

Opening the Warehouse Door

If you have an agreement for a warehouse line of credit, understand its terms and what's negotiable

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MORTGAGE BROKERS USE WAREHOUSE lines of credit to increase their profit margins in originating loans or as a first step to becoming a mortgage lender. In an increasingly tightening market, however, warehouse lenders who once overlooked nonperforming loans because they were making a huge profit may now be looking to warehouse borrowers (i.e., brokers) to repurchase the loan to help their struggling bottom line.

Although the requirement to repurchase loans likely will be more prevalent in the nonprime market than in the prime market, it is important to understand the trend. It may become applicable to all sectors because of other industry slowdowns.

The typical warehouse line of credit starts when a warehouse lender agrees to purchase loans that a warehouse borrower — or broker — agrees to sell. The broker agrees to sell within a specified time. Brokers also represent to the warehouse lender that they are duly incorporated, have the proper licenses to lend money and can indemnify the warehouse lender if they aren't what they say they are.

This is set up in a warehouse-line-of-credit agreement, which most often comprises a loan-purchase agreement and a guide or master-purchase agreement. Less frequently, the warehouse agreement is made up of only one document.

If you understand the remedies associated with breaching these warehouse agreements, as well as the most-common representations that can get you into trouble, you can better work with and negotiate with your warehouse lender.

Associated remedies

The remedies portion of the warehouse agreement is broad. Although specific remedies vary

among agreements, you can count on two different remedies in the document — the repurchase remedy and the indemnification remedy.

In a repurchase remedy, brokers are required to repurchase the loan when their representations and warranties are breached. In an indemnification remedy, brokers must cover the lender for the costs and losses of the loan because of a breach of the representations and warranties made regarding the loan. Commonly, this also covers a breach of any agreement made between the warehouse lender and the broker.

Either of these can cost warehouse borrowers hundreds of thousands of dollars.

Typical warehouse-line-of-credit agreements will require repurchasing the loan you originated if:

- **The lender finds evidence of fraud** in the origination of the loan;
- **The mortgage borrower defaults on payments** within the first 12 to 24 months; or
- **You breach any of the representations and warranties** that you make in connection with originating the loan.

In addition, these agreements generally require indemnifying the warehouse lender if it loses any money on the loan because of a breach of any of the representations and warranties of the agreement, as well as of any agreement they ever agreed to with you. The indemnification remedy typically is broader than the repurchase remedy.

Representations and warranties

The representations-and-warranties section of a warehouse agreement is important and should be reviewed carefully. Warehouse lenders likely will not negotiate on most of the

representations and warranties. They may be willing, however, to negotiate on items such as the amount of time they have to state that the broker breached certain representations and warranties.

Most warehouse lenders also are willing to give brokers a specified time to cure the breach of representation or warranty. Some of the most-common representations that may be negotiable include: early payment defaults; compliance with lending laws; appraisal valuations; and the ability to cure.

Many warehouse-line-of-credit agreements include a provision regarding the mortgage borrower's early payment defaults. Although the definition of early payment defaults varies among lenders, it typically means borrowers have missed their first payment or two or more payments in the first one to two years of the loan.

These types of payment defaults concern lenders. There are several reasons that borrowers may miss one or two payments in two years, however. You can negotiate with the lender regarding its definition of early payment defaults, rather than trying to eliminate it completely, which will not happen. Try to limit the definition to one year instead of two years.

If the warehouse agreement states that an early payment default occurs when borrowers have missed any two payments in two years, try to negotiate with the warehouse lender to ensure that these missing payments are consecutive.

Another common requirement in warehouse is that you must comply with all federal and state lending laws in connection with originating the loan. Although this requirement will always stay in the agreements, business practices may make it negotiable as far as the amount of time this requirement is active. Some warehouse lenders limit this requirement to the origination of the loan itself.

But many agreements do not limit the compliance portion of the warehouse agreement. For example, if there is a compliance violation in a loan's 20th

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year, lenders may have the option to require you to repurchase or indemnify them for that violation.

Keep in mind, however, that warehouse lenders typically audit the file even before approving the loan purchase. If they find what they consider a compliant loan, they will purchase the loan from you. Otherwise, they will require you to modify the loan before you purchase it. Because this is a common business practice, you can attempt to limit your part of the agreement to assuring the loan is compliant only until the warehouse lender reviews and approves the file.

Valuations

When it comes to appraisal valuations, a common sentence in warehouse-line-of-credit agreements is: "The fair market value of the mortgaged property as indicated by the property appraisal or valuation is materially accurate."

This type of appraisal valuation representation is a dangerous warranty for a broker to make and should be stricken if at all possible.

The problems with warranting appraisal valuations are obvious. You hire an appraiser who is duly licensed by your state as an expert in the appraisal industry. In turn, the appraiser gives you an opinion of the property's value.

What if the appraiser's opinion is not accurate? Who determines exactly what "materially accurate" means? If it is not "materially accurate," do you have to repurchase the loan or indemnify the lender?

Even if appraisers indemnify you because of your reliance on that appraisal, they likely are in the same cash-flow position as you are — or worse. This is an especially timely concern considering the current housing market.

Finally, although it is not necessarily a representation and warranty, the ability to cure is definitely something you want in your warehouse agreement. In most agreements, this typically states that "the seller will, upon notification to the buyer, correct or cure such defect within the time prescribed by seller to the full and complete satisfaction of buyer."

This gives you an amount of time to cure whatever default exists in the loan. This could be a cheap way to avoid repurchasing the loan from the lender. For instance, if the loan failed to comply with the Home Ownership and Equity Protection Act (HOEPA), you could cure the breach by refunding the mortgage borrower the amount that caused the loan to be covered by HOEPA. Thus, for comparatively

little cost, you have avoided the requirement to repurchase the loan.

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There are many dangers that could be lurking in your warehouse-line-of-credit agreement. You can however, take steps to negotiate your agreement with the warehouse lender. As with other agreements, you should have your attorney review all warehouse agreements in which you want to enter. This will help you avoid the many pitfalls of which you may not be aware. **!**