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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Q4 2018 Impac Mortgage Holdings, Incorporated, Earnings Conference Call. (Operator Instructions) As a reminder, this call is being recorded. I would now like to turn the program over to your host, Mr. Justin Moisio, from Investor Relations.

Justin Moisio - *Impac Mortgage Holdings, Inc. - SVP of Business Development & IR*

Thank you. Good morning, everyone. Thank you for joining Impac's fourth quarter 2018 earnings call. During this call, we will make projections or other forward-looking statements in regards to, but not limited to, GAAP and taxable earnings, cash flows, interest rate risk and market risk exposure. I would like to refer you to the business risk factors in our most recently filed Form 10-K under the Securities and Exchange Act of 1934. These documents contain and identify important factors that could cause the actual results to differ materially to those contained in our projections or forward-looking statements. This presentation, including outlook and any guidance, is effective as of the date given and we expressly disclaim any duty to update the information herein.

I would like to get started by introducing George Mangiaracina, Chairman and CEO of Impac Mortgage Holdings.

George A. Mangiaracina - *Impac Mortgage Holdings, Inc. - Chairman & CEO*

Thank you, Justin. Welcome and thank you for joining Impac's fourth quarter 2018 earnings call. I have online with me, Rian Furey, our COO; Paul Licon, our Controller; (inaudible), our Legal Counsel; and Jon Gloeckner, our Head of Financial Reporting.

Before we review our results, I'd like to spend a moment to discuss what proved to be yet another difficult quarter for residential mortgage originators.

In the fourth quarter of 2018, the industry continued to experience deterioration in market condition that served to limit the prospects for interest rate-driven GSE and government origination.

Fannie Mae's most recent mortgage lender sentiment survey reported a profit outlook for mortgage lenders fell for the ninth consecutive quarter in the final 3 months of 2018, an all-time survey low across all loan types: GSE eligible, non-GSE and government.

As discussed on our previous earnings calls, with respect to total industry origination volume, MBA annual projections for 2018 and 2019 continue to be revised downward to $1.6 trillion, approximately 25% below the 2016 volume of $2.1 trillion. The MBA projects volume to be flat to marginally incremental for the foreseeable future.

Originations of first-lien home mortgages dropped 15% from the third to the fourth quarter of 2018 according to a recent analysis by Inside Mortgage Finance. Estimated $370 billion mortgages originated in the fourth quarter of 2018 was the market's lowest quarterly output since the end of 2014, when originations totaled $355 billion.

Mortgage lending activity's been decreasing since the second quarter of last year, and it's likely to decline further in early 2019.

In Southern California, including the counties of Los Angeles, Riverside, San Diego, Ventura, San Bernardino and our local market of Orange County, CoreLogic reported that home sales dropped in the fourth quarter of 2018 to their lowest levels since 2007, with a decline of 20% year-over-year, 2017 to 2018.

Southern California accounted for 3 of every 4 loans we originated in 2017 and nearly 2 of every 3 we originated in 2018. The company historically experiences an increase in California production through the tax refund season. It's unclear how the SALT caps limiting state and local tax deductions associated with the Tax Reform Act of 2018 will impact our California volume for the next several quarters.

Taken in totality, the developments over the past year have exposed the excess capacity in the industry can result in further compressed margins within our GSE and government product lines.

In the face of these headwinds, we believe that many nondepository market participants over the last year have continued to attempt to protect market share at the expense of margin, profitability and liquidity.

Liquidity reserves that were accumulated over the last decade's favorable market conditions continue to be depleted. These reserves were created over the course of, arguably, the most prolonged period of prosperity for nondepository mortgage originators, an environment made possible by a confluence of factors: quantitative easing served to tighten rate spreads of mortgages to U.S. treasuries; accommodative monetary policy lowered absolute mortgage rates to historic lows; also preassigned unfavorable risk weightings, capital treatment to mortgage servicing rights held by depositories creating an imbalance between economic and market values of MSRs, and shifting MSRs from traditional depository lenders to nonbank lenders.

Term debt and financing of MSRs became available to nonbank lenders through the evolution of GSE acknowledgment agreements and securitization of MSRs. Postcrisis measures have tapered and macro conditions for nonbank lenders have become more difficult to navigate.

Notwithstanding more accommodative language from the Fed and recent signaling of a hold on future rate increases, we do not believe that current macroeconomic trends or market dynamics will ease in the near term.

Impac has not been immune to these broader trends and market forces; however, we anticipated and planned to manage for scenario to address these market conditions.

Over the last year, we've continually measured and proactively rightsized our cost and overhead. We've focused our near-term origination activities on healthier margin credit product for our NonQM offering, and we've concurrently maintained optionality within our GSE and government businesses through our direct-to-consumer channel. This shift by the company, of course, has not been without disruption to the company's operating results, GAAP income and EPS. Our headline reporting reflects these stresses. However, excluding costs associated with nonrecurring and legacy matters, the company's recurring adjusted operating income for the year 2018 was a loss of $5.7 million as compared to GAAP losses of $145 million. In our view, these results more accurately measure the company's performance and reflect the effectiveness of the initiatives we've executed over the last 12 months.

I will now spend a moment to provide an update on some central themes to our repositioning: One, rightsize and run common. The company operates across 3 origination channels: direct-to-consumer via our call center and business-to-business via third-party origination comprised of wholesale and correspondent.

As mentioned in previous earnings calls, due to margin compression and sensitivities around the fluctuations in interest rates, the company's proactively scaled and continued -- and contracted the call center to calibrate the platform to changing market conditions. That effort continued at the beginning of 2019 with a reduction to headcount designed to reduce expense and excess capacity. The company's executive team will continue to closely examine market conditions and channel efficiencies to determine appropriate sizing of the organization, while also allowing for optionality for the expansion of its variable compensative workforce if the conditions become more favorable. Rian Furey will touch on this later in the call.

The company believes that this proactive behavior, which commenced in the third quarter of 2017, positions us well versus our peers mainly from continue -- to compete on price for compression of margins in order to drive volume and protect market share. As part of our continued objective to run common across channels, we've recently realigned management of operations underwriting post-closing under an enterprise concept. Enterprise focus will commit our production teams to leverage and management to consistently deploy critical resources across technology, marketing compliance in capital markets.

In October of 2018, the company relocated the consumer direct call center from Orange County to Irvine, consolidating all of our employees into our headquarters at 19500 Jamboree. This move resulted in cost savings with respect to lease expense and improved operating efficiencies and fixed cost expense load. Additionally, we gained the added benefit of being able to redeploy personnel between the consumer direct channel and the TPO channels, allowing the company to recalibrate each channel's resource requirements based on varying origination growth curves. The company now has the ability to transition staff seamlessly between channels, while retaining institutional and product knowledge.

Two, NonQM enterprise. The company's core mission is to be recognized as the market leader in the creation, origination, securitization, selection and management of alternative residential credit product, responsibly matching consumer need with investor demand. To further that mission, the company continues to redirect a substantial percentage of our focus towards NonQM. In 2018, the company originated $1.3 billion in NonQM loans versus $900 million in 2017, a year-over-year gain of 46%.

Within TPO and consumer direct, we've gained traction with the broker community and the consumer, respectively, through training, product offering and revised marketing campaigns around NonQM. This is evidenced by the following Q4 and 2018 results in our NonQM business. NonQM volume increased to $400 million or 63% of total originations in the fourth quarter of 2018 versus $235 million, 14% in the fourth quarter of 2017. NonQM production accounted for 34% of our total volume in 2018, up from only 13% in 2017.

During 2018, California represented approximately 60% of our NonQM production, down from 70% for 2017. The decrease in California NonQM concentration is a positive trend. It signifies our ability to organically grow NonQM through geographic expansion in lieu of downward trend in credit profile. The company would like to highlight its commitment to maintaining integrity of the credit profile of our NonQM borrower and overall credit quality of NonQM origination. The average FICO score of NonQM origination in 2018 was 725 versus 723 in 2017. The weighted average loan-to-value ratio remained in the mid-60s year-over-year.

With respect to NonQM Capital Markets execution, the company continued to expand our group of investors in the fourth quarter of 2018 to include direct distribution to Wall Street as a supplement to its stable of hedge fund and alternative capital investors. We view this development as the next step in the evolution and maturity of NonQM market and further evidence of the acceptance of the company's NonQM product within both the primary and secondary markets reflective of the quality consistency and performance of our loans.

In November, we announced the second securitization of the company's NonQM loans by Starwood Property Trust, STAR 2018-IMC2, to be backed exclusively by our NonQM loans. STAR 2018-IMC1 and 2 both closed with a AAA ratings from S&P and Kroll and were oversubscribed at various levels of the capital structure. Impac's NonQM collateral performance origination rankings and adjustment factors with the rating agencies have resulted in efficient permanent capital structures for our investors. The third securitization by Starwood, again, is scheduled to be backed 100% by the company's NonQM collateral is expected by the second quarter of 2019.

We invested in the capital structure of the 2 Starwood deals in 2018, and again, intend to take down a portion of the noninvestment-grade bonds of the 2019 Starwood deal.

Three, liquidity and capital allocation. To create liquidity and reallocate capital to our NonQM franchise, the company liquidated $7.2 billion of its Fannie Mae MSRs in December of 2018, a follow-on to our $3.4 billion sale of Ginnie Mae servicing executed in the third quarter of 2018. A portion of these sales proceeds have been utilized to deleverage the balance sheet by retiring higher cost debt, including debt secured by the pledged MSRs and higher interest rate involving warehouse finance debt. The company will also redeploy net proceeds from the sales to invest in increasing share of the capital structure of NonQM securitizations. We will also utilize net proceeds to invest in our NonQM activities, including investments in our production teams and tools for technology, marketing and business reengineering.

NonQM is a core competency and differentiator for the company. We'll continue to build on the momentum we've created over the last several quarters by directing financial capital and resources to further our competitive advantage in these alternative credit products. We believe that the risk-adjusted returns on NonQM core assets and the concurrent value added to our related NonQM franchise will be superior to the returns associated with our MSR portfolios.

As mentioned on our second quarter 2018 earnings call, we stated that we may selectively sell MSRs on a flow or bulk basis if we determine market values to be attractive. Market values exceeded our economic basis in the third and fourth quarters of '18 and as a result, we closed 2018 with the servicing portfolio of $6.2 billion, down from $16.3 billion at the end of 2017.

I'm now going to pass the discussion over to our Controller, Paul Licon and COO, Rian Furey, who'll provide greater detail on our financial results and origination activities.

Paul Licon - *Impac Mortgage Corp. - Senior VP & Controller*

All right. Thank you, George. I will now provide a brief review of the financial results as well as some additional color on servicing and production during the fourth quarter.

We reported a net loss of $6.4 million or $0.31 per diluted common share in Q4 2018 compared to a net loss of $44.9 million or $2.14 per diluted common share in Q4 2017. Adjusted operating loss for Q4 2018 was $10.3 million or $0.49 per diluted common share as compared to an adjusted operating loss of $30.8 million or $1.47 per diluted common share for Q4 of 2017.

For the year ended December 31, 2018, we reported a net loss of $145.4 million or $6.92 per diluted common share as compared to a net loss of $31.5 million or $1.62 per diluted common share for the year ended December 31, 2017.

Adjusted operating loss for the year ended December 31, 2018, was $21.4 million or $1.02 per diluted common share as compared to an adjusted operating loss of $28.6 million or $1.47 per diluted common share for the year ended December 31, 2017.

Gain on sale declined $12.9 million for the fourth quarter of 2018 compared to $19.5 million for the fourth quarter of 2017. For the year ended December 31, 2018, gain on sales declined to $66.8 million compared to $136.1 million for the comparable period in 2017.

Now for an update on production. During the fourth quarter of 2018, total origination volume was $632 million. This was a decrease of 26% from the $853 million in the third quarter of 2018 and a decrease of 62% as compared to the $1.7 billion originated in the fourth quarter of 2017.

For the year ended 2018, refinance volume decreased approximately 53% to $2.5 billion as compared to $5.3 billion for the year ended 2017. Purchase money transactions decreased 25% to $1.3 billion in 2018 as compared to $1.8 billion for the year ended 2017.

Some additional color on NonQM production. During the fourth quarter of 2018, the consumer direct retail channel accounted for 26% of NonQM originations, while the wholesale and corresponding TPO channels collectively accounted for 74% of NonQM production.

The NonQM originations in the fourth quarter of 2018 had a weighted average FICO score of 730 with a weighted average LTV of 69%, which was consistent with prior quarter's weighted average FICO score of 724 and weighted average LTV of 68%.

Moving on to servicing. The servicing portfolio generated net servicing income of $37.3 million for the year ended December 31, 2018, a 17% increase over the net servicing income of $31.9 million for the year ended December 31, 2017. At December 31, 2018, the mortgage servicing portfolio decreased $6.2 billion as compared to $16.3 billion at December 31, 2017, primarily due to the sale of $10.5 billion in UPB of our mortgage servicing portfolio during the fourth quarter of 2018. The decrease was due to a shift in strategy during the third and fourth quarters of 2018 to direct our efforts on repositioning the company by focusing on our core NonQM lending business and strengthening our liquidity position. As a result of this shift in strategy, the MSR asset on the balance sheet decreased by $89.7 million to $64.7 million at December 31, 2018, as compared to $154.4 million at December 31, 2017.

Moving on to liquidity. As of December 31, 2018, total warehouse borrowing capacity was $900 million versus borrowings of $284 million and available MSR financing capacity was $38.5 million with no outstanding borrowings.

Finally, to expenses. During the fourth quarter of 2018, total expenses, excluding contingent consideration and impairment charges was $25.8 million as compared to $42.4 million during the fourth quarter of 2017, a 39% decrease in total expenses.

For the year ended 2018, total expenses, excluding contingent consideration and impairment charges was $126.4 million as compared to $167.3 million for the year ended 2017, a 24% decrease in total expenses.

During Q4 2018, personnel expense decreased 15% or $2.4 million to $13.7 million from prior quarter. The decrease is primarily related to staff reductions and reduced commissions due to declining origination volume. As a result of staff reductions during the year, headcount decreased by 29% to 417 at the end of 2018 as compared to 588 at the end of 2017. The company will continue to align capacity and expenses with loan origination volume in 2019.

In addition, business promotion expense decreased by $497,000 from prior quarter to $3.9 million for the fourth quarter of 2018. G&A and other expenses decreased 34% to $8.3 million for Q4 2018 as compared to $12.6 million for Q4 2017.

That concludes the financial results. I'll now turn the call over to Rian Furey to discuss our mortgage operations.

Rian Furey - *Impac Mortgage Holdings, Inc. - President of Direct Lending & COO*

Thanks, Paul. Good morning. For the fourth quarter, we saw a continued downward pressure on originations, particularly in agency, refinance observed in our consumer direct channel and consistent with the broader competitive market. As consolidation in that space takes hold and excess capacity works its way out, we focus our efforts on our noncore -- on our core NonQM products. NonQM now makes up 40% of new originations in the consumer direct channel and as much as 33% of funded volume. Investments we made earlier in 2018 around call center technology like CRM, web, chat and e-mail campaign management enabled us to further target our efforts around NonQM. We've expanded our marketing footprint in the digital arena adding new digital campaigns aimed at those users of Facebook and started targeting with traditional direct mail, both of which have allowed us to further reduce our reliance on TV and radio, which should bring consumers to the platform at a lower cost. As George said earlier, to date, our growth in NonQM is not driven by expansion of our credit parameters, rather geographic expansion are more popular programs that our self-employed borrowers and single-family real estate investors both using alternatives to traditional income documentation.

In the fourth quarter, we completed the reallocation of all of our consumer direct team to our Irvine California headquarters. As George said, eliminating the physical separation of our teams allowed us to advance a run common ideology.

In the fourth quarter, we consolidated leadership in our operating silos, leveraging the skill sets for fulfillment of our consumer direct leaders across our wholesale and corresponding operations.

We continue to react to fluctuations in volume in our channels and are now able to more easily move personnel from consumer direct to assist in the TPO business, while maintaining optionality to return those associates to consumer direct if GSE refinance picks up. As we continue to closely monitor and adjust our capacity, we can now holistically analyze staffing needs across the enterprise. As the year progresses, we'll continue to focus on realizing further efficiencies between the platform, and ultimately, plan the consolidation of the business on to one common technology and one loan origination system.

In addition to leveraging and [find] operational teams of the enterprise, we've continued to invest in technology to enhance efficiency in our TPO channels. We've selectively grown our account executive base focused on geographic diversity. From a technology standpoint, in the quarter, we launched tools to streamline TPO pricing, loan submission and status update. Our initiative in the future will be automation around loan conditioning and automated underwriting.

With that, I'll hand the call back to George.

George A. Mangiaracina - *Impac Mortgage Holdings, Inc. - Chairman & CEO*

Thanks, Rian. 2018 was a year to reposition the company, a challenging task made, although more so by prevailing market conditions. I'd like to close by highlighting some of the company's 2018 accomplishments that in totality position us well for 2019.

In January, we undertook the repositioning of our origination platform across all channels. With respect to direct-to-consumer channel, we instituted measures to reduce GSE prepayment speeds, which were elevated throughout 2016 and 2017. Our discipline and commitment to that effort is evidenced by the fact that in 2018 and continuing into 2019, our GSE prepay speeds have converged to and remains consistent with industry cohort. This has resulted in the normalization of our relationships with many of our capital markets partners, increased acceptance in valuation of our GSE loans and MSRs in the marketplace and enhanced our liquidity and best execution levels. Solving for our GSE prepay story was a precondition to securing market clearing levels for our GSE MSR book and foundational to our strategy of redeploying capital from noncore MSR assets to our NonQM franchise.

Also with respect to our direct-to-consumer channel, in October, we completed the final step of fully integrating the channel by relocating it into our corporate headquarters in Irvine.

With respect to our TPO business, in 2018, we consciously redirected our production teams away from GSE origination in order to focus on our NonQM franchise. Our success in this endeavor is evidenced by the 60% growth year-over-year in NonQM from our TPO channel, from $600 million in 2017 to approximately $1 billion in 2018.

NonQM accounted for only 24% of TPO volume in the fourth quarter of 2017. In the fourth quarter of 2018, NonQM accounted for 94% of TPO volume. In July of 2018, we announced the slate of newly elected Board of Directors that included the addition of members with the material share of the equity of the company with the goal to align corporate governance with the senior management decision-making and compensation in order create long-term franchise value for our shareholders. To evidence this alignment, in February 2019, our CFO, Brian Kuelbs, and I voluntarily restructured our 2018 bonus from a predominantly cash award to 100% in equity in the form of restricted stock units and option grants. The company's non-C-suite 2018 bonus structure for our senior and middle management business leaders also included component of equity award in the form of restricted option grants. We will continue to align and incentivize our employees to create and participate in shareholder value in 2019.

Throughout the last year, we have taken advantage of market dislocation to assemble a sophisticated team of seasoned mortgage professionals with deep content knowledge, industry experience and relationships. We entered 2019 with new leadership in every vertical and business unit of the company, the entire C-suite, the business unit leaders and the control functions. We have and will continue to be disciplined with respect to managing our cost structure while selectively recruiting talent. To illustrate how profound and complete the personnel changes to the company have been over the last year, our employee count currently stands at 397, down from 588. We've exited 654 employees and added 348 since December 31, 2017.

The company incurred severance costs of approximately $2.2 million in 2018 associated with these activities. As previously noted, in August of 2018, we sold over $3 billion of Ginnie Mae MSRs followed in December by a sale of $7 billion in Fannie Mae MSRs. These trades were a culmination of a long-dated effort to derisk and deleverage the company with the goal of creating a margin of safety with respect to liquidity, and ultimately, to redeploy a portion of that liquidity from noncore MSR assets to NonQM franchise.

In 2019, we will utilize this liquidity to continue to invest in subordinate bonds backed by our NonQM loans and to expand our NonQM account executive presence in geographies outside of the state of California.

For 2018, California made up 60% of NonQM production as compared to 70% in 2017. We're also actively building out a correspondent channel to buy closed loans on both a bulk basis and a nondelegated basis to take advantage of our competitive positioning in the NonQM space. These production initiatives are early stage, but should contribute to sustaining the growth of the company's NonQM origination volumes in the future.

In the latter half of 2018, the company successfully resolved through dismissal of settlement 3 long-standing litigation matters dating back to origination and securitization activities related to the mortgage crisis of 2008. These matters discussed in detail in our previous SEC filings represent the resolution for the company of pending 2008 crisis-related legacy lawsuits. The company incurred legacy legal settlement costs along with related legal and professional fees associated with legacy matters of approximately $5 million in 2018.

Finally, last earnings call, we introduced the metric, recurring adjusted operating income that management utilizes to gauge the company's performance in addition to the traditional measures of GAAP income and EPS. Effectively recurring is adjusted operating income, excluding certain nonrecurring items, such as changes in the provision for repurchase reserves, net gain or loss of mortgage servicing rights, severance and legacy litigation costs. For the year ended 2018, the company's recurring adjusted operating income was a loss of $5.7 million, in our view, a more accurate reflection of the company's performance in the 2018 reported GAAP loss of $145 million and better evidence of the effectiveness of the initiatives we've executed over the course of 2018.

Thank you for your time. That concludes our prepared remarks. I will now turn the call back to Justin Moisio to open up for questions.

Justin Moisio - *Impac Mortgage Holdings, Inc. - SVP of Business Development & IR*

So we're now ready to accept questions. So if you want to open up the line Q&A line that would be great.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Trevor Cranston from JMP Securities.

Trevor John Cranston - *JMP Securities LLC, Research Division - Director and Senior Research Analyst*

Just wanted to follow up on the last comment about the recurring adjusted operating earnings first. So I heard the number for full year 2018, can you share what it was just for the fourth quarter?

Rian Furey - *Impac Mortgage Holdings, Inc. - President of Direct Lending & COO*

Sure. For the 3 months ended December 31, 2018, the adjusted operating loss was $4.3 million. However, I will note that we do not -- that number does not include an allocation of settlement severance and legal professional fees into the fourth quarter. We kind of view those as a full year events. So that excludes about $7 million in those 3 line items that we incurred for the year that we haven't allocated to the fourth quarter.

Trevor John Cranston - *JMP Securities LLC, Research Division - Director and Senior Research Analyst*

Okay. Got you. That's helpful. Then on the NonQM business, obviously, you guys were able to grow that pretty meaningfully over the course of 2018 and you talked a lot about the initiatives and efforts that have gone into that. I was wondering if you would be willing to discuss at this point sort of what your goals are for that business in 2019? And if you have sort of a target in terms of the growth in the origination numbers that you believe you could hit throughout 2019 as we go forward and some of those initiatives continue to take hold?

George A. Mangiaracina - *Impac Mortgage Holdings, Inc. - Chairman & CEO*

Sure. I'll speak of a run rate as opposed to 12 months 2019 because we're building out the production team around the TPO, account executive footprint in geographies that we're currently not very active in. And I also preface it by saying that we look at the addressable market. Nomura puts out a pretty decent piece on industry data and target for that was $20 billion in NonQM originations in 2018, growing to somewhere between $30 billion and $40 billion over '19 and '20. So that gives you a sense of the growth in the addressable market. I would say that we did $1.3 billion in NonQM in 2018, that was up 45% from where we were in 2017. It's aspirational, but I think something between $1.75 billion or $2 billion run rate by the fourth quarter of 2019 should be achievable. That's a 30% to 50% growth year-over-year. What you'll see is a commitment to invest in an account executive build-out, additional digital marketing campaigns for our retail call center and then increasingly investing in larger portions of the subordinate bonds that come off the securitizations that had done -- backed by our collateral. So some of the NonQM strategies repositioning the liquidity and capital of the company away from noncore MSR assets into investing in what we create. And per $1 billion of securitization, that's about $25 million after 2.5% levered investment per $1 billion for us in the bottom portion of the capital structure. It's $25 million per $1 billion of origination. So that will give you a sense of sort of how we feel we can size our balance sheet and our liquidity to our origination targets.

Trevor John Cranston - *JMP Securities LLC, Research Division - Director and Senior Research Analyst*

Got you. And on those -- the investments in the NonQM securitizations, can you maybe comment on what the expected return on those investments would be and if there's been any change our impact from the market volatility we saw in credit markets during the fourth quarter?

George A. Mangiaracina - *Impac Mortgage Holdings, Inc. - Chairman & CEO*

We had compression for sure in the fourth quarter. I mean, I can give you a sense of whole loan sales, taking some of the noise away from coupon, our LTV in FICO are pretty consistent, but fourth quarter, there was a lot of supply in the market. I think some of the credit pressure found its way over into NonQM space. And so we saw maybe 75 to 100 basis points backup in margins in the fourth quarter for our NonQM sales. We've gained some of that back in the first quarter. Market's been clearing those traits nicely. In terms of what we believe our return -- risk-adjusted return is on the bottom portion of the capital stack, we think low double digits depending upon leverage, of course. Cost originate -- that's in excess of what we believe the returns or economic value will be on the noncore MSR assets, and so we're happy to create those returns into NonQM.

Trevor John Cranston - *JMP Securities LLC, Research Division - Director and Senior Research Analyst*

Okay, great. And the gain on sale margin for the fourth quarter, obviously, it looked like it ticked up, which sounds like it was probably mostly due to the shift in the product mix between NonQM and GSE originations. I was wondering within that number, can you comment on how margins were in the fourth quarter, more specifically on the GSE business, and if they were kind of stable with where they had been or if there was any further deterioration or improvement within the GSE side?

Rian Furey - *Impac Mortgage Holdings, Inc. - President of Direct Lending & COO*

Yes. It's Rian. We continue to see price competition in the marketplace. We continue to believe there's still excess capacity around GSE, particularly refinance. So we continue to see margins compress further around GSE products in the fourth quarter, and we wouldn't expect that to correct until excess capacity is normalized in the market.

Trevor John Cranston - *JMP Securities LLC, Research Division - Director and Senior Research Analyst*

Okay. Got you. Then, I guess, last question for me. On the MSRs that are remaining on the book, can you comment on how you guys are thinking about those, and if you sort of view that as a core part of the portfolio that you'd like to retain or if that's something that you would continue to opportunistically look at selling as you have more opportunities to grow on the NonQM side of the business and focus on that going forward?

George A. Mangiaracina - *Impac Mortgage Holdings, Inc. - Chairman & CEO*

Yes, that's a good question. We've retained the Freddie Mac MSR portfolio for a number of reasons. One is, clearly, there's a transition from freeing up liquidity and being able to redeploy it. The leverage in the NonQM securitization is fairly high, so it takes a good deal of volume to be able to reposition the liquidity that would come off of the servicing portfolio. Additionally, the servicing book provides us organic lead (inaudible) for our retail call center. We do a very good job of recapturing runoff on that portfolio, and so we wanted to maintain some of that portfolio in order to feed our loan officer group, as volume otherwise in the market has been tough to combine driving consumers to the funnel to originate. So there's a lot of self generated business that comes up for that portfolio. And we -- I think we will continue as we have all year, continue to manage economic and market value and to the extent, if we get another backup in rates, we're kind of -- we're now at [2. 60%] or probably at the low end of the range on the 10-year for 2019. I think we traded off our Fannie Mae portfolio when the 10-year was closer to the [3.20%] . If we would have a gap out again in rates, you might see us recalculating the market to economic value dynamic and freeing that capital up to invest elsewhere.

Trevor John Cranston - *JMP Securities LLC, Research Division - Director and Senior Research Analyst*

Okay. That makes sense. Actually -- and then, there was a -- the comment in the press release about the deal expenses associated with selling the MSRs in the fourth quarter. Just wanted to clarify, were those expenses all recognized during the fourth quarter or was some of that in the 3Q results as well?

George A. Mangiaracina - *Impac Mortgage Holdings, Inc. - Chairman & CEO*

Yes. No, all of them were recognized in the fourth quarter.

Operator

We will conclude the Q&A here (inaudible) presenters. I would like to turn the call over back to the presenters for the closing remarks.

George A. Mangiaracina - *Impac Mortgage Holdings, Inc. - Chairman & CEO*

We thank you all for joining us on our fourth quarter earnings call, and we will be back in short order for our first quarter call. Thank you for joining us.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation, and have a wonderful day. You may all disconnect.

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