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Grow Your Mortgage Business

A Guide to Branch Office Acquisitions

Lauren B. Pryor
Partner

Robin Gieseke
Regulatory Compliance Analyst

Stacey L. Riggin
Government Affairs Advisor

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Deal Framework

- Deal Structure
  - Purchase Price and Earnouts
  - Assets, Pipeline Loans, Employees, Intellectual Property, Material Contracts
  - Office Space and Leases
  - Transition Services
- Licensing Strategy and Federal Agencies
  - Licenses and registrations maintained by buyer and seller
  - Strategies and pitfalls
  - Steps prior to closing

Consideration – Cash and Earnouts

- Cash Purchase Price
  - May be nominal valuation of FF&E; employees are the most valuable asset
- Earnouts
  - Protects the buyer from an earnings decline post-sale; allows for lower cash at closing
  - Offers a greater potential “upside” for the seller
  - Timeframe: 24-48 months
  - Possible pitfalls
    - Buy side: Carve out new business acquisitions and legacy revenue sources
    - Sell side: Capture new offices in the region; watch out for overly restrictive covenants and tax implications if the earnout is tied to employment

Earnout Metrics

- Metrics
  - Volume by branch office or by region
    - E.g., metrics based on aggregate principal balances over a set time period
  - Profit and loss allocable to branches or profit centers
    - Including gain on sale and loan level losses
    - Requires internal P&L statements and careful thinking of what income and expense items are taken into account
  - Measure by origination channel
    - Retail, wholesale, correspondent
    - Consider refinancing /recapture rates
  - Consider critical intellectual property assets

Due Diligence

- Employees
  - Identify key personnel and evaluate the cultural fit
  - Benefits, severance and compensation
  - WARN Act considerations
- Intellectual Property Assets
  - Material software and systems
  - Unique apps or origination software
- Licensing Diligence
  - Evaluate seller licenses and consider filing requirements for state regulatory agencies

Due Diligence (continued)

- Regulatory Compliance
  - Consider patterns and practices that may continue with the buyer
    - More relevant if agency servicing rights are being sold
  - Existing orders and understand the impact for buyer
- Material Contracts
  - Lease and landlord consents - Complexities in negotiation – Critical for state licensing
  - Vendor agreements
  - Investor relationships and bond programs – Critical for federal agencies
  - Importance of broker agreements for wholesale

Assumed and Excluded Liabilities

- Assumed Liabilities
  - Use of the assets and operation of the branches after closing; obligations under material contracts; employee liabilities post-closing
  - Continuation of obligations in regulatory orders may be imposed on buyers
    - How to get comfortable – Non-objection from a regulator or at least no MAE by closing
- Excluded Liabilities
  - Retained by the seller – e.g., litigation matters and employee claims pre-closing
  - Be wary of successor liability - Generally not an issue in limited asset / branch sales
    - Misclassification of employees can be an issue under the Fair Labor Standards Act
  - Consider successor liability in sales of substantially all of the assets of a business

Employee Retention

- Diligence Fair Labor Standards Act compliance
  - Proper classification of employees as exempt/non-exempt
  - Consider possible successor liability for the buyer with a 3-year look back and multiples of damages for failure to pay overtime
- Key Employees
  - Lock in the branch managers; they wrangle the troops
    - Branch manager agreements are important for state licensing
  - Employment agreements for key employees (management and high performer LOs)

Employee Retention (continued)

- Compensation and Benefits
  - Cash retention arrangements; performance bonuses
    - May be paid by the seller or buyer
  - Payouts for accrued bonuses/commissions, benefits, vacation time
  - Comparable compensation and benefits for 6-12 months

Indemnity

- Coverage
  - Standard representation and covenant breaches
  - Retained Liabilities and known risks or specific diligence findings
  - Survival
    - Non-fundamental reps: 12-18 months; Fundamental reps: 18-24 months
    - Shorter time frames in strategic sales or if the seller is winding down
- Holdbacks, Baskets and Caps
  - Strategic deals will have some sort of limitations of liability package
  - Less common in limited asset sales

Post Closing Negative Covenants

- Non-compete
  - More common if the seller is exiting the business
  - Restriction on a certain business in a designated area
  - Typically 12-24 months (3 years is more common in stock deals)
- Non-solicit/No-hire
  - Buyer looks to prevent poaching
  - Seller is prohibited from hiring employees for 12-24 months (3 years in stock deals)
  - Buyer can also prevent poaching through compensation, commissions and benefits
- Confidentiality and Non-Disparagement

MSR Portfolio Sales

- Servicing Rights Portfolios
  - May change the economics if an MSR portfolio is included
  - Closing timing should align with the sale date
    - More difficult if the assets are being sold to different buyers
  - Consider transfer logistics and agency approvals
  - Interim servicing component; tricky with a wind down plan

Transition Services – Closing the Pipeline

- Identify Pipeline Assets
  - Locked and unlocked loans; investor consent
  - Consider timing to close loans in the pipeline
- Services to be performed post closing
  - May include obligations on both sides depending on when certain employees transfer
- Closing the pipeline (buyer provides services to seller)
  - Consider employee commissions and bonuses due with respect to the pipeline
  - Consider broker agreements - Transition plan and communications to broker agreements
  - Consider whether an IP license is necessary

State Licensing

- Pre-transaction
  - Cross reference licenses
  - Identify outstanding deficiency items
    - Buyer and Seller
    - Control Persons, Branch Managers and Qualified Individuals
    - Mortgage Loan Originators
- Notifying State Agencies
  - Details of Transaction
  - Pipeline

State Licensing (continued)

- Evaluate licensing requirements for each state mortgage finance regulatory agency
  - New corporate office applications
  - Transition branches
  - Transition Mortgage Loan Originators
  - Identify Branch Managers and Qualified Individuals
  - Identify new Control Persons
  - Identify processing timelines and unique requirements
  - Trade Names

State Licensing (continued)

- Mid-transaction
  - State specific documentation
  - Existing Leases
  - Loan Pipeline transition
  - Regulatory Communication
  - Mortgage Loan Originators and Branch Manager Communication

State Licensing (continued)

- Closing Date / Post-transaction
  - License surrender
  - Mortgage Loan Originators and Branch Managers – Relationship/Sponsorship/Employment updates
  - Deliver post-closing state specific documentation

Federal Agencies

- Conventional loans (Fannie Mae and Freddie Mac)
  - Cross reference GSE contracts for Memoranda of Understanding (MOU), Waivers, Authorities
  - Use of Fannie Mae Desktop Originator (DO) / Desktop Underwriter (DU) and Freddie Mac Loan Product Advisor Loan Prospector (LP) for Automated Underwriting
    - Add/Remove Sponsor relationships for wholesale activities
    - Change preset system codes
- Cross reference investor and State Bond Agency/Housing Finance Agency approvals (approval process can be lengthy)
- Third Party Originator and Authorized Agent Relationships

Federal Agencies (continued)

- Cross reference delegated authorities and relationships for Insured/Guaranteed Loans
  - U.S. Department of Housing and Urban Development (“HUD”)
    - Title I/Title II
    - Direct Endorsement/Lender insuring by program type (Forwards/HECMs)
  - U.S. Department of Veterans Affairs (“VA”)
    - Automatic Underwriting
    - Lender Appraisal Processing Program (“LAPP”)
  - U.S. Department of Agriculture Rural Housing Service (“RHS”)
    - Guaranteed Underwriting System (“GUS”)

HUD/FHA, VA and USDA General

- Preparation for transaction
  - Confirm no open audits, outstanding payments, HUD Creditwatch terminations or Administrative Actions
  - List of locations (cross reference with state licenses), authorized personnel and user registrations
  - Detailed transaction letter
    - Use appropriate terminology
    - Timing and method of submission
    - Information to be included

HUD, VA and USDA Branch Approvals

- Branch Office Registrations
  - FHA Bulk Conversion
    - Transactions where seller will relinquish mortgagee approval
    - Transactions where seller will remain an approved mortgagee
  - VA and USDA/RHS Branch Registration Requests (optional)
  - Complexity of retaining seller name for use as d/b/a
  - Lease issues

HUD, VA and USDA Personnel

- Transfer of User Registrations/Authorized Personnel
  - HUD/FHA
    - Direct Endorsement Underwriters
    - FHA Connection logon/LEAP User roles
    - Loan Review System (“LRS”) submitter
  - VA
    - Automatic Underwriter
    - LAPP Staff Appraisal Reviewers
    - Portal access
  - USDA
    - GUS personnel

HUD, VA and USDA Pipeline

- Transfer of Loans in Process
  - Case transfers
    - Re-application
    - Re-issuance of credit approval/Notice of Value
    - Re-rerun Automated Underwriting/TOTAL
- Use of authorized agent relationships
- Letter for case binder
- Submission of loans for insuring and guaranty (*note*: HUD paper case binder if seller approval terminated)

HUD, VA and USDA General

- Leaving personnel behind
- Updating pre-programmed ID#s
  - TOTAL (Automated Underwriting Systems)
  - Cash flow accounts
- Mortgage record change filings, if applicable

Questions?

- Please submit questions by using the chat feature on the right panel of the WebEx portal
- Please email lwhitley@mayerbrown.com with any additional questions, or reach out to us directly:

Lauren B. Pryor
lpryor@mayerbrown.com
+1 202 263 3205

Robin Gieseke
rgieseke@mayerbrown.com
+1 202 263 3384

Stacey Riggin
sriggin@mayerbrown.com
+1 202 263 3362