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# HW MAGAZINE

The fall and stalled rise of the mortgage broker

**by**[**Justin T. Hilley**](http://www.housingwire.com/author/justin-t-hilley)

In the fall of 2008, amid the worst housing market since the Great Depression, Eric Weinstein, chief executive of mortgage brokerage firm Carteret Mortgage, sent an email to his employees that read:

“You should definitely seek other employment immediately… I would expect that you have about 30 days to close your loans before it starts getting bad.”

He signed the note, “Eric ‘Shut the Lights’ Weinstein.’’

His company was bankrupt.

Founded in 1995, the Centreville, Va.-based company originated nearly $5 billion in loans at its height in 2003, the year in which originations among retail, broker and correspondent channels climbed to their apex. That year, Inc. 500 listed Carteret as the 59th-fastest growing private company when it employed 1,775 loan officers, eventually expanding to more than 4,500 employees. The company’s business model allowed employees to work from home and earn income by recruiting and managing other workers.

Carteret had little overhead, giving its brokers the ability to price loans cheaper than banks thereby improving service, says Weinstein, who started the company as a one-man operation in his house. The sharp drop in real estate prices (the period between June 2007 and December 2008 saw the quickest drop since prices peaked in June 2006, according to Lender Processing Services) caused company revenue to fall below breakeven profitability.

“We ran out of money,’’ says Weinstein, who works today as a senior loan officer at Springfield, Va.-based 1st Commonwealth Bank of Virginia. “There wasn’t anything wrong or bad with the loans. It was simply a lack of business.”

And so have much of the nation’s mortgage brokerage companies. Blamed by many for blowing-up the real estate market, the ranks of mortgage brokers have been cut to nearly a third and most of them are doing significantly less business as potential homeowners who seek mortgages shy away from them in droves. Brokers made up 31% of all loans in 2005 to 11.4% at the end of 2010, according to Inside Mortgage Finance.

David Olson of Access Research & Consulting Inc. estimates the number of mortgage brokerage firms is down from a peak of 53,000 in 2004 to less than 15,000 today.

“As the financial crisis unfolded, they unfairly blamed the broker as the originator of these loans, which is not really true because the government set the guidelines, and we didn’t underwrite the loans, we just sold under whatever the guidelines were,” Weinstein says. “If the guidelines were crazy, then we sold under crazy guidelines. It wasn’t us, it was everybody.”

After he folded up the company, Weinstein left to work for a federally chartered bank because they have a huge advantage right now, he says, adding “the pay is a lot lower, but the money they make per loan is a lot higher than we ever did as a broker.”

Legislation in 2009 and 2010 aimed at brokers coupled with a gradual decision by banks to focus on direct lending helped to dismantle the mortgage broker segment from originating about $1.1 billion worth of loans in 2003 to $173 million in 2010.

“I don’t think the mortgage broker industry is coming back,” Weinstein says. “I think it’s declining. I don’t see it coming back anytime soon.”

**LEAVING THE SPACE**

Mortgage brokers who survived — for the most part — avoided the bad loans that made villains of the profession. While billions were spent to bail out mortgage monoliths Fannie Mae and Freddie Mac, the industry’s future depends on restoring faith by upholding stricter standards and changing public perception.

The National Association of Mortgage Brokers, the largest association representing mortgage brokers, had about 25,000 members in 2006. Today it’s down to 5,100.

Membership, however, is slowly, but steadily growing every month, says the association’s president, Donald Frommeyer.

“We’re starting to see increased interest in being a mortgage broker and from wholesale lenders who are coming back that were gone,” Frommeyer says. “Some of the goals of these wholesale lenders is volume and the only way they’ll get the volume numbers is to use brokers.”

Some, like Weinstein, say brokers were victims of taking advantage of relaxing underwriting standards by banks. A 2007 survey by The Office of the Comptroller of the Currency found that commercial and retail underwriting standards at most banks, especially the larger ones, eased for the fourth consecutive year because of increasing competition. The following year, after the downturn in residential real estate, the survey found that most banks tightened their standards because of a burgeoning negative economic outlook and shrinking market liquidity. Last year’s survey showed some signs of easing.

“When banks ran out of the best customers to loan to, they had to relax their standards,” says Gus Altuzarra, CEO of Irvine, Calif.-based investment firm Vertical Capital Markets Group. “I don’t know if brokers were to blame, but it would be unfair to say it was a result of what they did. Blame should have been more evenly dispersed.”

The SAFE Act, a key component of The Housing and Economic Recovery Act of 2008, which NAMB helped push through, was designed to enhance consumer protection by encouraging states to establish minimum standards for the registration of state-licensed mortgage loan originators. The act requires originators to pass a written qualified test, take continuing education courses and requires all mortgage loan officers to submit fingerprints to the FBI for a criminal background check.

“Because of that, a lot of people moved from the broker world to the banking world because they couldn’t pass the test or didn’t like it or couldn’t pass the background test. That’s where we’ve been,” Frommeyer says.

To crack down on the practice of paying brokers more when a borrower accepts a higher interest rate mortgage, the Federal Reserve created overarching rules governing how loan they were paid under the Dodd-Frank Act. The rule was an attempt to prevent borrowers from being steered into higher-cost mortgage products than the lender requires.

“We had a lot of loan officers think the grass is always greener on the other side, and they went to work for other companies that might pay more,” Frommeyer says. “If you were used to making $50,000 and now you’re making $30,000, the last thing you want to do is pay an association.”

The regulations are good in that they put customers’ interest first, but the pendulum has swung too far, Altuzarra says. “It needs to come back toward the center a little bit so there is a purpose, which is to help the customer,” he says.

Weinstein, a former member of NAMB, says he was a big believer in building political clout to compete against the big banks, but the association was never able to build that influence.

“The banks have a huge lobby in Washington whereas mortgage brokers were typically small shops, and they never really banded together and didn’t have the political clout,” Weinstein says. “The overhead for being a broker shop when it came to regulation was a hundred times tougher. The banks had a huge advantage.”

**DWINDLING OUTLETS**

With players as big as Bank of America, PHH and Metlife exiting the wholesale brokerage channel, the outlets to which brokers can sell loans is rapidly disappearing, which makes their product less competitive. When brokers controlled 80% of the origination market, the banks likely would have never left wholesale mortgage lending because they’d lose a tremendous amount of business, but now they can because of their upper hand in terms of market share by devoting more resources to their correspondent and retail channels.

Bank of America exited wholesale mortgage lending in October 2010, limiting its dealings with mortgage brokers. Last year, JPMorgan Chase announced that it would no longer purchase loans originated by brokers. Both banks downplayed the loan quality issue, emphasizing their moves as a strategy shift that lets it play on its strengths and work more directly with customers. “We tend to prefer business where we have scale,” said Barbara Desoer, former president of Bank of America Home Loans, who retired in February.

And then this year, Citigroup completely abandoned business with brokers after scaling back from its broker channel some time ago to sharpen its focus on retail and correspondent channels, which the bank said have the highest opportunity of increasing long-term engagement with its clients.

Brokers scour the marketplace to connect borrowers up with a lender that will accept a particular borrower. About 95% of loans are backed by government agencies, so the underwriting standards across the board are similar, whether that loan is taken to BofA or Chase, for example.

“That, combined with the fact that the mortgage broker has really lost an ability to earn what I think is a sufficient income to survive, means that the industry is on life support,” Altuzarra says. “Will it improve? I think it will, but it’s not going to be like it was. The determining factor is going to be the increased amount of credit in the market and increased number of private lenders that enter the market who will potentially do private securitizations.”

**GAINING SELF-CONTROL**

As regulation grew and brokers fell victim to the retail branch mentality, companies such as Austin, Texas-based 360 Mortgage were created to give brokers back the freedom they once had.

Andrew WeissMalik, 360 Mortgage chief operating officer, said he’s trying to give brokers the amount of control and autonomy that they once had. He hopes to empower brokers to complete as much of the origination process as possible.

The company recently released Broker Docs, an online closing document clearing functionality designed to shorten closing time by at least 50%. Previous advancements by 360 Mortgage include the development of FHA Connection, which allows brokers to pull case numbers directly from Federal Housing Administration’s portal, and an online chat tool that instantly connects brokers to a 360 Mortgage account executive.

“We’re out there promoting the broker and using technology to empower the broker is key,” Malik says. “We feel that brokers left to go to retail because of fear, they were scared into it by all the retail recruiters. We try to alleviate their fears and let them know that in wholesale you can still stay in charge of the transaction.”

Although he couldn’t provide a number, WeissMalik says over the last seven months he has received calls weekly from brokers like Weinstein who joined retail banking and now want to fill out a broker application.

**BYPASSING BROKERS WITH TECHNOLOGY**

Technology may also be a conduit for consumers to bypass the broker, with the rise of mortgage investment trusts like PennyMac that have subsidiaries that allow consumers to obtain a mortgage online. Last year, PennyMac expanded its relationship with LendingSpace to use the technology firm’s full-service mortgage production platform, which includes a loan origination system and a point-of-sale application. The system does, however, feature a broker portal for desktop origination submission. PennyMac said it expects originations in the U.S. to hit the $1 trillion mark in 2012, with $300 million through correspondent lending.

“I think technology might be the only way because regulation isn’t about to change, processes aren’t about to change,” WeissMalik. “Keeping the broker in control, giving them the benefit of actually speeding up the process more so than a retail lender.”

Smart mortgage brokers will find a niche to fill, says Chuck Cowan, chief executive of mortgage banking recruiting firm CCowan & Associates.

“Brokers are going to have to redefine their whole business model and clean up their act,” Cowan says. “They’re going to have to become less transactional and more relationship-oriented.”

Perhaps the niche upon which mortgage brokers can stage a return to prominence is with self-employed workers. Many of them have solid credit and a healthy ability to earn, but have a difficult time documenting their income, which makes it even more difficult to get a loan from a bank.

“Finding a lender for a borrower like that is where mortgage brokers can really do a good job, but they can only do their job if they have multiple choices to look at that are going to be different,” Altuzarra says. However, he remains skeptical.

“I don’t know if there’s going to be a mortgage broker in 10 to 20 years,” he says. “The amount of business they’re going to do will increase from the levels that it’s at right now, but the endgame is — I think they’ll be gone.”

In the meantime, NAMB will work to bolster the image that brokers are indeed the ethical and professional brokers that the association prides itself on. NAMB is offering additional continuing education such as webinars that train brokers to understand the business more and its products.

“I don’t see them getting rid of the mortgage broker,” Frommeyer says. “The mortgage broker is here to stay. You always need that avenue of additional originations. It’s less costly. I think you’ll see a more prominent broker standing in the community.”

As for Weinstein, he says he’d rather be a mortgage broker because running his own company was more fun than being in retail banking. He reminisces on the days when he was a leader in the broker industry. “I was kind of famous,” he remembers.

“But the tide turned. It’d be silly not to go with the winning team,” Weinstein says about becoming a loan officer for a retail bank. “If it ever goes back, I would love being a broker. I just have to go with the most efficient, best way I can operate, which is to be a banker. Whatever it takes to do business and feed my family, I work for this one or I’ll work for that one.”

jhilley@housingwire.com

[@JustinHilley](http://twitter.com/#!/justinhilley)

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