



Increase Profitability.  
Improve Performance.  
Manage Risk.

## Hedging the Mortgage Pipeline

Mortgage loans start as applications, which must be processed, underwritten, closed and packaged as a whole loan or mortgage backed security before they can be sold into the secondary market. Industry standards dictate the perspective borrower is offered a rate lock at the time of application. Pipeline hedging refers to the process of protecting the pipeline of rate-locked mortgage applications against interest rate risk until they are packaged and sold into the secondary market. The pipeline must also be protected from fallout risk. Interest rate risk occurs because rates rise or decline during the lock-in period. Fallout risk occurs when applications do not become loans. The lender does not know with certainty which loans are available for sale until after each application either falls out or closes. Lenders protect against interest rate and fallout risk by selling their locked pipelines forward into the secondary market. The three broad categories of hedging strategies are:

### Best Efforts

A best efforts commitment allows a lender to enter into an agreement to sell a fixed dollar amount of mortgage loans at an agreed-upon price and to deliver these loans to the investor by a specified date. Applications are rate locked with an end investor as soon as the lender rate locks the application with its customer. If the loan closes, the lender must make delivery of the end loan to the investor. However, if the loan does not close, the lender is not charged a fee for non-delivery.

### Mandatory Cash Delivery

The lender sells forward individual loans or blocks of loans to an end investor. The lender agrees to sell a fixed dollar amount of mortgage loans at an agreed-upon price and to deliver these loans to the investor by a specified date. The lender is charged a fee if it is not able to fulfill the terms of the commitment.

### Mortgage Backed Securities

The lender sells forward mortgage backed securities (MBS) into the secondary market. Closed loans are packaged and delivered as MBS to the end investor.