Freddie Mac Single-Family Home Starts Here Podcast Episode Transcript:

Leveraging Automation: Assessing Borrower Financials with AIM

Announcer: [00:00:01] Welcome to the Freddie Mac's Single-Family Home Starts Here podcast. Your connection to all the latest industry trends, insights and points of view on the mortgage market. From Freddie Mac leaders and other industry experts.

Liz Mugavero [00:00:18] Welcome to the Freddie Mac Single-Family Home Starts Here podcast. This is your host, Liz Mugavero with Freddie Mac Single-Family. My guests today are here to discuss one of our automated solutions— loan product advisor, AIM, or asset and income modeler for self-employed and how it simplifies loan origination. Particularly during a time of heightened need like the one we're in now, where faster, easier digital options are critical to keeping the mortgage market going.

Liz Mugavero [00:00:42] I'm so pleased today to have our Single-Family guests, Terry Merlino, Senior Vice President and Chief Credit Officer, and David Fulford, Vice President of Strategic Technology Integration with us. And we also have a special guest today, Tamara West, Investor Specialist with our client partner NBKC Bank. Tamara will talk to us about how NBKC's use of aim for self-employed made all the difference during this time of uncertainty and also a real difference to their bottom line. So welcome, everyone, thanks for being here today.

David Fulford [00:01:07] Thank you for having us.

Terri Merlino [00:01:08] Thanks, Liz. Great to be here.

Tamara West [00:01:10] Thank you.

Liz Mugavero [00:01:10] So, let's get started by talking about the AIM journey. David, if you could tell us a little bit about what challenges lenders are experiencing with borrower capacity assessment and why this is important.

David Fulford [00:01:20] Yeah, well, if you think about the origination process and how it works today, an underwriter is really trying to understand three key aspects about a loan: the value and condition of the property being purchased or refinanced, the credit history of the borrower in the financial stability and capability of the borrower, which is what we call a borrower's capacity. Essentially, this is an assessment of a borrower's assets, their income and their employment stability. Basically, how much do you have, how much do you make and how likely are you to continue making it during the life of the loan? Well, property values are mostly well understood, and there's an entire industry dedicated to assessing their value and condition. And credit history is standardized across the country with FICO scores and reporting available from heavily regulated sources. But the capacity aspect has a million potential combinations that have to be accounted for between how borrowers employed— part time versus full time, hourly versus salary, bonus or no bonus, overtime or no over time, employment, income or retirement income, etc, etc. You get the picture, it can get very convoluted. And on top of that, more borrowers than ever have multiple sources of income, multiple employers, part time self-employment like Uber or AirBnB, TaskRabbit. There's just a lot of different combinations that have to be accounted for and ultimately, it can be overwhelming even for a seasoned underwriter. You throw in today's added risk of spiking unemployment and small businesses being under so much stress and all sudden determining a borrower's capacity can be a huge challenge and a significant risk if it's not done properly. So that is the foundation of the challenge. There's also more opportunity than ever to automate a significant portion of this process, if not all the process in many instances. And that's where AIM comes in.

Liz Mugavero [00:02:53] Yeah. So, in short, there's a lot to consider when trying to create a solution like this. So if we could articulate some of the challenges that came with trying to implement the solution, so namely getting buy-in from loan officers, getting underwriters on board, explaining how the process efficiency, you know, it's going to help really speed up the process. Tamara, could you tell us a little bit about that?

Tamara West [00:03:13] Absolutely. And thanks for having me here. It's definitely a challenging time. Getting people on board with any new technology is always going to be a challenge. This is very much an industry where historically you found your efficiencies through your process. And so, you get a very well-established process and that works for you. So, when you bring in a new technology, getting people to accept that, there's obviously going to be your first challenge. But when you're talking about especially self-employed borrowers, a lot is going on with that. And that's what's been exciting about the AIM product, is it's really taken probably the most challenging aspect of self-employed borrowers and really scaled it down to the key components and allowing the sales people (the underwriters, the processors) allowing them to really look at the important parts of it in order to truly assess the capability, kind of scrape away the busy work and get down to the truly important information. And in getting them on board with it, really, it was the proof is in the pudding. To put it simply. Getting them to just use it—went from a standpoint of just give me two, just do it on two of them, take a look, see what you think. And the rest, really just took over after that, after they saw how it worked and that it allowed them to easily incorporate it into that process that they have found for themselves. Really, everybody just kind of came on board. And in the grand scheme of things, it was relatively seamless, once they saw how it worked.

Liz Mugavero [00:04:44] That's great. Leading by example. But it does sound like there are a fair amount of challenges that you needed to overcome. And then on top of all that, we had a pandemic. So how has the COVID-19 pandemic played into those initial challenges that you had getting people on board?

Tamara West [00:04:57] Well, I think the first challenge internally that it presented was obviously everybody working from home. It took out that ability for somebody to just pop their head over the wall and say: hey, this thing that I'm looking at, what do I do? It removed that immediate interaction and that was probably the biggest challenge. But what's odd about that is it, we're starting to see that it's turning into a good thing for this aspect of it, for using these tools for self-employed borrower analysis, because they're not able to just immediately turn around and say, what do I do about this one thing? It allows them the opportunity to sit down, look at it, kind of gather their questions before they meet with somebody or have to get into an online meeting. And that's actually allowed them the opportunity to come to their own conclusions, to kind of walk themselves through it. And I think, once people took that time to try to digest it themselves, they realized, oh, this is all connected, this all starts to make sense. You know, we're very much in an environment that is keep moving, keep moving and it's hard sometimes to slow down. And in a way, this is afforded people the opportunity to slow down and take in some things that maybe they would have gone about in a different way before.

Liz Mugavero [00:06:13] Absolutely. And in light of the pandemic and all of the crisis mode that we've been in since COVID-19 started a few months ago, Freddie Mac has been really putting forth great efforts to make sure borrowers, servicers and the industry at large know where to go for resources and that we have an understanding of what is needed at this time. So, Tamara, would you say that this AIM for self-employed solution has made it easier for self-employed borrowers in this environment?

Tamara West [00:06:39] I think they are faced with an incredible challenge just in general. But it certainly has made it easier. It takes away some of the busy work, the kind of initial legwork, and allows the person who is looking at that borrower's situation to scrape away all the noise and really assess what's important. The actual information, the actual numbers. And I think when you have the ability to get rid of all of that surrounding noise, it allows you to focus more on those details that ultimately are important to assessing that borrower's ability to carry that loan.

Liz Mugavero [00:07:16] David or Terri, did you add any thoughts or comments here about borrowers and challenges that they've been facing and how this product has been helping?

Terri Merlino [00:07:23] Liz, yeah, I was thinking, you know, as Tamara was speaking, you know, one of the great benefits of the AIM product, especially for the aim for self-employed, is it takes the guesswork out of the calculations. And I think at a time like now, where everyone is more concerned about how much income is available to be used, there is adjustments our AIM for self-employed product allows lenders to make adjustments so that if they see that's necessary, based upon some of the information that they know about that particular business, they're able to do that and still evaluate the borrower's capacity.

Tamara West [00:08:01] Yeah, that's a really great point. And we have found that in the current environment, we've used that a lot. We're taking, you know, what is historical information through the tax returns and comparing it to more current information in order to make that determination. Have they been affected? And if they have, to what degree? And having that very easy to use tool to do that kind of analysis in of itself lends a certain level of comfort that they're making a sound decision.

Liz Mugavero [00:08:32] So Tamara, can you give us a sense of the timeline? So, when did you begin using AIM for self-employed through Loan Product Advisor and how long did it take you to start seeing some of the benefits from doing so?

Tamara West [00:08:44] We have actually been using it since the very beginning, which is pretty exciting. We were involved in the initial pilot, so it was very exciting to be a part of that inception, process, inception, at least from the lender's perspective. And from beginning to end, I would say that it probably took about six months, maybe a little less than six months to really just incorporate it as a standard part of our process. And within that six months, that was all in that was getting in on board and training people how to use it, training people what to see. And then ultimately, truly incorporating that as just a standard part of our process.

Liz Mugavero [00:09:19] And can you share with us some of the benefits that you've seen? You know, time savings, cost savings, how it's helped you manage risk during the COVID environments? Any competitive advantages that you've seen from using it?

Tamara West [00:09:29] Absolutely. So, cost and time savings are really kind of incredible with it. As I was saying earlier, analyzing self-employed borrowers is probably the most time-consuming aspect when you're looking at borrower capacity. It's one thing to take a pay stub and do a pretty standard calculation. But with self-employed borrowers, you have many different structures. You can have a lot of different ways to arrive at what is that borrower's income. And so, having a tool like this to help you arrive at that final number, the time savings is incredible. I would be very safe to say it cuts it definitely in half, but many times even more than that. It's a very exciting thing to not have to do all of the data entry. It sounds very simple, you know, it's just data entry, but it's time consuming and to even take away that component of it…i even puts Underwriter's in a better mindset to go into those not already frustrated, as they've already just put it, and 30 minutes of busy work before they can even get to the core of it. But we historically have found that it is saving our underwriters upwards of 45 minutes per self-employed borrower in any given month. That can translate to ten thousand dollars, if not more. That's not pennies. And then in this current environment, in terms of managing risk, having those tools readily at your fingertips to be able to do an analysis of historical information compared to current data, that's key. It really allows you to take a look at the historical picture compared to where they are now and know are we still stable? Are we still good? Then be able to see what that variation looks like. So, it's been very much a time saving and time and efficiency is money. So that's been great for us.

Liz Mugavero [00:11:17] That's terrific. Those costs and timesaving proof points are pretty incredible. So, thank you for sharing.

Terri Merlino [00:11:22] So the other thing, Tamara, as you were speaking, I was thinking, this is probably really helpful at a time when there is so much volume and the ability to hire underwriters can be challenging. So, I'm sure that efficiency is a big help as well, because you're able to get more done with less resources and you're not having to continually add to that headcount in order to handle the additional volume.

Tamara West [00:11:45] Absolutely. Using the technology to leverage those changes instead. It also allows you to be more nimble and that can be used anywhere. I see that as just a savings account of your time. Anything that you can use to make you more nimble is just going to be better all around, better internally, but also better for our borrowers.

Liz Mugavero [00:12:03] I'm going to switch gears now and turn to Terri so she can talk about one of her favorite topics, risk management. So, Terri, what role does credit risk play in automating asset and income assessment?

Terri Merlino [00:12:12] Thanks, Liz. AIM definitely reduces risk, but it also provides our clients with purchase certainty so they can have that assurance of regarding the calculation of the income as they sell their loans to Freddie Mac. And as Tamara said, there's also the processing efficiencies as well. The reason why it reduces the risks is if you think about it, we're independently obtaining data from trusted third parties in order to provide that independent risk assessment. So, we're able to get that independently and we're not relying upon the paper being provided by borrowers in the traditional sense. This streamlines the lender's process and gives them that certainty prior to the sale to Freddie Mac that the loan is going to meet our requirements.

Liz Mugavero [00:12:57] Great, and it's definitely a key component in this time of social distancing, I would assume.

Terri Merlino [00:13:01] That's right, everything's automated. So there's no face to face interaction or exchange of paper documents required. Or the borrower grants their permission to share their income asset data, and we've retrieved that data independently. And then we're able to provide that risk assessment and the feedback messages come back directly through loan product advisor. So, everything's right there at the lender's fingertips.

Liz Mugavero [00:13:23] Will Freddie Mac continue evolving the AIM offering?

Terri Merlino [00:13:26] Yes, we will. We're constantly looking for opportunities to improve the offering. Also looking for opportunities to provide additional service providers in order to give our clients more options.

Liz Mugavero [00:13:38] So, Terri and David, we've put out recent guidance that offers temporary requirements when assessing income from self-employment. And as I mentioned earlier, we've been committed to breaking down and being really clear and transparent about solutions and resources for the industry at large. As part of our hashtag #helpstartshere campaign since this crisis began. So, can you break this down a little bit? What are some of the highlights from these temporary requirements?

Terri Merlino [00:14:03] Sure, Liz. You know, in light of the current economic environment and if you think about the impact that it can have on the revenue, the income and the cash flow of the self-employed borrower, it's important for us to make sure that we're providing guidance to lenders on how to evaluate this income in assessing the credit risk associated with the loan. Typically, this income is evaluated using tax returns and we have the extension for filing 2019 tax returns, so 2018 may be the most current available. And the 2019 returns may not be reflective of the current environment. So, the temporary requirements that we've put out there is for additional documentation to be obtained, such as a year to date profit and loss statement. And that can be prepared by the borrower themselves and also gather their business account statements so that you can see how that profit and loss statement aligns with the business account statements. And using those, you can determine that the borrower stable monthly income, exactly what it is, in light of the current environment. And then, the great thing about the AIM for self-employed, as we talked about earlier, there is functionality there based upon that analysis that the underwriter can make the appropriate adjustment for that income before they upload the income to Loan Product Advisor for assessment.

Liz Mugavero [00:15:24] Terrific. David, anything you'd like to add?

David Fulford [00:15:26] The only thing I add there is that, you know, our technology partners in this space, they certainly understand the additional scrutiny that's being applied with everything that's going on. And as much as they can, they are very willing and excited to try to step up and add any additional automation that they can. So, while some of these initial things may be a little bit more manual upfront with additional documentation being collected, they are looking at how they could potentially automate some of that collection as well so that it ultimately becomes a streamlined as kind of the traditional product does. Still a work in progress, but that's the value of having these partners at the table with us. They're always looking at ways to innovate, improve their solution, while luckily the current offering already has the base capabilities in place to support these additional requirements. We do think that there are opportunities to automate more of that going forward. And certainly, we'll have to see just how long, you know, a quote unquote, temporary environment continues on, but I think it's safe to say that it's going to be a while. So, we'll look for opportunities to innovate more with our partners to continue providing more automation capabilities in this space.

Liz Mugavero [00:16:36] Terrific. Thanks, David. So, in that vein, what is on the horizon as we continue to refine the solution and look at different ways to evaluate borrower capacity responsibly?

David Fulford [00:16:46] Sure. Good question. So, Terry mentioned probably one of the most critical ones, which is just making sure that we have as great of access to our products and offerings as possible through partner integration. So, we have one really great partner already available in this offering space with us. We are looking to expand to additional partners later on this year, which should just make it even more accessible for other lenders who have different relationships out there in the industry. Certainly, always looking at how to add more sources in additional forms that we can provide support for and have automation around and include income from. So ultimately looking to expand where and how we capture income and the additional forms that can be used to support it. And then I think, you know, one of the bigger pieces in the self-employed spaces, what we've been talking about today is really automating the calculation of self-employed underwriting. And that's a big deal, as Tamara was mentioning. That in and of itself provides a lot of value.

But did the day we are still looking at data that's coming off of documents and there's risk in the fact that this data is coming off of documents and it's not source data. So, we will be looking at ways of trying to compare data from documents with data that we can get, that's from a verified source such as the IRS to be able to see, OK, we have their tax returns, we know what they've shared with us, we can now go look at tax transcripts and see how their current income stacks up against an income history from sources like the IRS. They could give us additional certainty and capability to provide additional rep and warrant coverage in the future. So, while the focus up front has really been around the calculations themselves, we'll be looking going forward, how we get additional data sources that could give us the ability to provide additional relief and therefore more opportunity to streamline how lenders underwrite and the self-employment space.

Liz Mugavero [00:18:33] Thanks, David. That's really helpful. Terri, Tamara, any final thoughts or closing comments from either of you?

Terri Merlino [00:18:38] The only thing that I would say, as David said, you know, always stay tuned because we continue to make enhancements and additional rollouts and adjustments to respond to the feedback that we get from our clients. So, stay tuned.

Liz Mugavero [00:18:53] Well, thank you all for being here and we appreciate it very much. And Tamara, it was lovely to have you.

Tamara West [00:18:57] Thank you.

Liz Mugavero [00:18:58] We look forward to having you back to hear more about how AIM has helped you on your journey in the future. Thanks for tuning in.

Terri Merlino [00:19:04] Thanks, Liz.

David Fulford [00:19:05] Thank you.

Tamara West [00:19:05] Thanks, everyone

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