

The 1920s brought further expansion of mortgage companies financing from home loans to include loans on income properties such as office buildings, apartments, and hotels. With little regulation and a “let the buyer beware” attitude, some projects were over-financed as speculators moved into these lucrative markets. The Depression years, beginning in 1929, revealed many basic weaknesses in the mortgage loan system. Most mortgage companies that had issued bonds, as well as those that guaranteed bonds for other development companies, were faced with massive foreclosures. Unable to meet their obligations, many were forced into bankruptcy.

Unlike regulated depository institutions, mortgage companies without depositors were not a concern for the government. The money that mortgage companies used to make their loans was derived from the sale of bonds, which was considered a business transaction, not a savings account deposit procedure. Therefore, mortgage companies were granted no help in recovery after the Depression years. One method that mortgage companies used to reestablish their business was the promotion of FHA and, later, VA loans, which had been widely rejected by regulated

lenders. Mortgage companies such as Franklin American Mortgage Company are still the main originators of FHA and VA loans.

Mortgage companies share the mortgage market with regulated lenders; each has a market share of about half of all loan originations. A major difference between mortgage companies and regulated lenders, however, is that mortgage companies do not hold depositors' cash for the purpose of funding their loans. Nor do they normally have investment cash with which to hold loans. To fund loans at closing, most mortgage companies rely on commercial banks that grant them "warehouse" lines of credit. The loans are short-term, collateralized by the mortgage notes they fund, and normally repaid through the sale of these notes to secondary-market investors. Warehouse lines of credit will be discussed more fully in subsequent chapters.

Even within the industry, mortgage companies may operate in substantially different ways. Some, including mortgage bankers, offer a full-service facility including loan origination, funding, and servicing. Others, including mortgage brokers, specialize in serving as agents for large lenders. A number of individuals and companies serve as correspondents or agents representing specific investors. We will now review how mortgage brokers operate, specifically in terms of their residential mortgage loan work.

Mortgage Brokers

Mortgage brokers once operated in one of the high-growth areas in loan origination. The complex nature of mortgage lending has increased the need for knowledgeable experts to advise borrowers and open doors to the most effective lenders. The historic role of mortgage brokers as handling primarily commercial loans began to shift with financial deregulation in the 1980s. With the decline in the savings and loan industry as a primary source of residential mortgage funding and the need to save costs on brick-and-mortar branches, residential mortgage brokers came to the forefront. Many knowledgeable individuals formally trained at regulated institutions or independent mortgage companies began working as mortgage brokers, structuring loans and placing them with funding sources. Independent residential mortgage loan brokers are now referred to by their primary licensing regulator, the **National Mortgage Licensing System (NMLS)**, as "**mortgage loan originators**" (**MLOs**). The NMLS was created to provide a uniform mortgage application for state mortgage regulatory

agencies; a nationwide repository of licensed mortgage loan origination professionals; and a minimum education, experience, and testing requirement under the **Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE)**.

More details on this entity are located in the Licensing of Mortgage Loan Originators section that follows. The SAFE Act requires all residential mortgage loan officers who work at federally regulated deposit-taking institutions who are exempt from provisions related to the new educational, experience, and testing requirements to have a unique identifier or registration number generated by the NMLS.

Mortgage brokers formed their own association in 1973—the National Association of Mortgage Brokers (NAMB)—and through this organization and other means, are expanding their influence within the industry. NAMB offers its members a series of designations that define levels of expertise based on experience and education. The association works in cooperation with mortgage bankers and others to explain the needs of the industry and of the borrowing public to state legislatures and to Congress. It is helping to move regulatory practices into more effective channels.

A mortgage broker specializes in serving as an intermediary between the customer/borrower and the client/lender. While brokers are capable of handling all arrangements for the processing, or packaging, of the loan, they normally do no funding and they do not service the loan once it has closed. Some brokers serve as “retail” offices for large mortgage bankers or big institutional lenders, providing a lower-cost outlet than a branch office. Or they may serve as correspondents in the local area for a major lender that specializes in a particular category of loans, such as hotels or shopping centers. The broker earns a portion of the normal origination fee plus an application fee.

Large commercial loans are normally funded directly by the lending institution, such as an insurance company, and the monthly payments on debt service go directly to the lender. This procedure works very well for mortgage brokers. On the other hand, residential loans require an intermediary who assembles the smaller loans into larger blocks for easier selling to the big investors. Furthermore, residential loans produce relatively small monthly payments and require the substantial servicing capacity that can be found with a mortgage banker. However, the differences between commercial and residential loans have diminished in the present market, as many mortgage brokers have begun to operate in the

“retail” market for residential loans, passing them on to various “wholesale” mortgage banking companies. The recent financial crisis has caused many regulated lenders to rethink their relationships with the retail, independent, licensed mortgage brokerage community for residential mortgage lending. One primary difference between commercial real estate lending and residential lending is the application and underwriting process. The concept of automated underwriting systems used for over 80% of residential mortgages is not a uniform technology used in commercial lending. Rather, in commercial real estate loan underwriting, the determination of the appropriate net operating income (NOI) is the first step in the process. The borrower will typically submit a rent roll and a pro forma, but the lender will almost always construct their own pro forma for loan underwriting purposes, which may result in a different NOI calculation. Possible lender adjustments to NOI include increasing the vacancy and credit loss factor to account for market conditions or tenant rollover risk, or deducting reserves for replacement from NOI.

The following list of data, reports, or analysis will be required for a lender to fulfill their normal lending guidelines used for underwriting. For commercial properties that are already producing income, they are the Debt Service Coverage Ratio and the Loan to Value Ratio. Other documents that a mortgagor might expect to provide or have performed on behalf of the lender, besides historical and pro forma NOI financials, are listed below:

- Discounted cash flow analysis
- Financial stability of existing tenants
- Creditworthiness of principles that represent the proposed mortgagor
- Fair market valuation of property and the current rents charged
- Full rent rolls with maturities and possibly sampling or full lease agreements in place

Development properties that are not being immediately developed into a subdivision, mini mall, or commercial office building will require a heavier emphasis on the valuation of the real estate property proposed for the loan and usually a personal guarantee of the borrower(s). Detail discussion of the commercial real estate loan process is explained in detail in Chapter 11.

Other types of mortgage brokers are companies operating on a national scale that primarily arrange purchases and sales of mortgage loans between originators and investors, or between investors and other investors. In so doing, they greatly aid the free flow of mortgages across state lines in the private mortgage market. These brokers seldom originate a loan and do not service them. However, they are part of the secondary market in some of their operations.

Occasionally, a commercial banker or savings association will broker a loan for a customer with another lender. Money may not be readily available through regular channels, or the loan request may be for something the local banker cannot handle with his or her own funds. The banker may then turn to other sources and earn a brokerage fee for handling the loan. This type of extra service is more commonly found in smaller communities. Many smaller, regulated lenders who are not FHA-approved will broker a mortgage loan in this way.

Mortgage Bankers

The distinction between “bankers” and “brokers” has diminished. Nevertheless, an essential difference between the two remains—the full-service facility offered by **mortgage bankers**. *Full service* means: (1) originating the mortgage loan, (2) funding the loan at closing, and (3) servicing the loan as it is paid off. But even this distinction between mortgage bankers and brokers is blurring as brokers divide themselves into those who close loans in their own names and those who close in another lender’s name.

The need for a full-service facility developed from both the desire for a new approach to mortgage lending after the economic collapse of the 1930s and the implementation of the Federal Housing Administration (FHA) programs handled in conjunction with private industry. Economic pressures of the early 1930s had dried up lendable funds, new construction had halted, and many banks had closed their doors. The shortage of available funds made the mortgage banker an intermediary for the only remaining sources of cash: insurance companies, a few large savings banks, and the Federal National Mortgage Association.

In the 1930s, Federal Housing Administration programs were rejected by regulated depository institutions as a government intrusion into the field of banking. Within the industry, the extension of credit was then

considered a banker's prerogative. The FHA's desire to work in cooperation with private industry was met by mortgage bankers. They offered the full-service facilities and market contacts that enabled the FHA to fulfill its purposes in meeting the needs of home buyers.

As early as 1914, mortgage bankers formed a trade association known as the Farm Mortgage Bankers Association, highlighting the original emphasis placed on farm loans. The name was changed to its present title of Mortgage Bankers Association (MBA) in 1923. MBA is a major communications and information center for the industry. It sponsors educational programs to keep the many people employed by mortgage bankers up to date in an ever-changing business. The MBA actively promotes legislation favorable to the industry and its borrowers.

With a better understanding of the variations among the businesses and individuals who serve those seeking mortgage loans, we can now examine the question, "What does it take to become a mortgage company?"

Qualifications of a Mortgage Lender

For many years, there were no federal requirements regarding the qualifications or licensing of an individual or company handling conventional mortgage loans. Most states had established some requirements, consisting mostly of registration and the posting of a bond. Many states had been exploring the possible need for further regulation, including licensing. In the past, any individual meriting the confidence of a lending institution could assist in arranging a loan, thereby earning a fee for his or her services. However, with the passage of the SAFE Act in 2008, the federal government signaled its intent to increase uniformity in the regulation and licensing of those making residential mortgage loans outside the employment of regulated financial institutions. The SAFE Act represents an attempt to ease regulatory burdens, enhance consumer protection, and reduce fraud by establishing the NMLS for the residential mortgage industry. This new regulation has had the greatest effect on the independent residential mortgage brokerage community. The SAFE Act did not replace the mortgage broker licensing requirements that were already in place in 38 states; rather, it created a uniform set of minimum licensing requirements that all states had to implement no later than April 1, 2010. In practice, mortgage company qualifications are set mostly within the industry itself, although many states require that mortgage companies be



A LICENSED MORTGAGE PROFESSIONAL

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licensed to do business in that state. If a mortgage company elects to deal with a government agency involved with mortgage lending, that agency's standards must be met. These agencies include HUD/FHA, VA, Fannie Mae, Freddie Mac, Ginnie Mae, and Farmer Mac. Their requirements are similar: acceptable net worth and liquidity levels, experienced personnel, and adequate office facilities available to the general public. Even if these criteria are met, approval must be obtained from each agency with which a mortgage company wants to do business. The same is true of any other client-lender of a mortgage company. Approvals by either HUD/FHA or VA in the past were often accepted by conventional lenders as adequate qualification except for minimum capital requirements, which can be much higher for Fannie Mae and Freddie Mac. This will be no longer true after new minimum net worth and liquidity requirements for FHA approved seller/servicers go into effect in 2015 (more about this in Chapter 5).

Licensing of Mortgage Loan Officers

Due to the complexity of residential mortgage lending, with its many guidelines and requirements, there has been a marked increase in the number of cases wherein consumers are misinformed—either as a result of a loan officer's lack of knowledge or through the dissemination of information known to be false. Problems with correct loan documentation, the existence of several hundred variations in repayment plans, confusion over the proper handling of escrow account money and loan closing costs covered by the Real Estate Settlements Procedures Act, the need for accurate advice on loan prepayments and disclosure of interest costs

required by the Truth-in-Lending Act, along with the need for compliance with the Equal Credit Opportunity Act amid rising concerns about possible discriminatory lending and the new requirements of the Dodd-Frank Act, have all increased the need for mortgage personnel with full knowledge of the mortgage lending industry.

Regulation of mortgage brokers was limited for many years. Early consumer protection laws enumerated above were enacted and regulated primarily by the Federal Reserve Bank, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank, the Federal Trade Commission (FTC), and the Department of Housing and Urban Development. It was not that these laws did not apply to private mortgage brokers; rather, there was no official regulatory body with direct oversight of licensing, compliance, or enforcement powers except for the FTC. Mortgage loans made by independent retail or wholesale mortgage brokers increased from a small percentage of residential mortgage loans originated in 1972 to a 69% peak market share in 2004.³ States began to react to the lack of federal regulation of the activity of these emerging mortgage loan originators. By 1996, all but eight states had some registration or licensing requirements for the mortgage industry, and by 2006, all but one state—Alaska—had some state regulatory oversight.⁴ In addition to states' involvement with licensing and professional training, state governments also became more aggressive in opposing predatory lending and mortgage fraud abuses than did regulators at the federal level. But while there was a patchwork of state licensing requirements for those involved in residential mortgage loan origination, various Supreme Court decisions held that states did not have regulatory oversight over national banks. These decisions left a large gap in regulatory control over mortgage lending within the commercial banking industry, a gap that contributed to the concentration of banking through consolidation and a lack of adequate regulatory oversight and enforcement resources at the federal level.^{5,6}

³Sichelman, Lew. "Loan Brokers Lose Share, but Still Rule the Market." *Realty Times*, June 18, 2007.

⁴Pahl, Cynthia. "A Compilation of State Mortgage Broker Laws and Regulations, 1996–2006." Federal Reserve Bank of Minneapolis Community Affairs Report No. 2007-2.

⁵Seabury, Chris. "The Causes and Effects of Credit Shocks." Accessed Dec. 28, 2014 at <http://www.investopedia.com/articles/economics/08/credit-shock-mortgages.asp>

⁶Harvey, Keith, et al. "Disparities in Mortgage Lending, Bank Performance, Economic Influence, and Regulatory Oversight." *The Journal of Real Estate Finance and Economics*, Volume 23, Number 3, November 2001.

As a result of these combined concerns, the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) embarked on a four-year study which concluded that a uniform mortgage application for state mortgage regulatory agencies and a nationwide repository of licensed companies and professionals should be established. They made this recommendation to a Congressional House subcommittee in 2005.⁷ Ultimately, at the continued urging of many industry experts, and as a result of additional pressure brought on by the financial crisis, state and federal officials determined that a uniform licensing method should be implemented, and Congress accordingly passed the SAFE Act. Consequently, all states have created licensing commissions that set minimum qualifications for those who handle consumer mortgage loans, which may exceed those established by the NMLS. The SAFE Act mandates minimum standards for mortgage loan originators, including that applicants pass, complete, or maintain the following five general requirements:

1. A criminal history and credit background check
2. Pre-licensure education, including:
 - a. Three hours of federal law and regulations
 - b. Three hours of ethics
 - c. Two hours of lending standards
 - d. Twelve hours of mortgage origination
3. Pre-licensure testing
4. Continuing education, including:
 - a. Three hours of federal law and regulations
 - b. Two hours of ethics
 - c. Two hours of training related to lending standards for the nontraditional mortgage product market
 - d. One hour of undefined instruction on mortgage origination
5. Provide evidence of certain net worth and provide a surety bond or recovery fund

⁷Dean, Teresa. "CSBS Describes States' Plan for Mortgage Licensing and Registration at House Hearing." *CSBS Examiner*, Sept. 30, 2005.

More information about state specific licensing and compliance rules can be found at the NMLS website at <http://mortgage.nationwidelicingsystem.org/slr/Pages/default.aspx>, which provides additional links for information on each state.

The requirements above apply to those residential mortgage loan originators who do not work for an institution that takes federally insured deposits or any agency that falls under the examination or supervision of the Farm Credit Administration. The NMLS grants national licenses and unique identifier numbers to individuals whom it refers to as mortgage loan originators or MLOs. But since states are within the dual licensing system established by the SAFE Act, many refer to their dual-licensed mortgage loan originators by different titles; for example, Texas uses the term “Residential Mortgage Loan Originator” to describe its licensees. As a result, the acronym RMLO has developed different meanings. It originally stood for the “Registered Mortgage Loan Originator,” which was a term defined in the final rule in the Federal Register of July 2010⁸ that directed federal depository regulators and the Farm Credit Administration to promulgate rules to enforce the registration of MLOs as defined by the SAFE Act. Later, various industry trade groups and individual independent loan originators—in an effort to differentiate themselves from banks or savings and loan mortgage loan originators—redefined RMLO as “Registered Mortgage Loan Officer” and began to refer to themselves as MLOs, now meaning Mortgage Loan Officer (Licensed and Trained). Neither of these is a regulatory term.

The new licensing requirements with the NMLS and state regulators caused the number of licensed mortgage brokers to fall dramatically. Whether due to the new requirements of the NMLS or the general decline in the mortgage market, or a combination of both, the number of mortgage brokers licensed in Texas fell from over 30,000 to under 4,000 between 2008 and 2011. A slight recovery in the mortgage market began in 2012, and by the end of 2013, the number of mortgage loan originators in Texas had grown back to over 15,000 with a growth rate in new MLOs of 28% in 2013 alone.⁹

⁸Federal Register. 12 CFR Part 34, 208, 211, et al. Registration of Mortgage Loan Originators: Final Rule. Accessed July 10, 2015 at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20100728a1.pdf>

⁹Jones, Caroline C. “2014: A Year of Changes.” Presentation in June 2014 by Commissioner of Texas Department of Savings and Mortgage Lending.

Where Are We Now?

Who Needs to Register With NMLS?

If your institution is federally chartered or insured by one of the following agencies and your institution employs individuals required to be federally registered as mortgage loan originators, your institution must register with the NMLS.

Office of the Comptroller of the Currency
 Board of Governors of the Federal Reserve System
 Federal Deposit Insurance Corporation
 Office of Thrift Supervision
 Farm Credit Administration
 National Credit Union Administration

Mortgage Company Operations

Although mortgage companies vary widely in their methods, the business organization common to most operates with three basic divisions: (1) administration, (2) loan servicing, and (3) loan acquisition.

The administrative group supervises and directs all operations and, using its sources of money, seeks out and maintains contact with lending institutions and, more recently, poolers of mortgages for issuance of mortgage-backed securities. The development of stable, continuing relations with a group of investors is a source of pride for mortgage companies. In the past, it was not considered good business for either a mortgage company or a lender to maintain an exclusive arrangement. Since the beginning of the current financial crisis in 2008, the number of investors has declined and those that remain tightened their credit standards initially. In early 2014, several lenders began to offer more relaxed requirements; for example, Wells Fargo began accepting 15% down payments for jumbo mortgage, reduced from 20%. Investors in residential mortgage loans are in and out of the market as their particular investment needs fluctuate, while mortgage companies must maintain a steady supply of funds. Mortgage company officers must know which sources are available for loans and the particular type of loan or loans that each lender or investor prefers. A mortgage company's secondary marketing department

resides within the administrative group and works with investors to establish the pricing that the loan acquisition group will use to attract borrowers.

Loan servicing includes the record-keeping section that maintains customers' or borrowers' accounts. Larger companies have converted much of this accounting to computerized methods for more efficient handling. The escrow section holds the required insurance and tax deposits. Escrow account personnel must maintain a continuous analysis of taxes and insurance costs for each property to assure the company that sufficient money will be available when needed for payment. Another responsibility of the servicing section is to ensure prompt collection of borrowers' monthly payments and to send out notifications if delinquencies occur. All lenders insist on knowing borrowers' account status and depend on mortgage companies to use diligence in keeping their accounts current. Laxity in this area could jeopardize a lender's rights in a foreclosure action.

The loan acquisition group, the division best known to outsiders, consists of loan originator/officers or supervisor/managers who make the contacts with potential borrowers. These contacts are made through real estate agents, banks, accountants, and others and help mortgage personnel seek out the best loans as well as to handle actual loan applications. Loan processors normally work with these representatives to maintain files and to help collect information required on both the property and the borrower. Complete documentation of the loan must be included in the loan package. Any person who works directly with a mortgage loan applicant who recommends a product or discusses the applicant's credit or other qualifications for the loan is required to be a registrant with the Federal Registry maintained by the NMLS. While regulated financial institution personnel need not have or maintain NMLS mortgage originators' licenses, they must be registered with the NMLS Federal Registry to perform the function of making residential mortgage loans. The Federal Registry of the NMLS is set up under the law to maintain a record of all people involved in residential mortgage finance. If a person has committed fraud or had a mortgage license revoked, there will be a record of this revocation in the system, and the person who has lost the license cannot be employed or licensed in another location. The **Fraud Enforcement and Recovery Act of 2009 (FERA)** expanded the federal government's ability to prosecute mortgage fraud, securities and commodities fraud, and other types of fraud related to federal assistance and relief programs such as the Troubled Asset Relief Program (TARP).

How a Mortgage Company Funds Loans

As discussed earlier in this chapter, mortgage companies do not hold deposit assets that can be loaned the way regulated depository institutions do. Therefore, they must use somewhat different procedures to obtain an assurance of funds with which to make loans. When dealing with residential loans, mortgage bankers generally borrow money from a commercial banker on a **warehouse line of credit** to fund a loan at closing. The loan is pledged at the bank as collateral and held, or “warehoused,” by the bank until it can be sold.

Other methods are used by mortgage companies dealing with the larger commercial loans. These loans are more likely to be placed on a case by case basis with the most suitable lender available at the time. Mortgage bankers, and some brokers, use several methods to assure themselves of adequate funding at known costs, as the following section describes.

Sale of Loans to Secondary-Market Investors

A procedure long used by mortgage companies is the purchase of a **forward commitment** in advance of making any loans. This commitment is a promise by a lender (meaning a purchaser of loans or an investor) to have certain funds available for qualifying loans submitted to that lender over a limited period of time, such as 30 days to six months. With a forward commitment in hand, the mortgage company can give assurance to a commercial banker that loans pledged on a warehouse line of credit do have a ready market. A forward commitment generally includes an agreement for the mortgage company to service the loans that are delivered to the loan purchaser. The agreement between originator and purchaser is known as a *sales and servicing contract*. Savings associations, insurance companies, and some commercial banks, as well as Fannie Mae, Freddie Mac, and other loan poolers or mortgage conduits, buy loans from originators under commitments they have issued to originators. Mortgage companies maintain contact with various loan purchasers who are in and out of the market.

Both Fannie Mae and Freddie Mac are continuously in the market for the purchase of loans that conform to their requirements. This assurance gives their “conforming loan” parameters special importance for lenders seeking liquidity in loan portfolios. Like other secondary-market loan purchasers, Fannie and Freddie buy loans through the sale of forward commitments to make such purchases.