

Mortgage Insurance Meltdown Generates Opportunity



By William Spiegel

6/30/14 As the mortgage market began to hiccup in 2007, many investors ran away from the housing sector. At **Pine Brook**, however, we leveraged our expertise to identify market and capital dislocations for which our business-building investment approach was well-suited. So began our five-year effort to grow—from scratch—residential mortgage insurer Essent Group Ltd., which hit a milestone with its successful October 2013 IPO.

When we first saw signs of trouble in the housing market, we began an intensive effort to assess the mortgage ecosystem. We quickly homed in on an investment opportunity in the mortgage insurance sector. Mortgage insurance is an insurance product that takes the first loss on mortgages when consumers can't put down greater than 20 percent equity in their homes. Without the consumer's purchase of a mortgage insurance policy, banks cannot sell these mortgages to Fannie Mae and Freddie Mac, the primary purchasers of a vast majority of U.S. mortgages. Importantly, mortgage insurance is a vital product for first-time home buyers.

As we analyzed the industry, our research suggested that there were severe cracks in the foundations of the seven existing major mortgage insurers. Since mortgage insurance was a vital part of the U.S. housing market we believed there was a tremendous investment opportunity to create a new insurer with a clean balance sheet and no legacy liabilities. Moreover, Pine Brook's focus on building new businesses and funding equity over time through a "Line of Equity" financing model made us uniquely positioned to build this new mortgage insurer. The Line of Equity product allows Pine Brook to allocate more capital to a business as it grows and the business execution risk is diminished.

Before making a financial commitment, we needed an entrepreneurial CEO who shared our vision. We reached out to **Mark Casale**, an experienced mortgage insurance executive I had known since 2001. Mark shared our vision and was confident he could execute on the development and build-out of a new mortgage insurer. Mark and Pine Brook worked to refine the business plan and once in place, Pine Brook led a Line of Equity commitment of \$600 million and launched Essent in 2009.

Our investment thesis and assumptions about the mortgage insurance market proved true. With significant losses from poorly underwritten mortgages, most of the private mortgage insurers pulled back from the market dramatically, leaving Essent with a significant market void to fill. In early 2010, Essent received GSE approval and the 50 state licenses required to begin its operations.

In 2010, Essent began to sign up banks and wrote its first policy, reaching \$200 million of insurance in force by the end of the year. Essent's upward trajectory remained high, hitting \$32 billion of insurance in force by the end of 2013, representing a 12 percent market share for 2013. As the company grew, Essent drew on its Line of Equity to support its growing book of business. Essent's success, along with the improving U.S. housing market, allowed it to file for an IPO in October 2013 to finance its continued growth.

The best news is that there is more opportunity ahead. From 1993 to 2007 private mortgage insurance represented approximately 63 percent of the total mortgage insurance market. In 2009, private mortgage insurance had fallen to a low of 16 percent. It has since risen to 35 percent and is trending back toward historical levels, meaning private mortgage insurers could nearly double in volume without any growth in the underlying mortgage lending market. As the rebound continues, Essent is primed for both top-line and bottom-line growth. Reflecting this potential and success, E&Y recently named Casale a regional winner in the financial services category of the 2014 Entrepreneur of the Year Award.

For Pine Brook's professionals, few experiences can compare to ringing the stock market bell alongside a business we conceptualize through an intensive opportunity identification process, built with a committed CEO, and grew through an equity funding model that is unique in private equity.

William Spiegel is a co-founder and managing director at Pine Brook, an investment firm with more than \$5.0 billion of AUM that makes "business building" and other equity investments, primarily in energy and financial services businesses.