Mortgage QC Industry Trends

Q1 2019
Q1 2019 revealed the loan quality correction we anticipated after Q4 2018. While there are many positives related to the overall market’s upturn, we should be mindful of the increase in defects related to key underwriting and eligibility functions. This continues a trend that persisted the entirety of 2018 and shouldn’t be taken lightly.

-Nick Volpe, Chief Strategy Officer of ARMCO
Summary of Findings

In Q1 2019, the critical defect rate decreased from the previous three quarters and is now within range of the critical defect rate for calendar year (CY) 2018.

Q1 2019 report highlights include the following findings:

▪ The critical defect rate fell 6%, from 1.93% in Q4 2018 to 1.82% in Q1 2019.

▪ Defects related to core underwriting and eligibility functions continued to increase, with more defects attributed to Income/Employment than any other category.

▪ Critical defects attributed to missing, expired and/or incorrect documentation continued to be volatile (24% in Q3 2018, 16% in Q4 2018, and 24% Q1 2019) and noted a substantial increase from the prior quarter.

▪ Compliance-related critical defects fell to their lowest level since Q1 2016, likely the result of greater lender investment in compliance technologies.

▪ Defects related to Property and Appraisal increased noticeably from the previous quarter but remained low overall.

▪ Government-insured loans accounted for a slightly higher share of all loans in the benchmark with FHA, VA and USDA loans comprising 41% of all loans reviewed.
Critical Defect Rate by Quarter: Q1 2019
Critical Defects by Fannie Mae Category: Q1 2019

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>11.11%</td>
</tr>
<tr>
<td>Borrower and Mortgage Eligibility</td>
<td>6.48%</td>
</tr>
<tr>
<td>Credit</td>
<td>19.44%</td>
</tr>
<tr>
<td>Income / Employment</td>
<td>27.78%</td>
</tr>
<tr>
<td>Insurance</td>
<td>0.93%</td>
</tr>
<tr>
<td>Legal / Regulatory / Compliance</td>
<td>1.85%</td>
</tr>
<tr>
<td>Liabilities</td>
<td>2.78%</td>
</tr>
<tr>
<td>Loan Package Documentation</td>
<td>24.07%</td>
</tr>
<tr>
<td>Property Appraisal</td>
<td>5.56%</td>
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</tbody>
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Critical Defects by Fannie Mae Sub-Categories
Q1 2019

Credit
- Credit Calculation / Analysis: 19.05%
- Credit Documentation: 19.05%
- Credit Eligibility: 61.90%

Income / Employment
- Income Documentation: 66.67%
- Income Eligibility: 6.67%
- Income / Employment Calculation: 26.67%

Loan Package Documentation
- Application / Processing: 19.23%
- Closing / Title: 73.08%
- Loan File: 7.69%
Critical Defects by Fannie Mae Category: Q4 2018 vs. Q1 2019

- **Assets**: Q4 18 - 12.62%, Q1 19 - 11.11%
- **Borrower and Mortgage Eligibility**: Q4 18 - 13.59%, Q1 19 - 6.48%
- **Credit**: Q4 18 - 18.45%, Q1 19 - 19.44%
- **Income / Employment**: Q4 18 - 20.39%, Q1 19 - 27.78%
- **Legal / Regulatory / Compliance**: Q4 18 - 5.83%, Q1 19 - 1.85%
- **Liabilities**: Q4 18 - 7.77%, Q1 19 - 2.78%
- **Loan Package Documentation**: Q4 18 - 15.53%, Q1 19 - 24.07%
- **Property Appraisal**: Q4 18 - 3.88%, Q1 19 - 5.56%
Loans Reviewed vs. Critical Defects by Loan Purpose

Q1 2019

Percentage of Purchase vs. Refinance Transactions Reviewed in Benchmark

- Purchase: 71.53%
- Refinance: 28.47%

Percentage of Critical Defects in Purchase vs. Refinance Transactions

- Purchase: 80.20%
- Refinance: 19.80%

Q1 2019
Critical Defects as a Percentage of All Loan Types

Q1 2019

- **All Loan Reviews, According to Loan Product Type**
  - FHA: 30.71%
  - Conventional: 58.90%
  - USDA/RHS: 2.71%
  - VA: 7.69%

- **All Critical Defects, According to Loan Product Types**
  - FHA: 46.53%
  - Conventional: 42.57%
  - USDA/RHS: 0.99%
  - VA: 9.90%
About this 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.

Each 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.

The ARMCO Mortgage QC Industry Trends Report is available free of charge.

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