Standalone vs. Joint Venture Mortgage Company: The Case for Partnering with NewRez

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SUMMARY
In today's regulatory and capital-intensive environment, owning and operating a standalone mortgage banking company is not for the faint of heart. With the refi boom all but history, fierce competition for the purchase business is causing significant margin compression. As a result, many historically successful companies are struggling to achieve a reasonable ROI for the major amount of capital needed.

This article presents a high-level overview for the case of considering a 50/50 Joint Venture between NewRez and an established Realtor-owned mortgage business. A comparison of net income potential is presented, taking into account key factors such as equity, business outlook, and market changes. The ultimate goal is to create a strategic partnership that increases profit margins for both entities.

The Partnership. NewRez recently became part of New Residential Investment Corp., which brings considerable financial strength and resources to any Joint Venture. New Residential is a leading capital provider to the mortgage industry, with $5.7 billion market capitalization and a $21 billion balance sheet. What's more, New Residential uses its unique market insight to identify and create opportunities for growth and profitability.

With NEWREZ, a Joint Venture places strong emphasis on the partnership factor. Partners work closely together to apply best practices to every business function — from Human Resources and Marketing to Technology and Operations. Ultimately, a successful Joint Venture is intended to reap mutual benefits:

- Partnering companies close more transactions and increase profitability
- Agents expand capabilities and value
- Buyers have more options and services available from one source

Net Income. For the analysis presented in this report, three different volume scenarios have been created for a hypothetical Standalone vs. Joint Venture comparison. A preliminary estimate shows that even with owning 50% of the Joint Venture, net income would grow significantly over its current pace.

Equity.
For the partnering company, the Joint Venture model requires significantly less capital than what is being invested today to form a Standalone. This would allow for the reallocation of funds into other opportunities. When operating as a Standalone, a company likely experiences industry average purchase times for the loans sold to investors. Holding the loans longer in the warehouse requires a much larger facility and additional equity to support it. With a Joint Venture, purchase times may be considerably shorter when NEWREZ is the purchaser. This allows for material savings and reduced capital requirements.

BUSINESS OUTLOOK

In addition to fluctuations in interest rates, economic cycles, and inventory levels, the mortgage industry is experiencing a dramatic change in how consumers prefer to obtain loans. More and more buyers are choosing the lower-cost "self-serve" process of obtaining a mortgage online. This shift is driven primarily by two factors: advances in technology and demographic changes in the homebuyer population.

NewRez is a leader in using technology to streamline the loan process. This is the result of a proprietary solution that allows for a total end-to-end digital origination and CRM that can be co-branded with business partners. Additionally, many of the markets are transitioning to higher cost, non-conforming and non-Qualified Mortgage products. Non-conforming loans traditionally have a lower value that is not offset by the higher average loan amount. This places additional pressure on margins. NewRez and its parent, New Residential, have an extensive non-QM product portfolio. In addition, New Penn has the capital to create unique mortgage products, which can be securitized into new markets.

Changes in Profit Margins

In the period from 2012 to 2016, the mortgage industry experienced some of the highest profit margins in history. Margins fell in 2017 as lenders competed for a smaller market, primarily due to the reduction in refinance volume. The industry has adapted and margins are beginning to recover and stabilize, with a slight recovery expected in 2018. However, it is doubtful that the industry will see a return to the margins experienced in 2012 to 2016.

Of significant concern is the shift in borrower preference for obtaining refinance and purchase loans online. The cost structure of this business model places significant pressure on traditional retail mortgage company profit margins. Online lenders typically do not have a commissioned sales force — or if they do, the commissions are significantly lower than those at a traditional retail mortgage company. This allows online lenders to offer buyers a much better rate.

The shift to online lending may indicate what will become the dominant business model for mortgage origination. As previously mentioned, the encouraging news is that NewRez has already made a major investment in this area.

Changes in Market Area

Today many realtor mortgage businesses are in markets with affordable price points. Due to price appreciation, however, many new markets are comprised of "move-up" buyers seeking non-conforming loan amounts. These markets create a challenge in two forms: competition for the move-up buyer and lower margins on non-conforming loan products.

Move-up buyers are more likely to select a mortgage company that originated their previous loan(s) or currently services their mortgage. Move-up buyers who have previously had mortgages are also more likely to opt for an online process. This often means incurring some form of price concession to accommodate a move-up buyer.

Despite higher balances, non-conforming loans typically have a margin of between 50% and 75% less than conforming loans, as measured in basis points. The reduced margin will not be offset unless the loan exceeds $1.0 – 1.2M. Typical loans in high-cost markets range between $500K and $800K, which are the most competitive and least profitable loan amounts.

Regulatory Factors

The regulatory environment seems neutral to slightly positive for the mortgage industry. In many states, however, the cost of compliance appears to be moving up over the next few years.

NET INCOME

Three different net income scenarios were run, assuming annual funding volume of $500M, $650M and
$850M, and using average margins experienced during 1Q18. In each scenario, net income improved in both dollars and basis points, compared to 2017. Expenses increased in each scenario due to additional staffing required to support operations as a Standalone.

Below is a generic estimated comparison of a Standalone versus a Joint Venture model. Upon receipt of a signed NDA, NewRez will request detailed financials and provide a comprehensive pro forma for product mix, compensation, and operations structure.

Standalone vs. Joint Venture Income Scenarios

Estimates only, and not a guarantee of future performance.

Standalone				
Total Funding's - $		$500,000,000	$650,000,000	$850,000,000
Total Funding's - #		1420	1847	2415
Average Loan Amt:	$ 352,000			
Income @ 293 bsp	0.0293	$14,650,000	$19,045,000	$24,905,000
Expenses @ 245 bsp	0.0245	$12,250,000	$15,925,000	$20,825,000
Net Income	0.0048	$2,400,000	$3,120,000	$4,080,000
Capital Required		$6,000,000	7,000,000	9,000,000
Return on Equity		40%	45%	45%

Joint Venture Scenarios

Joint Venture				
Total Funding's - $		$500,000,000	$650,000,000	$850,000,000
Total Funding's - #		1818	2364	3091
Average Loan Amt:	$ 275,000			
Income @ 350 bsp	0.0350	$17,500,000	$22,750,000	$29,750,000
Expenses @ 229 bsp	0.0229	$11,450,000	$14,885,000	$19,465,000
Net Income	0.0121	$6,050,000	$7,865,000	$10,285,000
50/50 split		$3,025,000	$3,932,500	$5,142,500
Total Capital Required		$2,700,000	$2,700,000	$2,700,000
Return on Equity as JV		224%	291%	381%

Per Partner 50/50 split

Split 50/50				
Partner profit		$3,025,000	$3,932,500	$5,142,500
Partner Capital		$1,350,000	$1,350,000	$1,350,000
ROI		224%	291%	381%

Variance

Positive Variance from Standalone				
Capital		($4,650,000)	($5,650,000)	($7,650,000)
Profit post split for JV		$625,000	$812,500	$1,062,500
Improvement in ROI		184%	247%	336%

OTHER CONSIDERATIONS

As new processes, systems, and personnel are put in place to integrate both organizations, turn times and service levels may be temporarily impacted. However, NewRez has the experience and dedicated internal resources to assure a smooth start-up. With a combined 30 years of experience, NewRezs' management team has successfully launched hundreds of Joint Ventures. The longevity of these partnerships is due, in large part, to NEWREZ's unwavering commitment to ensuring mutual success.

Entering into a Joint Venture is not a decision to be made lightly. As this report has shown, there are many factors to consider and questions to be answered. The advised next step is to schedule a meeting with the NewRez executive team to determine how each partner can benefit from pursuing a Joint Venture.