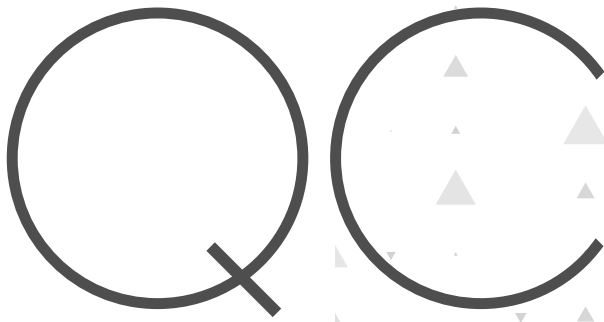
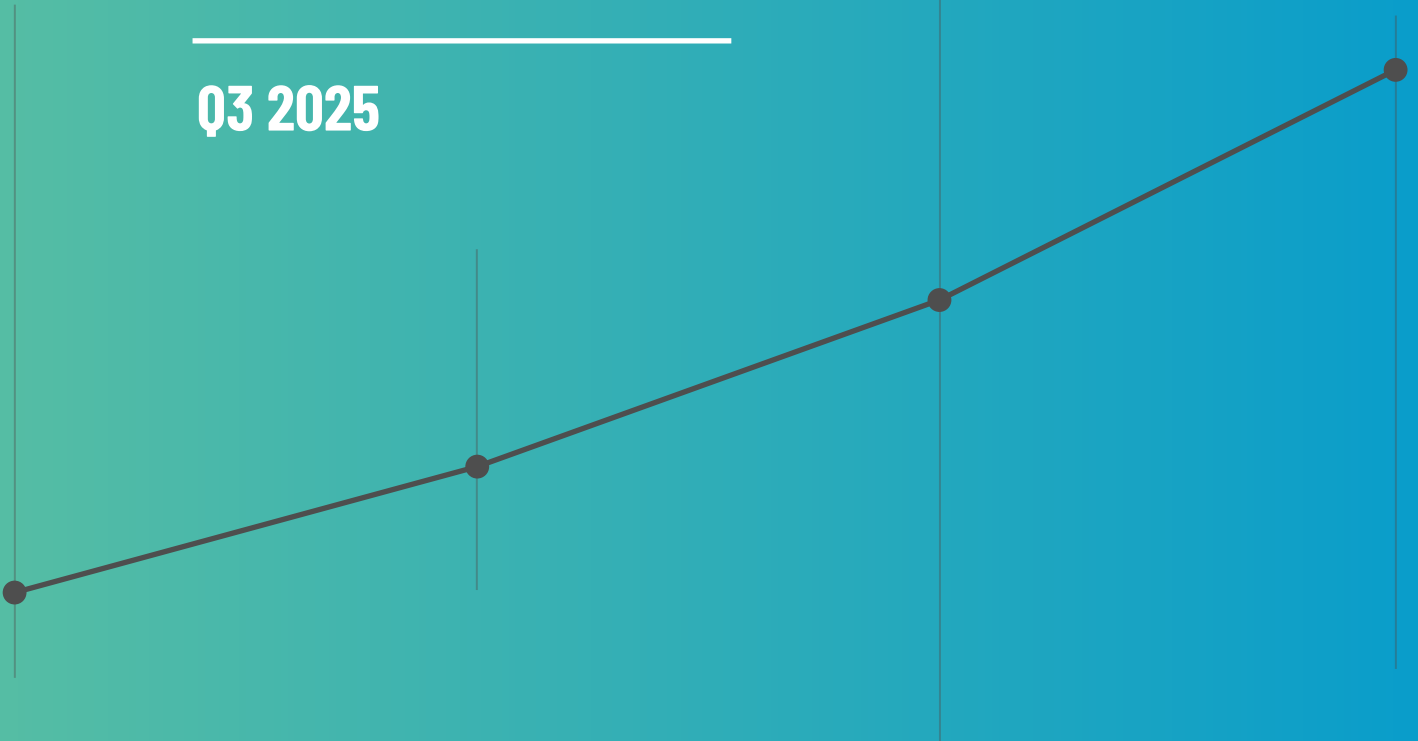


Mortgage



Industry Trends

Q3 2025



“While the overall critical defect rate increased again in Q3 2025, the underlying data points to a market adjusting to a shifting mix rather than a broad decline in manufacturing quality. The increase was driven primarily by concentrated deterioration in income- and compliance-related findings, reinforcing the importance of documentation integrity and disciplined validation as refinance activity expands and lenders continue to operate lean.”

Nick Volpe

Executive Vice President of ACES Quality Management

ACES' Mortgage QC Industry Trends Report represents an analysis of nationwide quality control findings based on data derived from the ACES Analytics benchmarking software.

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About This Report

This report represents an analysis of post-closing quality control (QC) data derived from loan files analyzed by the ACES Quality Management and Control® benchmarking system during the third quarter of 2025 (Q3 2025). The report incorporates data from prior quarters, where applicable.

Findings for the Q3 2025 Trends Report were based on quality control data from tens of thousands of unique records. Volumes are essential to this analysis, and the included records reflect trends in overall origination volumes. However, data from additional lenders is added to this analysis once the lender's QC review seasoning within the ACES software reaches the 12-month bar. Therefore, the overall volume in the QC Trends Report does not precisely mirror the overall market. All reviews and defect data evaluated for this report were based on post-close loan audits selected by lenders for full file reviews.

Defects are categorized using the Fannie Mae loan defect taxonomy. Data analysis for any given quarter does not begin until 90 days after the end of the quarter to allow lenders to complete the post-closing quality control cycle, resulting in a delay between the end of the quarter and our publication of the data.

NOTE: A critical defect is defined as a defect that would result in the loan being uninsurable or ineligible for sale. The critical defect rate reflects the percentage of loans reviewed for which at least one critical defect was identified during the post-closing quality control review. All reported defects are net defects.

Summary of Quarterly Findings

The overall critical defect rate increased to 1.79% in Q3 2025, rising 18.5% from 1.51% in Q2 2025. After a quarter where most categories improved and the overall increase was largely attributed to product mix-related complexity, Q3 reflected a more concentrated deterioration in a few key categories—most notably Income/Employment and Legal/Regulatory/Compliance—suggesting renewed pressure on documentation rigor, validation timing, and underwriting execution.

The most material shift occurred within underwriting. Income/Employment increased sharply and remained the leading defect category, indicating lenders continue to face elevated exposure tied to documentation sufficiency and consistency in guideline application. Compliance-related findings also increased, reinforcing the importance of procedural discipline and controls that prevent expired or incomplete documentation from advancing through the manufacturing process.

By loan purpose, purchase reviews remained the majority of the dataset, but refinance volume continued to expand. While refinance loans represented a modest share of reviews, the defect share for refinance increased meaningfully, reflecting the operational complexity commonly introduced as refinance activity rises. By loan type, conventional lending remained dominant and stable overall, while VA defect share increased and FHA remained elevated relative to review share.

Overall, Q3 2025 results indicate that the rise in the critical defect rate was driven by a handful of categories rather than broad-based weakening. The quarter highlights the value of active monitoring and targeted QC focus in areas where documentation and validation practices are most likely to drift during periods of shifting production mix.

Highlights include the following findings:

- The overall critical defect rate increased 18.5%, rising from 1.51% in Q2 2025 to 1.79% in Q3 2025.
- Income/Employment defects increased 47.6%, rising from 18.45% to 27.24% of all critical defects while retaining the highest defect share across all categories.
- Legal/Regulatory/Compliance defects increased 16.8%, rising from 16.24% to 18.97%.
- Borrower/Mortgage Eligibility defects decreased 56.5%, declining from 15.87% to 6.9%.
- Assets increased 4.1%, rising from 12.92% to 13.45%, while Credit and Liabilities were essentially flat quarter over quarter.
- Purchase review share declined modestly from 82.67% to 80.95%, while purchase defect share decreased from 73.96% to 62.65%.
- Refinance review share increased from 17.33% to 19.05%, while refinance defect share rose from 26.04% to 37.35%.
- By loan type, Conventional defect share decreased to 57.18%, FHA increased to 31.1%, VA increased to 11%, and USDA/RHS increased to 0.72%.

QC Industry Trends Overview

The overall critical defect rate rose to 1.79% in Q3 2025, up from 1.51% in Q2 and marking the third consecutive quarterly increase. While still low by historical standards, the continued upward movement suggests that loan quality is normalizing after near-record improvements in late 2024. The Q3 rise reflects a combination of shifting loan composition and renewed pressure in select defect categories rather than broad deterioration across the full manufacturing process.

That shifting composition is evident in the origination market. Total residential originations in Q3 2025 reached 1.77 million, a 1.6% decline from Q2 but a 1.9% increase year-over-year. Importantly for QC, purchase lending declined while refinance and home equity lending posted modest gains, a dynamic that can change documentation profiles and underwriting workflows even when overall market volume is relatively stable¹.

The rate environment during the quarter supports that mix shift, as the 30-year fixed-rate mortgage averaged 6.3% as of September 25, 2025, following several weeks of declines². Even incremental rate improvements can prompt “selective” refinance behavior. This shift often introduces different timing and validation sensitivities than a purchase-heavy pipeline, particularly around documentation refresh requirements and evidence standards.

It is also important to recognize that the year-over-year origination comparison benefited from a more favorable rate trend in Q3 2024. During that quarter, rates reached their lowest levels since the end of Q3 2022. Against that backdrop, the fact that origination volumes were up year over year in Q3 2025 is a constructive signal: volumes increased even though Q3 2025 began at a higher rate level and, while improving through the quarter, remained above the prior year’s low point.

Together, Q3’s results indicate a market exhibiting incremental movement and evolving loan mix. The QC outcomes aligned with that dynamic: overall performance remained strong, but the quarter showed a clearer rise in defects tied to categories most sensitive to documentation integrity and validation discipline, reinforcing the need for targeted attention in high-impact areas, such as refinance and home equity activity, as they continue to expand.

¹ <https://www.attomdata.com/news/market-trends/mortgage-origination/q3-2025-loan-origination-report/>

² <https://www.freddiemac.com/pmms>

Critical Defect Rate by Quarter: Q4 2024 – Q3 2025

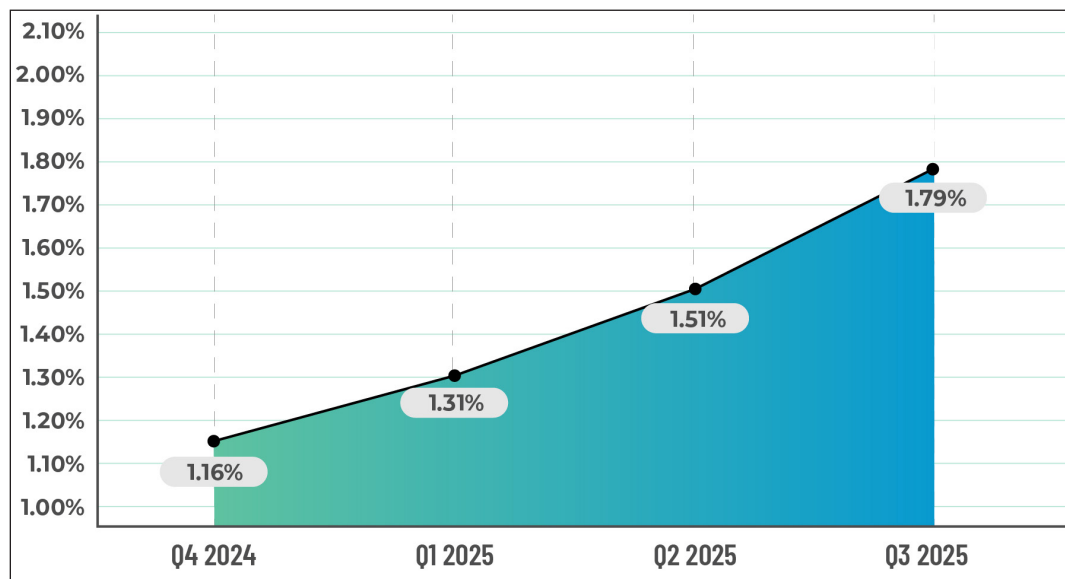


Figure 1 displays the percentage of loans with critical defects by quarter for Q4 2024 through Q3 2025.

QC Trends by Defect Category

Despite an increase in the overall critical defect rate in Q3 2025, the quarter's category-level results indicate the deterioration was concentrated rather than widespread. Income/Employment remained the largest category of defects and increased significantly, rising from 18.45% in Q2 2025 to 27.24% in Q3 2025 (+47.6%). Legal/Regulatory/Compliance increased from 16.24% to 18.97% (+16.8%), reinforcing that process discipline and documentation integrity remain meaningful drivers of loan quality outcomes. Assets increased modestly from 12.92% to 13.45% (+4.1%), while Credit was essentially flat, moving from 7.75% to 7.59% (-2.1%). Borrower/Mortgage Eligibility posted the most notable improvement, declining sharply from 15.87% to 6.9% (-56.5%).

As lenders continue to operate lean, even modest changes in volume and lending mix can meaningfully influence where defects surface. Q3's results aligned with a market that remained constrained overall but showed incremental movement in refinance and home equity activity. When refinance share expands, file profiles often shift, bringing different documentation timing sensitivities and a higher likelihood of documentation refresh requirements late in the process. In a lean operating environment, those added touchpoints can increase the chance of documentation gaps, missed updates, or inconsistent application of requirements, particularly in underwriting areas that are already documentation-intensive.

Sub-category analysis within the underwriting categories provides additional insight into how these pressures manifested in Q3.

For Income/Employment, the sub-category distribution shifted away from calculation-related findings and toward documentation-driven defects. Calculation/Analysis declined from 54% in Q2 2025 to 43.04% in Q3 2025 (-20.3%). At the same time, Documentation increased from 36% to 46.84% (+30.1%), while Eligibility remained essentially flat (10% to 10.13%). This shift suggests that, while lenders saw fewer calculation methodology issues, a larger share of Q3 income findings were tied to documentation completeness, timeliness, and file-level auditability, which are areas that can be more vulnerable when teams are managing high throughput with limited capacity.

For Assets, the category remained heavily documentation-driven, and that concentration increased in Q3. Documentation rose from 68.57% in Q2 to 74.36% in Q3 (+8.4%), while Calculation/Analysis declined from 25.71% to 23.08% (-10.2%) and Eligibility decreased from 5.71% to 2.56%. Assets is an area where minor documentation gaps can lead to critical findings, even when the underlying borrower profile is sound. In a lean staffing environment, the increased share of documentation-driven defects can reflect pressure on processes designed to consistently capture and reconcile supporting evidence.

For Credit, the overall share of defects was stable, but the internal composition shifted meaningfully toward eligibility-driven findings. Documentation defects declined from 51.14% in Q2 to 31.82% in Q3 (-37.8%), while Eligibility increased from 42.86% to 68.18% (+59.1%). Credit Eligibility encompasses a broad set of decisioning areas, including disputed tradelines, derogatory events, judgments and liens, collections/charge-offs/past-due balances, and unacceptable mortgage history, so an increase in eligibility-related findings can signal greater variability in guideline interpretation and decisioning consistency. As loan mix evolves and lenders handle a wider range of borrower scenarios with lean teams, eligibility risk can rise if decisioning is not supported by clear, consistent controls and documentation of the rationale behind the credit determination.

Beyond underwriting, two “categories to watch” moved in a favorable direction in Q3. Appraisals declined from 5.9% in Q2 2025 to 3.45% in Q3 2025 (-41.5%). Insurance decreased slightly from 2.58% to 2.41% (-6.6%) and remained comparatively stable. While neither category drove the quarter’s defect-rate increase, both remain important indicators because they can move quickly with market conditions, cost pressures, and collateral-related volatility.

Condo-related dynamics remained evident in Property Eligibility, which continued to trend downward, declining from 4.06% in Q2 to 3.1% in Q3 (approximately -23.6%). Although this category represents a smaller portion of overall defects, it remains a useful indicator given evolving requirements and heightened scrutiny that can influence condo eligibility and documentation expectations.

Critical Defects by Fannie Mae Category: Q3 2025

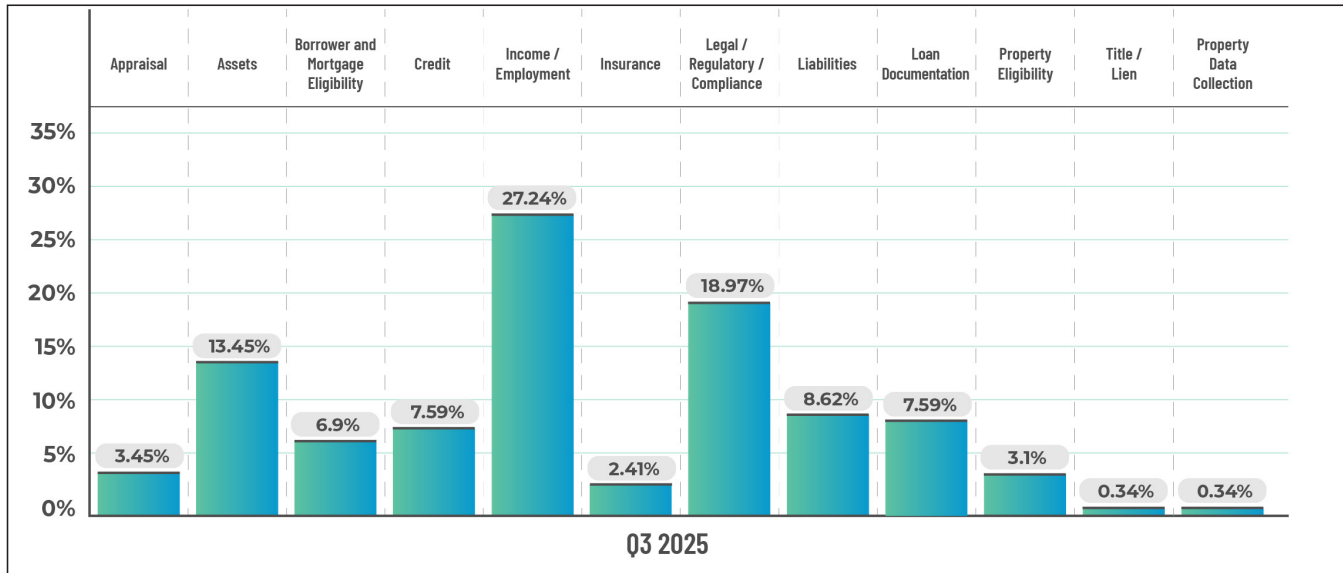


Figure 2 displays the dispersion of critical defects across Fannie Mae categories for Q3 2025. Please note that totals shown may not add up to 100%, as categories with negligible defects have been omitted.

Critical Defects by Fannie Mae Category: Q2 2025 vs. Q3 2025

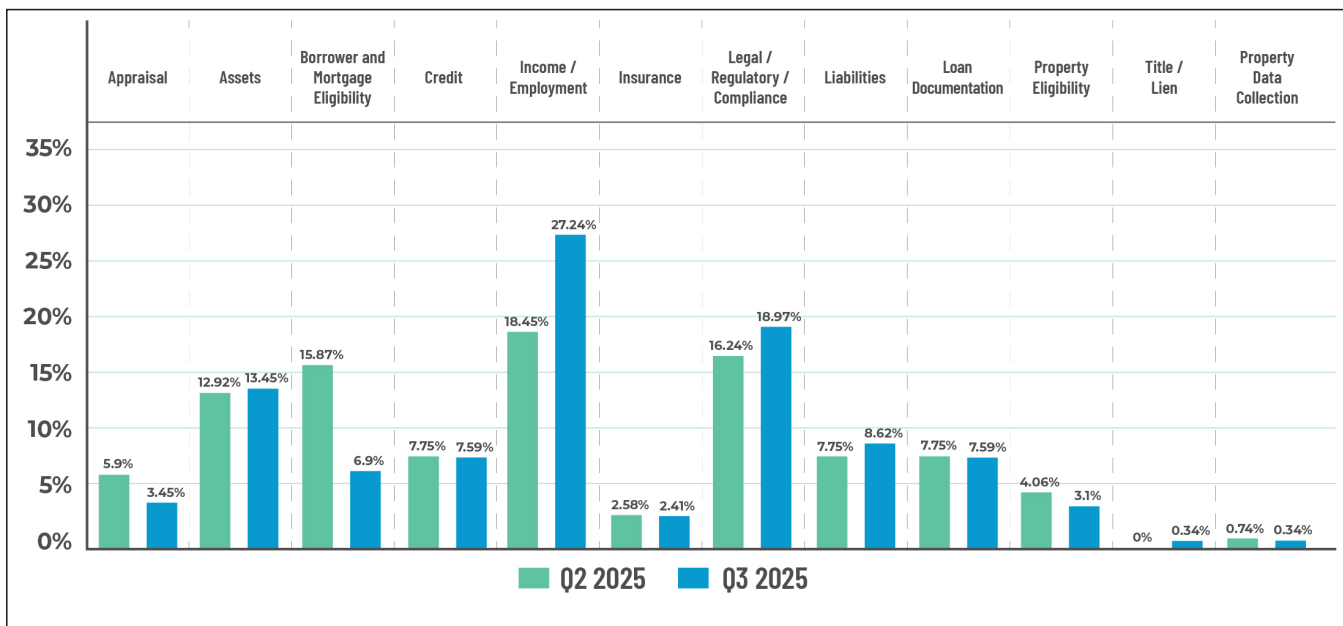


Figure 3 displays the critical defect rate by Fannie Mae category, comparing Q2 2025 to Q3 2025.

Critical Defects by Fannie Mae Underwriting Sub-Category: Q3 2025

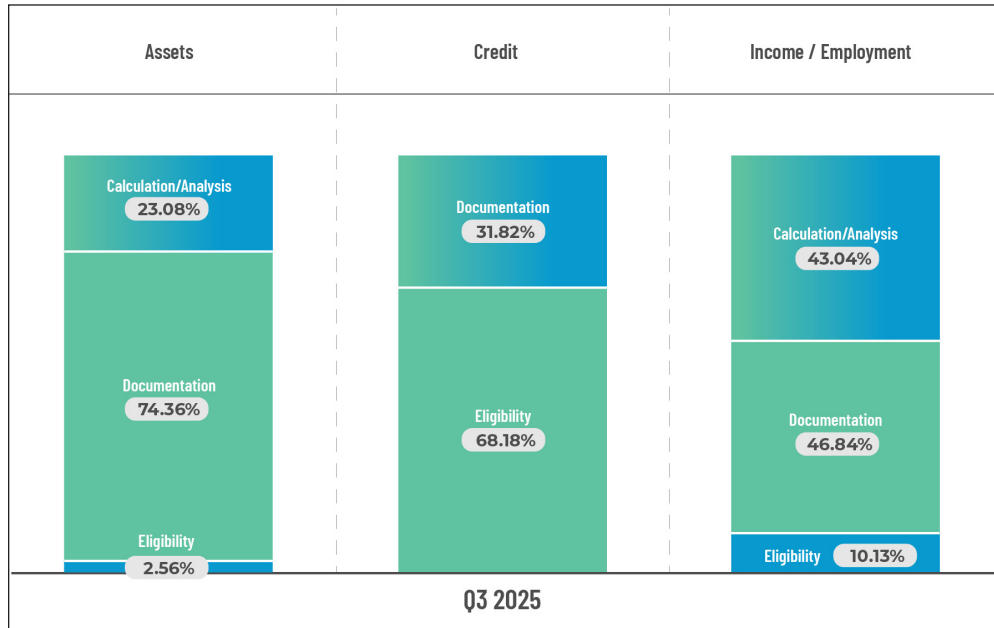


Figure 4 displays sub-category information for Q3 2025 within the Assets, Credit and Income/Employment categories.

Critical Defects by Fannie Mae Underwriting Sub-Category: Q2 2025 vs. Q3 2025

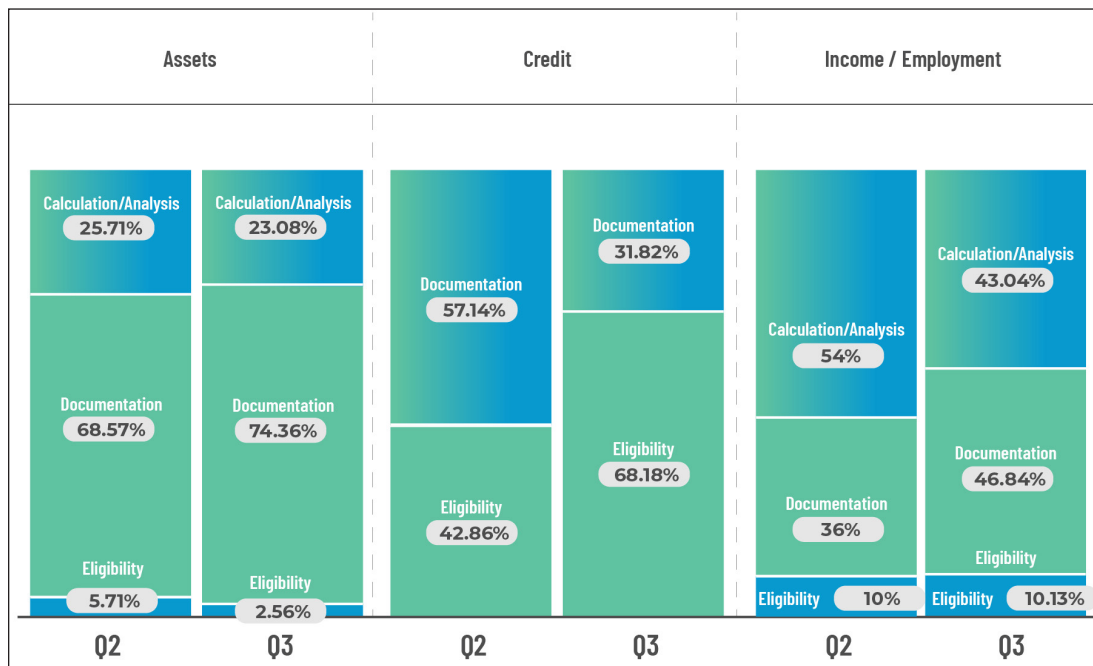


Figure 5 displays sub-category information within the Assets, Credit and Income/Employment categories, comparing Q2 2025 to Q3 2025.

QC Trends by Loan Purpose

Loan purpose trends in Q3 2025 reflected an expanding refinance share and a corresponding shift in the concentration of defects. Overall, the data indicate that the market continued to adjust to an evolving loan mix rather than experiencing a broad deterioration in quality.

Purchase loans remained the majority of reviews, comprising 80.95% of post-closing audits, down modestly from 82.67% in Q2 2025. Purchase defect share decreased to 62.65%, down from 73.96%, reinforcing the segment's relative strength and consistency.

Refinance loans accounted for 19.05% of reviewed files, up from 17.33% in the previous quarter, while refinance defect share increased to 37.35% from 26.04%. The rise in refinance defects aligns with the operational complexity refinance files can introduce, including documentation refresh requirements and validation timing sensitivity.

In total, Q3 2025 loan-purpose data depict a market balancing constrained purchase activity with gradually improving refinance volume. The shift in defect concentration underscores the importance of maintaining strong refinance-focused controls and documentation discipline as activity expands.

Defects by Loan Purpose: Q3 2025

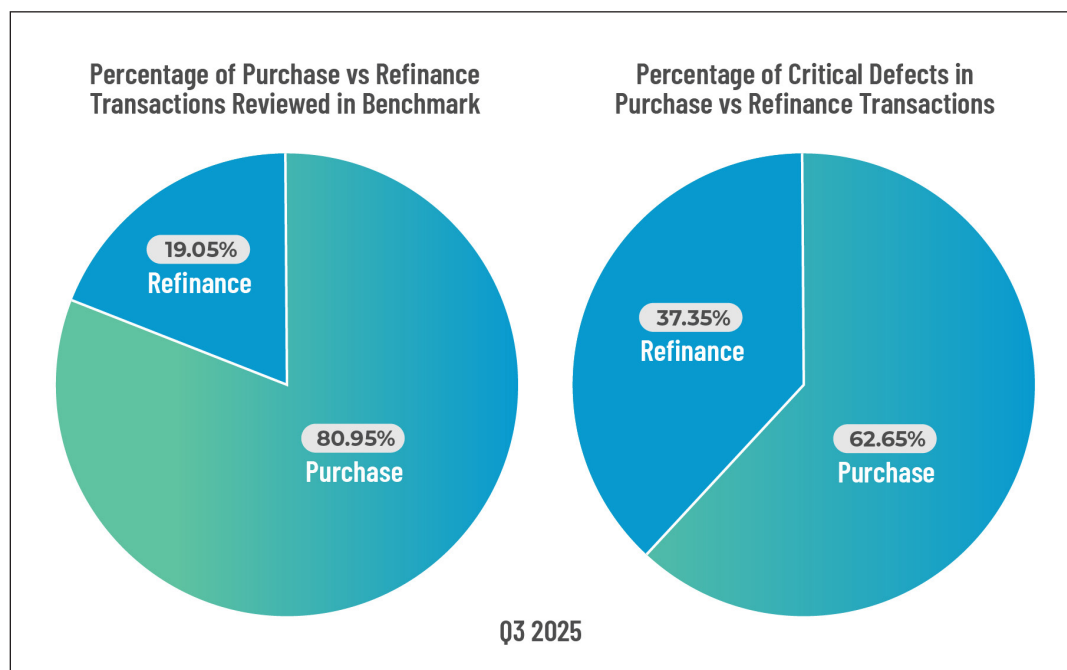


Figure 6 displays the loans reviewed and critical defects by loan purpose for Q3 2025.

QC Trends by Loan Product Type

Loan-type performance in Q3 2025 showed broad stability across products, with conventional loans remaining the largest share of reviews and defects. Shifts across product types were modest and generally consistent with the evolving borrower mix in a higher-rate environment.

Conventional loans accounted for 62.34% of all reviews and 57.18% of all critical defects. The decline in conventional defect share relative to review share suggests stable performance within the dominant segment.

FHA loans accounted for 23.91% of reviews and 31.1% of defects, remaining elevated relative to their share of review volume. VA loans represented 12% of reviews and 11% of defects, with VA defect share increasing quarter over quarter. USDA/RHS loans comprised 1.75% of reviews and 0.72% of defects, remaining comparatively small in volume.

Overall, Q3 2025 loan-type results show stability across products, with conventional performance steady and government-insured programs presenting mixed results. Loan quality across all product types remained strong by historical standards, with the quarter's increase driven more by category concentration than by uniform weakening across products.

Defects by Loan Product Type: Q3 2025

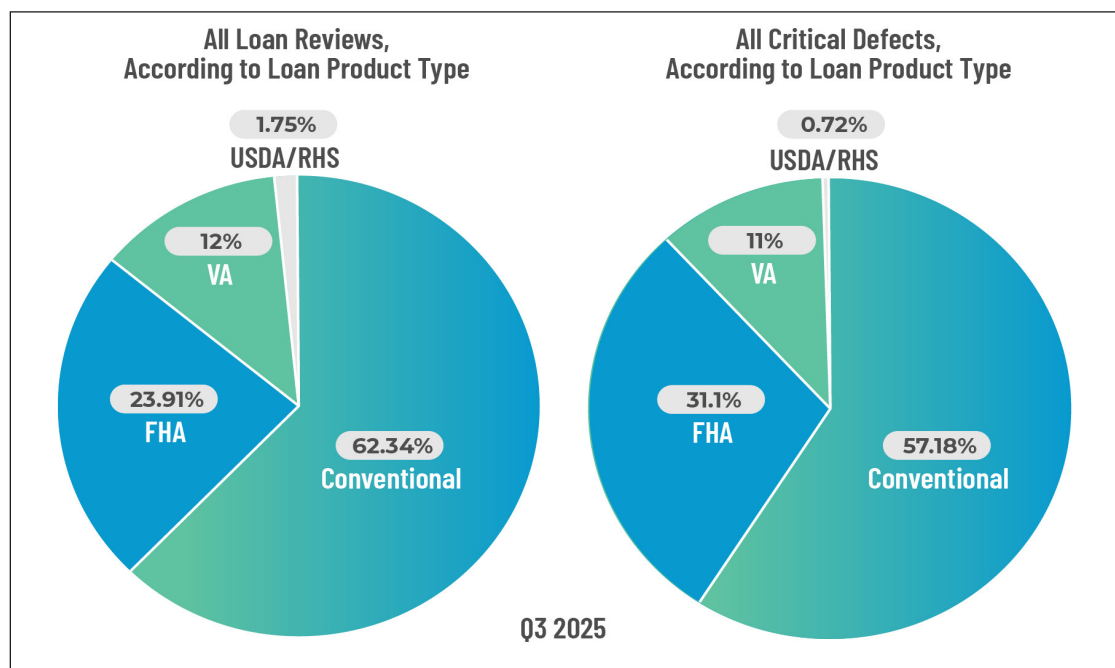


Figure 7 displays the loans reviewed and critical defects by loan type for Q3 2025.

Economic Discussion

Q3 2025 reflected modest quarter-over-quarter softening in overall originations alongside an improving rate backdrop that supported incremental movement in refinance and home equity activity. Against that foundation, the broader macro environment in Q3 was comparatively steady, but policy expectations began to shift. The Federal Reserve cut the federal funds target range by 25 basis points on September 17, 2025, reinforcing the perception that the cycle was moving from “hold” toward gradual easing.

Lender consolidation remained a meaningful operating backdrop through Q1–Q3 2025, as originators sought scale, distribution, and operating leverage in a still-margin-constrained environment. Much of the activity during this period skewed toward platform and channel acquisitions—deals designed to add production capacity, expand broker/partner reach, or strengthen a lender’s position in specific segments rather than simply “buying volume.”

One example was A&D Mortgage’s announced acquisition of Mr. Cooper’s wholesale and non-delegated correspondent lending businesses in January 2025, which reflects the broader theme of lenders pursuing targeted growth through channel expansion. More broadly, lender M&A in 2025 continued to be characterized by organizations rebalancing capacity and footprint—often while maintaining lean staffing models—creating an operating environment where process harmonization and change management are ongoing requirements, not one-time events.

From a QC perspective, the relevance of this backdrop is what typically follows deal announcements: integration planning and execution (policies, procedures, systems, vendors, training, and leadership structures). With multiple lender transactions announced across the first three quarters, it is reasonable to expect Q4 production, and, therefore, the Q4 QC review population, may reflect continued integration-related variability, especially in areas where consistent documentation trails and decisioning discipline are most sensitive to workflow change.

Labor dynamics provided another layer of “economic” context for mortgage operations. Even as overall staffing strategies remained cautious, competition for productive loan officers and shifting distribution channels continued to contribute to organizational churn. Industry reporting indicates that producing loan officer counts rose slightly in 2025 and showed meaningful shifts between channels (e.g., broker growth alongside IMB declines), reinforcing that lenders were still competing for production in a constrained environment.

While Q4 QC results will be observed later in the post-close cycle, the macro signals that emerged after Q3 point to continued mix sensitivity. Additional policy easing in Q4 reinforced expectations for lower rates into 2026, and further industry moves toward

servicing scale were announced by year-end, both of which can support incremental refinance responsiveness while increasing operational complexity through integration and process change. As a result, Q4 outcomes may continue to show heightened sensitivity in categories most exposed to documentation timing/refresh requirements and eligibility decisioning consistency.

Conclusion

Q3 2025 marked a quarter of continued normalization in mortgage manufacturing quality. The overall critical defect rate increased to 1.79%, driven primarily by concentrated deterioration in Income/Employment and Legal/Regulatory/Compliance findings. These results underscore the importance of disciplined documentation practices and consistent validation controls, particularly as refinance activity expands and loan mix continues to evolve.

As noted earlier in this report, the quarter's increase reflects concentrated category movement rather than a systemic decline in performance. Purchase defect share declined, while refinance defect share increased alongside a growing refinance share. By loan type, conventional remained stable and dominant, while FHA and VA continued to warrant targeted attention.

Overall, Q3's results illustrate that the mortgage industry is still performing well in a complex and shifting market. The quarter reinforces the value of ongoing monitoring and targeted QC focus in high-impact areas—especially income validation and compliance-related execution—where small process breakdowns can drive meaningful movement in critical defect outcomes.

About ACES

ACES Quality Management is the leading provider of enterprise quality management and control software for the financial services industry. The nation's most prominent lenders, servicers and financial institutions rely on ACES Quality Management & Control® Software to improve audit throughput and quality while controlling costs, including:

- 70% of the top 20 independent mortgage lenders;
- 7 of the top 10 loan servicers;
- 11 of the top 30 banks; and
- 3 of the top 5 credit unions in the United States.

Unlike other quality control platforms, ACES Flexible Audit Technology® enables independent mortgage lenders and financial institutions to easily manage and customize the system to their specific needs without relying on IT or outside resources. With ACES' AI-powered capabilities, audit teams can translate complexity into clear insights and accelerate performance.

For more information, visit <https://www.acesquality.com> or call 1-800-858-1598.

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