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Thoughts and Observations On The Market

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November 4,2014

IGNITE
BECAUSE DATA MATTERS

The founders of matchbox have created a sister company that is focused on building custom technology products that focus on streamlined LOS integrations. Simply put, our goal in this venture is to make your life MUCH easier. The company is Ignite Integration Solutions or IGNITE for short. If you want to learn more about its offerings, please let us know.

As we close another month and head into holiday season we reflect on the trends of 2014 thus far. It has been a consistent year of production and most firms have righted the ship from Q1 and have had a productive, profitable year. While this is encouraging, many lenders are nervous about the upcoming winter months and another bout of hibernation due to weather, holidays, and overall doldrums of a purchase market's annual slowdown. It is smart thinking and many lenders have made intelligent shifts in their strategy and model that will help them in the coming months. Refi shops have managed to turn the ship and adjust their allocations and marketing toward purchases. Many lenders have received their agency approvals and have entered into the world of retaining agency and government servicing. Others have finally converted to a paperless world - what is taking so long?!?!? Expansion and branding have also taken hold for many as the need to differentiate and stand out from competition is clearly becoming a necessity for the future.

These changes and a short, but welcomed drop in rates will hopefully give a boost to closings and revenue through Q4. So with the focus on so many macro items, let's not lose sight of the micro. The best strategies can go for naught if the day to day execution is sloppy - and that's what we're here for. Hope you enjoy.

Workflow or Work Stoppage?

The word workflow is very commonly used in this industry but rarely followed as its name implies. Breaking it down into two words, your workflow should represent a path that allows your **work** to **flow** efficiently. In working with clients, their "workflow" is usually anything but. Where an ideal model would have both Sales and Ops working in the fast lane, most are stuck in the on/off ramp working at reduced speeds. Interestingly, some realize this and are sometimes embarrassed while others are simply unaware of how much better things can (or should) be. When we listen to clients explain their current workflow, we hear a range from comedic to embarrassment, with a sprinkle of "this is how we have always done it" thrown in. At the MBA a few weeks ago, we actually had four different lenders ask us not to reference their poor workflow in our next newsletter as they were explaining their process. Seriously, the conversations all started with an embarrassed smile and "I'll explain what we do but please do not put this in your next newsletter." We promised not to delve into specifics but the fact than multiple lenders had a similar response was concerning. Why are so many struggling?

The key to a solid mortgage workflow as with any industry is to make the product a widget, in our case, a mortgage. To produce our widget, we strive for the least amount of touch points as possible during the production cycle. A major factor in making this a reality is keeping the file moving in a forward direction without stopping for help from others or slowing down for manual, laborious processes. The lead indicator of work stoppage, as opposed to work flow is to see the file ping-pong back and forth to the same players numerous times, often bringing in a third or fourth individual to ultimately assist. If we were on the road, this process would be akin to sitting in stop and go traffic - on just about every loan. To put it bluntly, lenders operating in this fashion will struggle to remain profitable as volume tightens and competition is fierce. Many smaller firms struggling with this have already been acquired by a larger lender in 2014. With origination costs for the widgets so high, we don't know many lenders who can continue to afford these struggles, particularly in the cold months of winter.

A workflow should be set up based on a 'total days in production' formula and this is where many companies lose focus. Most are very aware of certain timeframes within the process but do not look at the whole process and how other items are affected. Let us explain:

Let's say you have a total production timeline of 70 days from application to loan sale and let's say you are very focused on how many loans an underwriter can handle in a day. While you are very focused on these key components, you do not pay attention to the file submission process which allows for incomplete files which in turn slows our widget production cycle. And the quick answer by many is to insert someone in Ops to review and clean up the files; isn't that adding another touch point and thus adding to the cost to originate? So then the file comes into Underwriting and has three pages of conditions upon initial review. The file then goes back to Processing and a week later 80% of the conditions have been filled. The Underwriter reviews and clears 80% of the conditions and adds a few more which still leaves a number of the conditions open. The file goes back to Processing 1-2 more times and the file ultimately gets cleared to close. Sound familiar? Sure it does, but there are multiple issues with this workflow:

- No file should come out of underwriting initially with more than a page of conditions. Anything more is taking valuable time of an important resource (the Underwriter) and making them perform busy work instead of evaluating risk. So while you are concerned with how many files an underwriter can handle, nothing in the workflow is making the LO, the Loan Opener, or Processor improve the file quality so that the Underwriter can open a file and hit the ground running. Look no further for why some lenders have Underwriters reviewing 1-2 files per day and others reviewing 3-5.

- Files should not be resubmitted until all conditions have been received. It will take an underwriter minimum of 20-30 minutes just to re-acclimate to a file upon the resubmit so receiving 2-3 resubmits a day will lead to 1-2 hours of work just to familiarize themselves with files that they ultimately cannot even clear. Lots of hard work here and little to show for it. Also the more that a file comes in piecemeal, other files are pushed back which just adds to delays and frustrations.

- Files going back and forth which result in countless "touches" is a terrible workflow. Looking at another industry, if you were working on an assembly line at GM or Ford, and units were continuously pushed back to you because your section of the car was not complete, how many cars could the line get through in a day? More importantly, how could you gauge what the right level of productivity should be? And this is everyone's favorite question - capacity per employee. And when production is below targets, whose fault is it? If the dealer submits a wrong order form, and the intake desk just submits it through, and the car comes to you with an order for heated seats and the car is not supposed to have them and gets caught in final QC, which in turn receives a change order (CIC), how do you rate the Seat Guy i.e. underwriter? While not an exact comparison, you get the picture.

Why do you think all large correspondent investors supply sellers with detailed scorecards that evaluate their loan sale process based upon days to purchase, purchases without conditions, extensions/rolls, and fallout? The big banks don't exactly enjoy dealing with the inefficiencies of their sellers and will ultimately leave you with a tier 2 or 3 status and restrict pricing. Talk about an underlying cost - what if you had clean files in post closing and could add/negotiate 5 bps to all loan sales for particular lenders. If you don't think you can leverage better file quality for improved execution of 5bps, you're missing the boat. Just think, 5bps (net!) on say 30-40M. Not too bad for most mid-sized bankers. This would be substantial, but we highly doubt any lender is tying all of the dots together in how an inefficient game of ping pong can be so costly.

This industry right now, and for the foreseeable future is about managing costs and knowing how to build an efficient workflow.

Companies tend to deal with inefficient workflows when volume is high and they are over-capacity, looking to streamline efforts. Now that volume will likely dip in the coming months and possibly 2015, it is a good time to reevaluate your workflow and revamp it to be stronger for next year. In doing so, there are many variables to consider.

- Personnel / Talent
- Origination platforms
- Technology system
- Company culture and mindset
- Goals and standards
- Reporting

We are very skilled at breaking down workflows and seeing the exposure points. If you are looking for some improvements in this areas, let us come in and take look around; we can guarantee our independent, third party insight would highlight some areas of workflow (and revenue) exposure.

Rates Dropped, Then Popped

So lock desks have had some late nights over the past few weeks. With the sudden rate drop, lots of deals were locked in and locked pipelines doubled overnight. Those PPE email alerts were firing at a frantic pace. While a great thing, increasing the locked pipeline is not the end of the story, it should just be the beginning. After catching your breath, reality starts to set in and data becomes your immediate friend or enemy.

- If the majority of the new locks are for say 30 days and if a large percentage of those close within that timeframe which would result in the largest closing month of the year, is that realistic? Can Ops even handle this volume? Will warehouse capacity become an issue?

- Did you lock the majority of the volume with a specific investor? If you did it is most likely because they were the best execution and if so, then they were the best ex for a lot of other lenders as well. Just think of what a swell of volume can do to pre-purchase turntimes right in time for the holiday season. And we sure know that nobody wants volume tied up on their lines come Christmas time.

- Alternatively, for those who are hedging, we sure hope that (a) you took some margin on the side to account for the high volatility over the last three weeks and (b) you had a careful eye on how rates where published i.e. what BE investor may be loaded in the PPE or what MBS price was utilized. There are some large exposure points here which we've recently noticed for a number of lenders.

> -Lenders are setting their pricing to investors which they do not intend to sell volume (or at least not that much.) Lenders pricing is based upon Investor A but Secondary refuses to commit any volume to Investor A. So why would this investor be in the model? Sounds pretty basic but these models are not proactively managed by enough Secondary/Lock Desk Managers.

-Lenders are slow to the reprice game and always behind the curve, especially as rates retraced their rally. This is especially true for those pricing directly to the MBS market rather than investors.

-Rate volatility can be 'gut check' time when reviewing the broker/dealer P&L. This cash flow concern can lead to forced AOTs - a terrible strategy which will suck gains out of a P&L. AOTs are a great execution option but they should not be forced.

- Finally, take a look at where the locks came from and compare it to historical behavior. If the majority of locks came from a branch or LO with high fall out, get ahead of it and pro-actively get feedback on the locks so that you are not eating up unwanted hedge costs. Same goes for renegotiations and fall out. Remember this - much of your newly locked pipeline is likely fallout from another lender who locked them in at higher rates. The same can go for your previously locked pipeline. Managing pull through is critical now more than ever (note: wholesale/TPO and correspondent models carry the most exposure here.)

Ultimately, increased lock volume is a good thing but it needs to be managed to ensure that the expected income will flow through with the increased pipeline. Unfortunately, we expect most P&Ls to suffer in times like this and much of it can be tied to Secondary/Capital Market strategies. With investor mix at a 5-6 year high, sporadic turntimes, volatile markets and allocations, it's very easy for Secondary to unknowingly take P&L hits as they just try to manage the day to day. Keeping a close eye on, and understanding of their own pricing policies, allocation targets and proactive pipeline management will separate those who have under-performing /leaking P&Ls and others who remain stable or even use this time to improve gain on sale.

Not sure how your Secondary or Lock Desk Department has handled this volatile time? Are inquiries met with "I got it covered, we're good..." Shouldn't all bankers want clear validation that internal pipeline management and processes are in place to maximize net revenue / gain on sale? Don't be shy...

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 perspectives 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.