AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

ORAL HISTORY PROJECT

Interview with

Kevin Peranio

Bass Connections

Duke University

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PREFACE

The following Oral History is the result of a recorded interview with Kevin Peranio conducted by Malena Lopez-Sotelo on February 23, 2021. This interview is part of the Bass Connections American Predatory Lending and the Global Financial Crisis Project.

Readers are asked to bear in mind that they are reading a transcript of spoken word, rather than written prose. The transcript has been reviewed and approved by the interviewee.

Transcriber: Mariana Vedoveto
Interviewee: Kevin Peranio
Interviewer: Malena Lopez-Sotelo

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Malena Lopez-Sotelo: I'm Malena Lopez–Sotelo, an MBA student at the Fuqua School of Business and a member of the Bass Connections American Predatory Lending and the Global Financial Crisis Team. It is February 23rd, 2021. I'm currently in Durham for an oral history interview with Mr. Kevin Peranio, Chief Lending Officer at the PRMG, or Paramount Residential Mortgage, Group who has joined us via Zoom. Thank you for joining me today, Mr. Peranio.

Kevin Peranio: Thank you for having me. I appreciate it.

Malena Lopez-Sotelo: I'd like to start by establishing a bit about your background. I believe that you went to the University of Texas at Austin for college and received a B.S. in Advertising Business. Is that right?

Kevin Peranio: Yes, ma'am.

Malena Lopez-Sotelo: In the context of your work life and the transition from an Advertising Business degree, when and how did you first become involved with residential mortgages?

Kevin Peranio: The advertising industry is kind of a grind and I love the creative aspect of it, and it's part of the College of Communications at University of Texas at Austin. So, speaking and communicating is kind of a skill set that transcends all industries. I just remember not being happy sitting in a cubicle and looking at spreadsheets all day and trying to place coupons as the account leader for Baskin-Robbins and newspapers all over the country. So my buddy who was in Austin— Austin was way cooler than me moving back to Dallas and moving back in with my parents to save a buck and buy a car. And he said, "Hey, this mortgage industry is really doing well. Why don't you come check it out?"

I moved back to Austin and I interviewed with a company called First Magnus, which was based out of Tucson, and a really good friend of mine, who I went to college with and high school with, and we were both in a Young Life group together growing up in high school, said "Hey, come check this out," and I just, you know, it's people and numbers, you get to deal with people and help them get a home loan and foster the American dream. So, I just felt like it was an amazing thing to go and be a part of. And I went, interviewed down in Austin not knowing what an account executive would do in the wholesale channel, but I just went after it. That was in 2001, just two weeks before— I guess that was April of 2001 when I originally started. So, that's how I got into it. It's funny you ask that question because in the lending business, on the mortgage banking side, in the mortgage business, everyone always asks, "How did you get into the business?"

Because no one was intentional about getting into school and getting a degree and being a loan officer or a mortgage lender or an account executive. So there's always a way people back into it, which is one of the things I'm trying to do with many organizations that I am affiliated with now, which makes me happy to help you today, is to get people to understand about mortgage finance and the mortgage banking side and get people to have intent to come into our business, because it really is an incredible industry.

Malena Lopez-Sotelo: What sort of jobs did you hold between completing your education at UT Austin and when you became connected to the market sector?

Kevin Peranio: I'm a worker, I'm a hard worker. I don't sleep much. And since I was a little kid, I've always worked— mowing lawns, scoring baseball games, refereeing in soccer, you name it, I've always worked. I worked at a grocery store, I worked in college, and I worked at a law firm the summer after my freshman year, and that was mostly on oil and gas law in Texas, which obviously is huge. I rented out wave runners in the summer and worked on Lake Travis. Then I worked at a golf course running concessions— so, I've always worked. I love working. I love being productive in society and making money and doing something that is usually service based. Serving others is just part of my upbringing.

So, I got into advertising because it seemed like a lot of fun. It was kind of a way to take creativity. I was in the creative sequence at UT, which is very difficult to get into, you have to apply and get in. And then I was also in the media planning sequence. And then I also applied for the final class called the campaign class that only about eight people get into out of hundreds. And so, I had the only paid internship in college with Leo Burnett[1] the summer after my junior year, and that was in Chicago. So I just got a feel for the advertising life, so I figured, "You might as well try and get a job after college and the degree that you got," but sometimes the industry kind of disappoints you.

You have these grand ideas of what you're going to do with your life. And again, you realize you don't want to stare at spreadsheets all day. You want to actually have fun and enjoy your life. And that's when I moved back to Austin, and for the summer I literally sold swimming pools just to kind of stay on my feet and drive around and sit in people's homes and talk to them and say, "Hey, how can I make you and your family happy?" and they're like, "We want a pool. I've got little kids. We want a pool."— I'm going to help you do that. And then the summer ran out and that season kind of ended, and I went and worked for Dell Computers for a couple of years, about a year and a half. We had about 800 to 900 salespeople.

I was always in the top thirty. I won all the trips, I was number one in close ratio. You got on the phone with me, I was making sure that at some point you got a computer, maybe not at that moment, but at some point. And that's how I got my tech fix because I'm really into tech. Understanding and watching Michael

[1] A global advertising agency.

Dell walk the floor, not acting like a big shot, talking to his people, being very grounded – that was very inspiring for me. After a year and a half, they started cutting the prices on computers, like a lot of industries go through, they start to consolidate and have price wars. That's when my buddy was like, "You know, you tried advertising, you worked at Dell, you sold swimming pools, come get the mortgage business." I just kind of followed some opportunities there, and that's how I got into business and that's kind of my job path getting into lending.

Malena Lopez-Sotelo: When you began your professional mortgage career at First Magnus Financial, how would you characterize the big picture state of the mortgage market in both Florida and the larger United States overall?

Kevin Peranio: I was in Austin, Texas, and I was working for a company called First Magnus. I was learning all the basics about the business right around the dot-com era, the dot-com bust, and the recession that followed that. It's interesting in our industry, it's very insulated. When times are good and economies are good, people are buying homes, and when people purchase a home, it's pretty much price inelastic. I learned that if someone needs a place to live, they're going to pay the going rate. You hear these stories about the '80s, "Oh, I paid 15%, 19% interest rate." If you want a place to live and you don't want to pay a landlord to make a landlord rich, and you want to actually build equity and create wealth for yourself and future generations of your family, the easiest and best way to do that is to take that biggest expense in your life and buy a home.

But then when the economies go through recession, the Fed [Federal Reserve] usually steps in and cuts interest rates and treasuries and mortgage-backed securities usually end up driving interest rates lower. So, in a period like we just had this past year, in 2020, you have low interest rates and you have a bunch of refinances. So, you have a lot of refinances and lenders are busy there too. The in-between periods between recessions and boom economies are the slow periods for lenders, but there's always business, there's an abundance of business out there. Those are some things that I learned about the lending side of the business, about the American dream and about mortgages in general, starting in Austin, Texas. And then I made my way into a new territory two years later, in 2003, when I moved to Florida.

Malena Lopez-Sotelo: In Texas, what types of institutions at the time do you recall were making mortgages?

Kevin Peranio: Mortgages historically have been dominated by depository institutions. So, large banks: Wells Fargo, Chase Manhattan, Bank of America at the time— these institutions dominated mortgage lending. Mostly because mortgage lending was predicated on balancing risk and making sure that the balance sheets for the financial institutions behind mortgage-backed securities were sound and fiscally responsible— there was legislation prior to my time even being in the business,

like the Community Reinvestment Act.....[2] It really was federal legislation that said, "Hey, we need to do more and put more people in housing." If you just let the banks control the industry, they're only going to pick the things that never default, they don't like losing money. And that would marginalize people who are first time home buyers that are a more risky credit proposition. So, better regulation stepped in, for better or worse. It basically opened the credit box, and said, "Hey, we need to get more credit to more people. We need to get more people in homes." Yes, there's going to be more defaults, but with more defaults with higher volume, the risk is offset with the more volume and the profit that's being made to backup those fixed income securities, mortgage-backed securities.

It was a very interesting time to see independent mortgage bankers start to rise in the early 2000s, basically because they were willing to take more risk that the federal government wanted to be taken. If someone has a 600 credit score, they are below 620, they are "subprime." Does that mean that every person with a 619 or a 600 credit score or lower— does that mean every single one will default the second they take a loan? Of course not, but federal depository banks were not willing to risk below certain credit scores. Most of them wouldn't even go below 660 at the time. So, independent mortgage bankers like Countrywide Home Loans would step in and say, "We're willing to take the risk." Then they would act as a middle person between the borrower, and then the banks ultimately bought the paper, the mortgage-backed securities. So the bank said, "Fine, Countrywide, you show us your balance sheet. We'll lay off the risk on you. We're going to give it back to you if the loan goes bad." Countrywide said, "No problem. We'll build up better systems, we will be faster and will be cheaper." I think everyone knows that dealing with the bank, it isn't always the best customer service.

Back then you call the 800-number and you've got nine options on your cell phone to talk to. You don't know if you're talking to someone that knows what they're talking about. It's not the best experience. They weren't spending money on great websites or technology or marketing, and independent mortgage bankers were smaller, more agile, more intelligent, faster, more intelligent designed, which ultimately served the consumer better. That rise of the independent mortgage banker on the backs of the Community Reinvestment Act legislation, that said, "Hey, let's get more people into homes." I think that's what ultimately led to the biggest part of the global financial crisis.

Malena Lopez-Sotelo: Do you recall what the typical terms might've been for those independent mortgage lenders and how that was different from the status quo at the time?

Kevin Peranio: Typically independent mortgage bankers and lenders were always willing to risk more, but they could never risk what they could not sell. So, the banks always bought a Fannie Mae [Federal National Mortgage Association] and Freddie Mac

[2] Congress enacted the Community Reinvestment Act in 1977, during the first year of the Carter Administration.

[Federal Home Loan Mortgage Corporation]. [Banks] ultimately would buy Ginnie Mae [Government National Mortgage Association], would buy the GSEs, the government sponsored enterprises. If they said these loan parameters fit in our guidelines, that was the green light to do it. So, when it comes to conforming loan amounts and product types, if Fannie, Freddie and Ginnie would buy it, that was a greenlight directly from the government. There's a difference between the most liquid form of mortgage-backed securities that were backed by Fannie, Freddie, and Ginnie Mae. There's a difference between that kind of paper and say a "jumbo loan." So Fannie and Freddie and Ginnie Mae, they say, "Hey, we're not going to securitize jumbo loans."

So back then, a $500,000 loan was a jumbo loan. Certainly a million-dollar loan was a jumbo loan. So banks still continue to dominate that market and they still do today. One terminology for that is a non-conforming loan, that's another way of calling a jumbo loan. So even today, Chase Manhattan, JP Morgan Chase is the single biggest buyer of non-conforming aka jumbo loans today. Because when you buy a jumbo loan, if you buy a million-dollar loan, you buy a hundred million-dollar loans, you buy a thousand million-dollar loans, you're literally fronting the capital in buying that whole loan. And then you're holding that asset on your balance sheet and then for a longer term, and then packaging it up and then ultimately selling a non-conforming mortgage-backed security, which isn't as liquid, there's less buyers and it's more capital intensive.

That has never changed about our business, which is why traditionally depository institutions who can borrow money from the Fed, especially today and this year, February of 2021, at basically 10 basis points or zero. So you borrow money from the Fed at 10 basis points today, and then you back it up with an asset that has a 3% interest rate. That's a great spread for banks and non-conforming lenders, but it's very capital intensive. So again, to go back to the 2001 time when I was in Austin, it was a transitionary period for conforming loans. So Fannie and Freddie would back up your traditional conforming loan that, if you didn't put 20% down, would require private mortgage insurance. People call it PMI, we call it just mortgage insurance (MI). Anything with 20% down from the borrower is seen as less risky regardless of any exterior factors, "Hey, this borrower has skin in the game," but Fannie and Freddie would allow for loans to be backed with little to no skin in the game back then.

That credit box actually expanded from 2003, 2006, and 2007. And then Ginnie Mae is the third government sponsored enterprise. They specifically back FHA loans, VA loans— so, the Federal Housing Administration, FHA loans, Veterans' Administration, loans for veterans or those who served or family members of those who served with entitlement from the armed forces. Ginnie Mae also backs USDA [United States Department of Agriculture] loans, which are basically loans that are in rural areas, through rural housing. So, three different GSEs with three different missions made up the bulk of what was lent on. That's not even getting that deeply into what was called subprime lending, which is now really, since Dodd–Frank and after the global financial crisis, is its own asset class, with

its own set of guidelines and parameters. [This is] for the betterment of all of us so we don't have the same kind of crisis again.

Malena Lopez-Sotelo: Jumping ahead a couple more years to your time in Florida, were parts of Florida different or similar than Texas or other states that you had experience with, in any significant respects?

Kevin Peranio: That's actually a very intelligent question. In the lending business, there is basically what's called an SRP Schedule – Service Release Premium. You could basically take a sheet that would have all 50 states and it would say, "This is what lenders are willing to pay for loans or collateral from each state." And they weren't 50 different prices, but there certainly were some states that were seen as less risky or more risky than others. Texas traditionally is one of the top in most coveted collaterals because in the state of Texas, people put more money down, they stay in their house longer and, come hell or high water, they are not going to default on their loan. And California is highly coveted collateral because the loan amount sizes are large.

You've got larger loan amounts in California because it's just expensive to live here. I'm experiencing that now that I've lived there for five years with my family. It's probably 10 times more expensive than it was when I was living in Texas. Florida is in that top three to five range as well, as far as what lenders would pay for the collateral, the loans backed by the home and the land, creating that mortgage-backed security. Florida was always seen as a pretty highly regarded state, because the loan amounts had a good mix of being large, certainly larger than Texas, and then they had a propensity to perform and not default. But the other thing about Florida is that in South Florida, it's a very transient state, so you've got people moving in and out all the time. So, there's a lot of transactions that happen in that state.

That's another factor that goes into comparing different states, collaterals versus each other. I initially moved to Tampa in June of 2003, not knowing a soul, to go expand the state of Florida for my vice president of my division, a gentleman named Romaji Bali, and my mentor in the business, who was [in] more [of] a grassroots loan level [than] me, Leslie Inman. So I learned from a very capable vice president and Leslie, and she was my mentor in the business. I'm very honored that she still works together with me at this company that I'm at now. She really taught me the business. So, when that team out of Austin acquired Florida as part of their territory to expand on behalf of First Magnus, which was based out of Tucson, Arizona, they asked me to be the first person to go to the state.

I said, "Let's do it." I lived in Texas my whole life, nine years in Austin and eighteen in Dallas. I know everyone and everywhere to go, it's getting kind of old and I'm ready to go see the world. So, I moved to Tampa as a wholesale account executive. I think it's important … to understand the difference between retail, wholesale, and correspondent. I was specifically in the wholesale channel when I started in the business and all the way through the

crash of the global financial crisis I was only wholesale. So, retail, if you will, is if you or anybody wants to go get a loan yourself, you are talking directly to a loan officer, an originator, a mortgage loan originator. So that is a retail transaction.

I was in what was called the wholesale trade channel, which is more of a B2B [business-to-business] channel. As a wholesale account executive, my job was to go market to independently owned third–party originators called brokers. And those broker shops, for example, would be Duke Mortgage, right there a block away from Duke's campus. And there's maybe a couple that owns Duke Mortgage and they say, "Hey, we're in the community. We're here to serve the Duke community, and we're right here in the breeds with you. We know the schools, we know everything." And that third-party originator, that Duke mortgage, for example, would be able to decide which lender to sell Malena's loan to. So, it was their choice and they had multiple options of wholesale lenders.

As an account executive working for First Magnus it is my job to say, "Hey, Duke Mortgage send me that North Carolina loan, send that loan to us. Here's why: we're very fast on our turn times, our service is good. You can get on the phone with me, Kevin, or any of our team. And we're going to treat you with a smile. We're way better than dealing with a bank or dealing with another independent mortgage bank or whatever it is." And then we had to deliver so that Duke mortgage, their reputation and their community, and how they serve borrowers and consumers in that retail transaction was dictated in part, how we, as a lender performed for the third–party originator. So, we were all working together to put people in homes. When I moved to Tampa, I actually was an account executive with my own set of accounts, but I was also there to train other new account executives that joined First Magnus, because I'd been with the company for two years, I knew the company, I knew the business, and my job was to say, "Hey, here's how you come sell in the wholesale channel at First Magnus."

So that's what I did. It was exploding. The growth was amazing in the summer of 2003, and the industry so much so that my VP basically said, "Hey, we need to divide and conquer. We need to split the state in half." And literally six months later, in the fall of 2003 was the first and only Texas- OU [Oklahoma University] game I missed since 1994 in Dallas. I didn't go back home for Thanksgiving, I sacrificed everything, I left all my friends and family to move to Florida. And then six months later, I moved from Tampa down to Fort Lauderdale again, because the business and the service was needed. And so that was kind of my journey initially in Florida.

Malena Lopez-Sotelo: During that same timeframe, how would you characterize the environments in terms of refinancing or purchasing? How would you split those up for Florida at the time?

Kevin Peranio: What was interesting is between 2001 and 2003, there was a little bit of a lull. Obviously, the dot-com bust on Wall Street created a recession and that

recession in 2001— everyone got afraid. Consumers saw money leaving their 401k because they bet on “pets.com” or “this.com” or “that.com” and [it] evaporated, and people lost jobs in the recession, so there was less purchasing going on. So the Fed cut interest rates and created a little refinance boom. In between the recession and the growth period, the boom part of the economic cycle, there was that little lull. Interestingly enough, in 2003 there were new loan programs created by Wall Street, and there were new loan programs created by the banks. Remember, "He who has the gold makes the rules." So we, even as big as our company was, still growing in 2003, we still sold all of our loans to other people with more money.

They are always ultimately the ones that are making the decisions and shaping the landscape of the mortgage industry. What was interesting in 2003— you saw a real explosion in program creation, and it really continued all the way through 2005 and 2006. So, to harken back to the credit Community Reinvestment Act, it said, "Hey, we've got to do a better job putting more people in houses." Well, how do you do that when you're in a recession or coming out of a recession, when there are less people that are on solid footing? I think it's important to say, when you're talking about a recession – I'll give now as an example. If you have 20 million people that are out of work in a terrible recession, you still have 150 million people working. So, when you're in recession, you are taking a step back. There are less to serve, but there are still many to serve. What a lot of Wall Street and the banks, and those who had the money and making the rules, and wielded the influence over regulators, and creating loan products, what they were doing was saying, "How can we keep the faucet going? How can we continue to do more loans? What can we do?" And there were more products created and a lot of assumptions were made when those products were created, like, "Hey, no one will ever default. Why would anybody ever walk away? Loans and home prices will appreciate forever. The underlying collateral, if some of it doesn't perform, the rest of it does, and we'll make up for that lack." And those were some of its mathematical calculations.

Some of it is based on many factors, balance sheet factors, who's spending the money to buy this paper. So from my perspective, even though I worked for one of the largest privately owned lenders, in First Magnus we didn't make the rules. We didn't design the program. We sold our loans to other people who felt they were a good credit risk. For example, Lehman Brothers. That was a huge independent private company that we sold loans to. We sold loans to Bear Stearns. Both these companies no longer exist. We sold loans to Countrywide. They no longer exist. They're part of Bank of America. We sold loans directly to Fannie Mae, Freddie Mac and Ginnie Mae, and they made rules and decided these are the guidelines that loans can fit inside.

And we think they're a good credit risk. And ultimately the people making the rules of what was good credit risk, they were wrong. Not entirely wrong, but they were wrong enough to create the global financial crisis. But when you get so leveraged on financial products, and you're de-leveraging, you can create a lot of chaos. So, not to get super esoteric here, but our entire economy is based

on leverage. So, if you look at our entire federal debt and deficit, which are two different things, and you look at treasuries, and you look at monetary policy, it's all about leverage. If you have a credit card, that's leverage. So, anything that's based on leverage will inherently have risks. And what I saw from 2003 up to 2006 was a massive expansion of risk. We were merely at First Magnus, a lender playing in that sandbox, delivering loans that were deemed a good credit risk. And we all ultimately know what happened, but I think you'll get us to that soon enough.

Malena Lopez-Sotelo: You mentioned investment banks at the time, like Lehman Brothers, what were some of the incentives and descriptions that you found yourself interacting with at the time?

Kevin Peranio: Let me just say that in my position, in that time period at First Magnus, I did not interact with investors directly. So my corporate office had a capital markets team and they had a secondary team that was run by a very brilliant person, Gary Malice, who happens to be my partner in the lender that the four of us own now today. He is a conservative gentleman from Chicago with a Master's from the University of Illinois, an MBA, absolutely one of the most brilliant minds in the industry today and then. And again, very conservative, very conservative.

What's interesting is, he, at the helm of the company I was with at the time, he and everyone else believe that they were delivering the right risk tolerance of products, based on the balance sheet that that company, First Magnus, had at the time. And our counterparties felt the same. Lehman Brothers, Morgan Stanley, Countrywide, Wells Fargo and Chase— all these companies bought from all these lenders. They bought because they thought it was a good risk and they set the rules and it was their money. So, we delivered the product that was deemed within the tolerance of risk at the time. So, from my perspective, when I moved to Fort Lauderdale the day after Thanksgiving in 2003, I was promoted to be over operations and sales. So now I was running a region, not just sales, but also operations. So, I had a chance to really dig in and watch underwriters, look at files, look at the guidelines. I already knew the guidelines from the sales side and teaching all my salespeople, and then teaching sales managers, and scaling a team of 30 to 40 salespeople just in the south border region. But now I've got to watch the files come in and then behind the scenes manage directly the sausage making process. I got to watch the underwriters, look at loans, look at borrowers' credit, income asset, the collateral, the capacity, the credit reports, and basically deem whether a loan would perform and fit the guidelines.

I literally was in it in South Florida at an extremely high level, for one of the largest privately owned lenders right in the run–up to the global financial crisis. To get back to your question, when the crisis was over within two weeks of First Magnus failing, which happened in August of 2007, within two weeks, my 107-person team, I found a home for 33 of them within two weeks at another lender where I became partner in that lender, as an owner. And there, I was dealing directly

with investors and had a whole eye-opening experience on that level, and the global financial crisis was still unfolding at that time... Malena Lopez-Sotelo:
As I understand, you transitioned to a new role as a Chief Operating Officer at NorthStar Lending. Can you talk a little bit about that role change and that company?

Kevin Peranio: The transition from First Magnus to NorthStar Lending was basically the meltdown. And so, you have to understand when all these new credit products were being created by the banks and by Wall Street, there weren't enough people in our industry to do all the loans that were out there. We just went through that again in 2020 with low interest rate, monetary policy— there were more refinances than the industry could handle last year. Well, in 2005 and 2006, and maybe a couple of months into 2007, there was so much business out there, there weren't enough hands to do the work, to serve the communities, to get the people who were getting into houses.

And, don't forget, we haven't mentioned anything here— consumers play a part in this entire thing as well. Consumers sign all the papers. They decide whether they can actually afford a house, whether they were taught financial literacy anywhere in their life, anywhere along the way. When you buy something, most standard logical people say you buy something that you can afford. So there is a role here that consumers played as well. So, kind of get[ting] back to one of your questions earlier [on] how I transitioned into my NorthStar career— I just found that people in Texas take financial responsibility pretty seriously, so that's why there's so few defaults in Texas. Plus, when they do default, the state will foreclose on you in 90 days. So the process is less expensive and over for lenders, whereas states like New York and Massachusetts, they give the borrower every opportunity to make sure that before they get foreclosed on, in three years, that they've been afforded all the rights to ultimately say the exact same thing that maybe would take 90 days in Texas, like, "Did you sign this paper? Did you say you could afford it? And then you didn't pay." There's a little bit of that as well.

I'm not blaming consumers because there certainly was predatory lending, but I think that that narrative is a little more overblown and used as a scapegoat by people like Jamie Dimon, and people at Chase who were the ones that ultimately created the programs and bought the paper. There's a lot of scapegoating there. I think there's enough blame to go around if we're looking for blame. Certainly, there were bad actors on the predatory lending side, certainly there were consumers that knew that they were buying 10 houses in South Florida and they know they can't afford 10 houses, and certainly people in banks and Wall Street firms that bought the paper, they knew that there was risk. There's no one finger to be pointed, and that includes the Community Reinvestment Act. You can't say it's all that fault, there's a whole bubble that was created.

So, the global financial crisis was a de-leveraging event. These borrowers in late 2006, 2007 were defaulting, and they were not making their payments. And

when borrowers don't make their payments, the collateral is now, "Hey, this isn't A-paper." Just to give you an example, I think it's a very interesting story. A-credit paper was deemed anything with a 620 credit score and up. So, at that time, if you had a 620 credit score, even though you could put 0% down, you could do a no-doc loan, literally on the loan application, you put your job blank, income blank, the assets blank. But if you got a 620 score, that was A-paper. That's what all of Wall Street and all the banks said was A-paper credit at the time. And Fannie and Freddie bought that paper. And so did banks instead of Wall Street firms.

Now, me being in the weeds and watching my underwriters say, "This person cannot— I see their credit score— this person has a Fingerhut card, and prepaid credit card, and a car payment of $150 a month." Even though I can't see their job, their income and their assets, I can see by their credit profile, they can't afford zero money down on a $400,000 home, yet those programs were still pushed to be done because it fit the guidelines. And the idea was, "Well, these homes will appreciate in value, and these borrowers will be able to make up for it. And they're saying they can afford the payment by signing this affidavit and all the disclosures and saying, "Yes, I can afford this.""

There were a lot of internal battles inside these offices, at both First Magnus and many other lenders out there, where you have under RSA– this person can't afford this house, I have to deny this loan. And there would be many loan denials— many loan denials that didn't get done because even though they fit the guidelines, they just weren't going to perform. So there were many, many loans that were denied by many lenders that never became defaults that never made the headlines because the guidelines were so loose on what was created as A-paper. But ultimately those loans started defaulting, and when those loans are defaulting, if you had collateralized loan obligations, and structured investment vehicles, and mortgage-backed securities, and all these fancy financial instruments created by Wall Street and created by banks and by secondary desks, they were crumbling under their own structure when people defaulted. Just a few defaults led to some serious de-leveraging and a mortgage-backed security crisis. There wasn't enough capital to make up for the fact that there was defaulting loans and mortgage-backed securities and financial investment vehicles.

So, a lot of very large lenders— I'll give an example. In August of 2007, how it went down for my company at First Magnus, and then how I transitioned to NorthStar. There was a website called the ML-Implode, the Mortgage Lender Implode–O–Meter[3]. It's a famous website, it's out there. You should go and check it out. It's basically a list. Someone had a list online and they would just keep tabs. Every time a lender went out of business, there was number one, number two, number three. And in order, through hundreds of lenders, how they all just went through. I remember personally being in Maui the first week

[3] Mortgage Implode-O-Meter was a webpage whose objective was to track the in-progress failures of independent mortgage lending companies who were not being covered by mainstream media during 2007-2008.

of August of 2007 on our company's column club award trip, and we had all of our top producers. While we were there in Maui, on a prepaid trip, prepaid many months in advance, a very large privately owned lender called ABC, America's Broker Conduit, went out of business. They went out of business and they were bigger than us.

I remember my salespeople after breakfast sitting on a balcony, and they're looking up to me as their leader, and they said, "KP, did you hear about ABC?" I said, "Yes, I did." And they go, "What do you think?" I said, "We have a very long, long, long way to go before we find the bottom." And that was ultimately the truth. And within two weeks, that company that I was with was also bankrupt because we would buy loans. For example, let's just say, we had $750 million in loans at that time on our warehouse line slated to sell to Lehman Brothers or Bear Stearns. And that loan product type was deemed by the rating agencies, who obviously, up until that point said everything was A-Paper – Fitch, Moody's, S&P, all the ratings agencies said, "Oh, everything's fine. Everything's A-paper." But up until that point, they never downgraded that credit. At that point, they said, "Hey, you know what? We don't think this is A-paper credit." So the secondary market said, "Okay, we'll still buy this from Lehmann Brothers or First Magnus. It's going to cost you 20%, A 20 point haircut. So, with $750 million on your warehouse loan, do you have $150 million, First Magnus, to shell out of your pocket just to sell that loan?" So, that kind of capital should show you how leveraged the business is. So of course, First Magnus didn't have $150 million to just shell out for one set of loans, then deal with all the loans from the past. So they declared bankruptcy, and my team on August 16th was out of a job.

I found a local lender that was small, that only had seven people working there, and hadn't had much exposure to the past, and my thought was, "While all these lenders are just getting crushed because of past de-leveraging, I can start with this very small lender and I can help them grow from nothing by bringing my team over. So that's how I transitioned to NorthStar Lending. I took my very best 33 people out of 107 two weeks after crying my eyes out to my team and saying, "I'm sorry that we are no longer in business, but I'm going to find a home for you in the middle of the global financial crisis. I'm going to serve you, who serve so well, I'm going to find you a job so you can serve your families to continue to eat." That's how desperate it was. So I was able to find jobs for 33 people at a small company where the guys had some money, and it largely avoided all the past sins and they were ready to move forward. And so that's how I transitioned into being an owner of my own lender and trying to rise from the ashes and build something better and stronger still right in the middle of the global financial crisis, which didn't end for a couple of years.

Malena Lopez-Sotelo: You touched on a particular term "A-paper", and I wanted to take a minute and expand on what are some additional options aside from a mortgage being "A-paper?"

Kevin Peranio: There's A-paper, which is basically anything that Fannie Mae, Freddie Mac, and Ginnie Mae will buy, or securitize, if you will. In Ginnie Mae's example, they actually even insure. So, FHA and VA loans and USDA loans are insured by the government by Ginnie Mae. Those are "A paper" loans. Fannie Mae and Freddie Mac will purchase and securitize conforming loans that are A-paper. And then the insurance comes from the mortgage insurance companies, MI companies, who all suffered great losses back then and all had to get recapitalized, and some didn't make it. Back then during that 2003 to 2007 era, A-paper was seen as anything with a 620 credit score and up, regardless of what documentation you had to show. A-paper, to go back to that example of a no-doc loan, was, as long as you had the credit score, you didn't have to show, in some loan programs, your job, your income, your assets.

Now, you would pay a little bit higher rate by not having to show those things. So, there's more risk by not proving your income, by not proving your assets, and by not proving your job— but the higher rate wasn't so much of a burden that it couldn't get people in the door as consumers would sign their loan applications and say they could afford the payment. Then there was subprime. So you have to understand back then, subprime was anything with a 619 credit score or lower. So it was really predicated on credit score.

Now, the industry– there was alt-A paper, alternative-A, like they give you alternative documentation, like those examples, like the no-doc loan or the NINA loan, no income, no asset— the Ninja loan from *The Big Short* is a myth, no one ever called it that, but it sounded good in the movie. But these alternative-A paper, these alternative documentation types, they largely don't exist today because of a lot of great regulation that came out of the Dodd–Frank, bills that created so many rules and regulations for us. But back then, subprime was really the other alternative. You got to have a 500 credit score, which is basically like, "You've never paid a bill on time in your life," and you can get a loan from a subprime lender. I never worked for a subprime lender. First Magnus was never a subprime lender. We never did anything that was subprime. And I remember we would even kind of be like, "Oh, we don't do subprime. You know, that's the really tough stuff, let some other lender take that risk." We thought by doing A-paper 620 and up credit scores that we were doing the right thing, because that's what Wall Street and the banks wanted to buy, and Fannie, and Freddie, and Ginnie wanted to buy. So, we always thought we were doing the right thing. So those are the real differences between A-paper and subprime.

Malena Lopez-Sotelo: As COO at NorthStar Lending, what type of opportunities did you see at the time?

Kevin Peranio: I met two gentlemen that owned this company for many years, it was their company. They didn't know anything about lending and they needed a team to come in and help them build a lender. And my team was a team of experts that was able to facilitate wholesale lending. I felt that a company that was small, that had no baggage from the past, no bad loans that were defaulting, we could

start from scratch and build something great. And that was my vision and why I partnered up with two people I had no idea about. Now, of course you learn what people are about when you become their partner, and over time you learn about things that they do, good, bad, and ugly. But for me, the opportunity was I need to give my 33 top people a job so they can put food on a plate for their families in the middle of a global financial crisis.

That was my first main goal, and then build something great with no baggage from the past. Even if I don't know what I'm doing necessarily, dealing with investors, dealing with counterparties, dealing with warehouse lenders, dealing with Fannie Mae directly, dealing with all these companies, I learned on the job. I was at the company for three years, I literally just learned on the job a lot of stuff. But that was a great opportunity. I think the one thing that I didn't know about is even in September of 2007, we were still very much in the heart of the global financial crisis. There was more pain to come. Unfortunately, we experienced more pain even at NorthStar Lending and the de-leveraging of the entire financial industry lasted several years. That was something that I did not know would take that long. So, I got to provide, I have to work. I have to provide for my team and keep my team together. So I didn't care what the surroundings were, and anything brought at my team, I was going to make sure that I led them, through the worst global financial crisis.

Malena Lopez-Sotelo: You mentioned earlier that you worked with brokers at the time. Do you recall how you put forward criteria and how you chose brokers?

Kevin Peranio: There was a lot of guidelines that were in place basically saying, "Hey, what was your experience? Do you have experience in lending?" If you were going to do FHA loans, "Do you have an experienced FHA loan processor?" That was one of our criteria because you're dealing with first-time home buyers. Those deals can be a little more involved, maybe the credit requirements aren't as stringent as A-paper loan. So these were requirements that we had for the broker channel, but there were largely lax regulations throughout the industry. Another great thing that came out of Dodd–Frank was creating the National Mortgage Licensing System. States largely controlled who was licensed and who could perform in our business. So each state enacted their own rules. There were different rules, different ways to get a license in the state of Florida, or North Carolina, or Texas. So, you had to navigate all those different state guidelines. It was hard being a lender. We had to know how 50 different states did things. So, another great thing that came out of Dodd–Frank was more of a streamlined requirement.

People who sell insurance, they have to get Series Six, Series Seven licenses, stuff like that, or other financial products. There was no requirement in the lending business. Well, there is now. And there's more background checks—back then, you were independently, as a lender, having to do that on your own. So, trying to decide who to work with, lot of it had to do with reputation. If we would catch wind that a broker or an originator committed fraud, and we knew it, we just simply wouldn't allow them to sign up with us, either at first Magnus

or at NorthStar Lending. A lot of it was being local and knowing like, "That dude over there is a bad dude. He commits fraud. We're not going to do business with him." That's part of being in the ground, in the weeds, in the communities. And so, we had a blacklist of people that we would basically say, can't say that anymore, but we had a bad list. So, we knew who the bad actors were mostly, and word gets around in the community, and we just wouldn't sign these people up when they wanted to come do business at NorthStar Lending.

Malena Lopez-Sotelo: What were some of the incentives that brokers were really incentivized towards? I know you talked a little bit about spread, but are there any additional incentives that you thought were quite salient at the time?

Kevin Peranio: I think all originators, not just brokers, but I think all originators have to find that balance between giving the absolute lowest rate to the borrower and the consumer versus there is a premium that you charge the borrower based on the level of service that you give. I would say overwhelmingly all originators of all channels did the right thing, overwhelmingly. That's what I saw certainly in the wholesale channel. When I was at NorthStar Lending, we created a retail channel, so we would hire people to be our face dealing directly with the consumer. So, I got to watch it. So overwhelmingly, originators are very good people that are there to serve. But in every business and every city, there are good and bad actors, and unfortunately there are people that try to gouge the borrower and make the most money possible, even if it's not the best loan product for that borrower.

There was more of that pre-global financial crisis because there were more products created that incentivized that. If you could charge someone a higher rate at higher margin, because the loan product was easier to do— go back to that no-doc example, if you're an originator and you want to try and help a borrower win a property and get them into loan quickly, do you want to go collect two months’ worth of bank statements? A month's worth of pay stubs? Go verify with their job? You would do all that work, when you could just charge the borrower a little bit more and not have to do that work. And so, the programs themselves lent to that question of morality at the originator level, "What am I doing here? What's the balance?"

That striking of the balance was largely that relationship between lender, and for us our wholesale broker originator, and the consumer. We would all try and find that balance. A lot of times, if we saw things that were so egregious, we would step in, we would have caps on our rate sheet. So, "You can't charge more than this, or you can't bill above this. You can't gouge the borrower on this program. Why are you putting this bar on this program when they qualify for this program?" So, a lot of times the lenders would act as the backstop, but not all lenders did. I just know I can only speak for my team and know that we always try to do the right thing and always try to serve our community because we were in the community, we weren't in some distant, faraway place. We felt like we're serving people locally, they know who we are. We want them to know

who we are and know that we do the right things. But again, not every lender or every loan officer originator was set up that way or operated that way.

Malena Lopez-Sotelo: To what extent, if at all, did figures within your firm or yourself express concerns about that changing nature? And did those concerns lead to any significant debates internally or changes in business practices?

Kevin Peranio: Yes, absolutely. I remember more towards the end 2006 and 2007, the industry has the Mortgage Bankers Association. [It] is a great organization that aligns all vendors, whether federal depository institutions or independent mortgage banks. And so, there was always a lot of discussion with those high-level lenders amongst these trade organizations, "Hey, what, what are you seeing out there? What is happening with these programs? Should we do these programs anymore? Is anyone talking about changing the risk tolerance? We're seeing more defaults. What are you seeing?" There's a lot of collaboration behind the scenes in our business and even to this day. So, the Mortgage Bankers Association is a very strong organization that serves all vendors, and you take guidance from the people that create the programs and buy the paper, "who has the gold makes the rules." The Wall Streeters, the banks, Fannie, Freddie, Ginnie— what were they saying, we should do. What were they saying and buying, what were they saying? "This is still a good risk. We're going to buy it. Hey, you know what, hold off. We're not going to buy loans with a credit score under 550 anymore. Okay. We'll change our guidelines immediately and we won't do it." So that's kind of how we operated as an independently owned mortgage lender. Now again, in my NorthStar phase, where I was one of the people making those decisions, I will say this: after having experienced a crash and a meltdown, like we did with First Magnus going out of business, and almost every lender going out of business, basically the only lenders that didn't go out of business in 2007 and 2008 were banks that were bailed out by the Treasury.

So, if you were not one of the 17 "too big to fail" institutions that the Department of Treasury reflated with capital, you were out. So in essence, every single financial institution in the mortgage business was bankrupt. That's how bad it was. So, at NorthStar Lending, here I am trying to run this lender and build this lender with my experienced team, but from the ground up. I made a personal decision in the summer of 2008, we said, "All these lenders out there have problems." And we were selling to Chase at the time, and we were selling to Texas Capital as our warehouse line, and Affiliated Mortgage Corporation was another company we sold to at that time. But I said, "We feel good about how we operate. I want to get approved with Fannie Mae directly and service our own loans."

So, I personally filled out the package with our company at NorthStar Lending and got us approved with Fannie Mae to sell and service loans directly with them. And when we got that approval in, I believe, July or August of 2008, I made a personal decision.

And I said, "As the first wholesale lender in America, we're going to pull what's called a 4506 upfront." Now, a 4506-T is basically a form that a borrower signs and the industry standard at the time was, they just sign it and it goes in the package. If the loan defaults, that form allows the lender to go get IRS and reverify the income that the borrower said they made on that loan application. So I, me, personally made the decision to execute with the IRS upfront before we funded the loan, so if there were rats on the ship, make them all flee. We wanted to make sure that if a borrower or a broker said, "This is how much income this borrower makes," we're going to verify it with the IRS before we fund the loan. I'm telling you right now, I was the very first lender in America— my team— to do that. And the reason I did that is because I wanted to protect that relationship with Fannie Mae, because I felt like the industry was shifting towards that anyway. Now that's the common practice of the land in our industry. But that was something that I wanted to do to protect that Fannie Mae relationship and protect that servicing portfolio that we've created. If all the fraudulent brokers and borrowers, if they all ran away from this— fine, no problem. I even had to let go of some of my staff, because we lost about a third of our volume in South Florida because, "Oh, NorthStar Lending is no longer allowing us to just write whatever we want on our application. They're actually pulling 4506." That was a good reputation to have, because then we did only clean business. That was the kind of transitionary stuff that was going on in 2007 and 2008, and then coming out of the GSE.

Malena Lopez-Sotelo: To what extent do you see your personal experience as adding something important to our understanding of what happened in the run up to 2007 and 2008?

Kevin Peranio: I think having gone through multiple economic cycles, and being in this industry for 20 years, I think it's important for people that are learning about the business, that the American dream is alive and healthy. Buying a home is still the single best way to create wealth. You need a roof over your head, right? You know Maslow's Hierarchy of Needs, right? It's air, it's water, it's food, it's shelter. So if you're going to rent, you're making a landlord rich. Get into a home and just know that the process is completely safe and sound. We've had so many great regulations since coming out of that crash that it's just a much stronger industry. An example is right here in 2020, we just had a recession brought on by a health crisis, but the financial institutions are sound. All of the financial institutions made it through this crash without incident. And that is a sign of how strong the housing industry has gotten. In fact, when Q3 GDP was reported in 2020, it was a 33% increase in GDP of which housing led the way at 60% by 59.5%. That's how strong housing is now and how strong the financial sector is based on learning from the global financial crisis.

Malena Lopez-Sotelo: Looking back on the crisis over a decade later, what do you see as its most important lessons for mortgage lenders?

Kevin Peranio: I think that when you talk about risk and leverage, it's important for lenders to not—it’s kind of a no-brainer—but don’t take too much risk, but I also think it's important for everyone who runs a lender, or is involved in lending, to realize that the regulations and the guidelines and the financial requirements are high enough that you could survive a recession, like we just did in 2020. For me, the lessons were learned and the same mistakes were not repeated in 2020. So, it's proof that housing has gotten stronger. So going forward, just remember what we went through in 2008 and how we made it better to survive 2020's recession and not to say, "Okay, we were so good in 2020 that let's make the same mistakes of 2005 and 2006 and expand beyond our means again." Housing is very healthy. We have a supply issue right now. Builders got crushed in 2008, so they're not building more than they can get rid of. So, we have a nice pace here when it comes to housing supply and regulation on the lending side, that we've got a good balance right now. So, I would just say, let's not wreck that.

Malena Lopez-Sotelo: Thank you so much, Mr. Peranio.

[END OF SESSION]