# THE SERVICING CONUNDRUM

## To retain or to release your servicing, that is the question

*your*
**SECONDARY MARKET SPECIALIST**

**CHRIS ENDICOTT**
785.438.6087
chris.endicott@fhlbtopeka.com

Chris has been in the banking industry for more than 17 years, 11 at FHLBank Topeka. He is a graduate of Emporia State University. Contact him today.

Find out more about Chris and our funding specialists at **FHLBTOPEKA.COM/INTELLIGENCE.**

Many institutions find themselves weighing their options when choosing whether to retain or release the servicing on the loans they sell into the secondary market. The truth is, there isn't a wrong choice. But is there a better one for your institution?

For many, deciding to retain the servicing on their sold loans isn't a financial one but one made to meet the desires of their customers. While you may not consider income as a factor, it is important to understand income can be made servicing loans.

The main issue is how the income is obtained and the valuing of that income stream. You receive a Service Release Premium (SRP) when the loan is sold, and you immediately receive all of the benefit for the delivery of that loan, maximizing your upfront income. When you retain servicing, you forego the immediate SRP, but you receive that income over the life of the loan. Given that the income is received over time makes it more difficult to see — but the income is real.

| Loan Amount | $150,000 |
|---|---|
| Interest Rate | 3.5% |
| Term | 30-year Fixed |
| SRP | 74 bps |
| Duration | 4.5 years |

In the example above, an SRP one-time payment of $1,110 (74 basis points x $150,000) is paid by the buyer of the servicing. If the servicing is retained, the loan will generate average servicing income of $1,687.50 ($150,000 x 25 bps servicing fee) based on the duration or life of loan.

**$150,000 x .01125 or (.0025 x 4.5) = $1,687.50**

*continued on next page*

The duration of this loan of 4.5 years is based on the coupon and term of the mortgage and the interest rate environment at origination. The duration is influenced by expected prepayment speeds and represents the present value of the servicing fees based on the weighted average time over which the fees are paid. Using this approach to estimate the present value of the fees results in nearly $600 more income. Of course, this income could be more or less than the example, based on changes in interest rates and how long the loan is actually on the books. However, using this type of approach to estimating the life span of your portfolio will assist you in determining how valuable the servicing can be for you.

Another important consideration related to retaining or releasing servicing is the impact on operating expenses. Many people think that the "efficiencies of scale" of large financial institutions drive down the costs associated with servicing. While this can be true, a smaller operation can also benefit because one of the biggest costs for any business is personnel. Smaller community institutions tend to have employees that wear many hats, which translates to lower personnel costs. This means that if you began to service loans, you may be able to maintain personnel costs and increase revenue via servicing fees.

In addition to the income from retaining servicing, you can also collect ancillary income. When customers make their loan payments to you, you have access to their financial information. That information can be leveraged to cross-sell additional products and gain more income from the relationship. Do they need a HELOC, a boat loan or an auto loan? You have all of that information at your fingertips with their loan application. You just need to take advantage of it.

Considering these facts, why do so many institutions sell their servicing rights?

1. They don't want to take on the task of servicing.

2. They like the upfront income when they sell the servicing or they don't want to take the time to value the potential ongoing income stream from servicing the loan over its life.

3. Their systems aren't set up to handle the servicing of secondary market loans and all the accounting and investor reporting requirements. This may result in manual workarounds or their system would require too much modification to make the process efficient.

4. Their ability to make ancillary income is limited. Institutions that have multiple locations or a strong internet presence are more limited in their cross-sell opportunities because their customers aren't visiting the institution often.

These are just a few of the reasons institutions choose to sell their servicing. Your institution may have a completely different one that is just as valid. While there is no wrong answer, some additional analysis can help you reach the best choice for your institution.

**Please contact me with any Mortgage Partnership Finance® (MPF®) Program questions or to discuss your servicing options.**

## Contact Chris today for solutions that work for you.

☎ 785.438.6087 ✉ chris.endicott@fhlbtopeka.com fhlbtopeka.com/intelligence

FHLBank Topeka

Mortgage Partnership Finance and MPF are registered trademarks of the Federal Home Loan Bank of Chicago.