igniting ideas for the mortgage industry.

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Thoughts and Observations On The Market

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April 10, 2014

Before we jump into our newsletter, we'd like to take a moment to speak on how many lenders closed out March and kicked of April.

April Showers - Cloudy with a chance of Rain

We constantly preach the benefits of being 'all-in' with one database of record and utilizing your LOS to provide you with everything you need to run your business; after all data is king. But with the EllieMae outages last week, it brought about a new perspective where practicing what we preach could have limitations. On that note, keep legacy policies or back-up/manual systems and procedures in a safe place for an unlikely 'rainy day' outage.

Before making the move to a new LOS equipped with the bells and whistles of what a new system has to offer, we all had checklists, spreadsheets, and antiquated ways of conducting business. The good old manual process, prior to integrations and automation. The policies, although archaic and inefficient in more ways than one, worked. There was less emphasis on the "cloud" & weather (pun intended) it was a bright sunny day or a dreary rainy one made little difference in our day to day. These policies may need to be dusted off in the unlikely event that there is a systems issue that impedes workflow; if even for a day. When it comes to LOS-talk, we are all too familiar with redundancy centers, but what is your redundancy plan for an unexpected outage? It should look something like this:

- Credit: Enable access to order credit directly though the credit provider website
- Pricing: Enable access to get pricing direct through your PPE
- Appraisals: Centralized appraisal desk to place orders over the phone (old school)
- DU/DO: Enable access to Fannie Mae direct for users
- Closing Docs: Have closing docs vendor as backup in case of outages

These backup procedures, although less efficient, will prevent business from coming to a screeching halt and bring us back to the good old days when a cloud incident couldn't dictate productivity. Having a back up plan should keep the pipeline moving along, albeit slowly, in the event that there is an outage and allow you get back to business. We believe in technology

We strive to keep you all well-informed, as we share our views. Staying a step ahead and running a tight operation are the keys to success in the mortgage banking world, and we are here to help bankers do so. We hope you find our newsletter useful, and if there is anything you want us to cover, please let us know.

The YoYo Effect

The YoYo. Mortgage Banking margins and revenue better have some strong similarities to this classic toy. Over the last few months the financials and proforma models for most have seen better days. Sure we're all used to a little rate volatility, but it's been a while since profits have had a YoYo effect and swung so wildly. Luckily, some early reports are hinting that volume picked up in March, but the million dollar question remains, Is it Real? Will net revenue bounce back? We're sure that some will see a sharp snap back to profitability and others will certainly fumble in some scary territory and struggle to climb back up.

In our last newsletter, we spoke about the popular TV show, Shark Tank and the importance of knowing your numbers. Last week the MBA announced some shocking numbers of their own in its quarterly survey of mortgage banker's profits. While 2012 and most of 2013 were stellar years for most mortgage bankers, Q4 '13 rocked the status quo and put most lenders hoping for a YoYo effect bounce back. We were actually quite shocked this data didn't make more headlines, but here are some highlights and perspective:

- Independent mortgage banks and mortgage subsidiaries yielded a profit of $150 per loan in Q4, down from $743 in Q3. Yes, you read this correctly, $150 per file!
- In bps, lenders recognized 9bps per loan down from 38bps. Yes, you read this correctly, 9bps!
- Q4 production levels were at their lowest point since 2008 (the inception of the MBA survey)
- Production expenses increased to $6959, the highest level since inception of survey
- 58% of lenders posted a profit, compared to 74% in Q3 and 92% on Q2. To put that another way, 42% of respondants posted a loss for the quarter.

Another interesting note: The average respondent originated roughly 120MM in Q4, a period of historically low production. On average, the respondents are larger independents and subsidiaries which likely recognize efficiencies in economy of scale, but also face a different set of challenges in shifting focus and reallocating resources.

So what do we take from all of this shocking data? We knew Q4 was a struggle and the weather didn't do the purchase market any favors in most of the country. We expect Q1 to post similar results and it won't be until Q2 that the YoYo *may* swing back in favor of the mortgage banker. For many, the purchase market won't yield any significant pop in results until Q3, if at all.

Where do we go from here? Some positive feedback and opportunity lies in foresight, willingness, and access.

Certainly branch, origination source, personnel and acquisition opportunities are abound. These opportunities must be carefully vetted as negotiations and competition is strong. Many have been able to see around the corner and invest in these models already. Others are first trying to capitalize now.

MSR
Lenders who invested selling/securitizing directly to the GSEs and GinneMae recognized increased profits in their servicing portfolio. Many lenders are expecting this trend to continue as reflected in the aggressive multiples being thrown around. Whether it's the opportunity to sell flow MSRs at a high yield or retain them at a growing rate, the MSR vehicle has been an essential piece to many a banker's business. This should continue as long as the CFPB doesn't cause too many issues for the non-banks.

Crumbs
In NYC, this is just a wildly popular cupcake haunt, but for readers of our newsletter, this is the leakage or scraps of profits that often go unrecognized. The critical aspect of crumbs is that they have a net impact on profits; there is no cost basis here. As the MBA survey noted that the average yield was 9bps per loan, our notion of crumbs may finally be appreciated. On average the profit margin is a crumb itself, 9bps or $150 per loan. With profits down from 38bps to 9bps, does any lender really have the luxury of brushing off the crumbs? Heck, we're at a level now where a little crumb can double profits. A few crumbs are needed to just reach previous levels.

Many simple efficiencies in Ops and Secondary execution can make all of the difference. You've all heard this tune before as we've been purveyors of it. Recommendations like 'Update your lock or extension policy here ____' or 'Add XYZ investors to your execution' or 'Create a strategic workflow' are met with skepticism by some. We're sure they're thinking 'Great, what's all that really going to do for me?' Well, let's be clear, many of our suggestions for Operational and Secondary execution are focused on recognizing the crumbs. Our recommendations would allow a softer toss of the YoYo with less of an extreme and a smoother transition through the ups and downs of the mortgage banking business. It would allow bankers to be more profitable in challenging times. With further consolidation expected in the industry, it's the crumbs that could make all the difference and keep lenders from starving.

CFPB Redux

What four letters have instilled fear into every mortgage originator in America? The CFPB of course. We understand the fear is warranted and whether rumor or fact, the agency has enough power to have every lender stop and listen when they speak up. Regulators aside, the mortgage industry is still alive and a driving force in any economic recovery that this country is going to have. While volumes may be lower, there is still a lot of business that needs to be supported in a consumer friendly, profitable manner. Maybe, just maybe, we can conjure up more productive thoughts than fear when these four letters are mentioned.

Cannot **F**orget to be **P**roactive in **B**usiness
Business owners need to be running their business in a proactive fashion. Too many are running them in a constant state of reaction and fear, playing defense and too often putting out fires and making brash decisions. The mortgage industry is still strong and ripe with great opportunity. Competition is shrinking and strong leaders continue to look ahead with foresight and strategy while others are sputtering and spending their efforts researching dead-ends and reacting to the issue-du-jour. Management should have specific goals and a strategy to reach them. If the days are spent reacting to the day-to-day miscellaneous items there's an inherent issue in priorities right now.

Can't **F**igure out **P**urchase **B**usiness
By now, everyone knows the refi market will continue to be shaky at best and the future will revolve around the purchases. We see many lenders attempting to 'get purchase business.' This is not a business channel that comes quickly by making a few realtor visits with a box of donuts. It takes months, if not years for a strong realtor-based platform or referral network to be established. It is built on longstanding relationships and excellent service to keep those relationships fruitful. While the refinance model is transaction based, the purchase model is relationship/service based and this needs to be conveyed to all personnel when attempting to solidify the platform. Also those models, proformas and historical benchmarks should go out the window when shifting from a refi heavy model to a purchase model. Pull through, turntimes, stress points, and even protocols and concessions, etc., will all evolve in a purchase market.

Closing's **F**inal **P**rotective **B**arrier
With many lenders looking to alternate platforms (starting up a Wholesale, Retail or Branch channel), the Closing Department will continue to grow in importance as it is the one department where most operational models converge. The Closing Department has the ability to catch file inconsistencies and highlight exposure points in the origination workflow. Some will refer to this as preclosing QC. It is here where the checklists and final file audit is performed. Whether it is a specific person making the same errors, a glitch in the LOS or process that is causing tolerance cures, the closers have incredible perspective on items that can, and will, cause pain in the future. Closing can provide tremendous value to lenders who look to leverage the department correctly and take corrective action. Utilize the talent in the Closing Department to shift risks and prevent operational errors from slipping through the cracks.

Capture **F**alling **P**rofit **B**eforehand
While it seems obvious, many lenders are not truly aware of their numbers in a timely fashion (see our previous newsletter). Lenders fail to recognize that they are overstaffed, or that there is an issue in Secondary or Ops that is causing profits to fall or causing a stagnation effect in execution. Alternatively, there are other lenders who are simply holding out hope that things will improve without a real plan for the recovery. There is much that can be done to model and increase profitability.

About Us:

Matchbox is a collection of gritty industry veterans who decided to create a company aimed at helping mortgage companies ignite ideas that are outside the box to realize their true potential. We have years of real life, hands on experience in the business, and we want to offer our keen insight to others as they take on the challenges before them.

As individuals, we each contribute unique perspective and expertise. Collectively we provide a true roadmap to success, regardless of your current situation. Like any master craftsman, we are very passionate about our work and we approach each client as if your company were our own. In the end, we help you, be a better you.

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