matchbox

Matchbox OP(erations) ED(itorial) Page

Thoughts and Observations On The Market

The Shark Tank - Would You Survive?

Secondary Night Vision

What We Do

Fulfillment & Advisory Services:

Mortgage
Analytics
Technology
Consulting
Hedging

Quick Links

Learn more about us...

Join Our List

Join Our Mailing List!

Or Pass this along to a friend!

March 25, 2014

If you went on the tv show Shark Tank, how would you do? It's a question a client recently posed to himself. As we close the chapter on a bitter cold first quarter, we are starting to see (hear) that many lenders are seeing business pick up for Spring. The future is bright and the "numbers" are looking promising after a few rough months. We sure hope things are improving out there in loan land, but in the Shark Tank, those four sharks have a knack for digging, poking, and prodding into the real numbers of any business to see what the future may hold for net profits. Would you survive?

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 Shark Tank - Would You Survive?

Think you can swim with and impress the sharks? They are tough and tear through the unprepared. The questions typically start with the same two words: What's your _______? Most lenders and businesses in general, equate an increase in volume to increased success. Most often, sales are growing and there are smiles all around. While increased sales are great and critical for growth there are many other variables that tell us whether a particular business model and increased volume will ultimately be successful. Hopefully, when the numbers are tallied for March there will be improvement, but with a focus on purchase business, this improvement will not be felt for a few months at best. And will this improvement be realized on the bottom line or just in a tally of volume? The Sharks and matchbox would ask at least a dozen 'What's your' questions about business and pipeline. If these questions are met with blank stares or loose explanations, you're probably not leaving the shark tank with a smile. To truly gauge and forecast success, management must

truly understand their numbers from prior months and the business model changes that feed into the bottom line.

When reviewing the financials or metrics in January and February, lenders should have researched the areas where performance was off. Simply expecting revenue to be down because volume was down would see you get eaten alive by the Sharks. A financial report with static results are affected by many prior and future events. It is crucial to understand the points in your business that contributed to a negative performance in prior months in order to appreciate the assets that improved in March. Or is it an accrued asset that will not be recognized for 60-90 days? This business is pretty straight forward and your cost to originate should be a known data point that can be broken down by looking into four main expense components:

- Payroll expense
- Commissions expense
- Fixed Costs
- Direct Marketing costs to originate

Of course there are other miscellaneous cost factors, but if these components can be fully understood, it becomes much easier to formulate a baseline for gauging performance. We get a kick out of CFO's who are thrilled with re-negotiating their credit bill and feel that will be the key difference in profitability. It may be a nice pickup, but it certainly isn't improving the business model or making a significant change. Once these areas can be broken down, then it is up to management to dig into productivity levels and strategies behind them. Here are some questions that most lenders should have been asking themselves:

Is there excess payroll? Are there Increased commissions or draws? Was volume down due to lower productivity in certain departments; or simply because of the holiday season? Or is shifting the pipeline to be purchase-focused taking longer than expected? Or is it all of the above? Did we take on new avenues of business which required investments in the future, but came at a significant cost? Were there unusually high levels of lock extensions and concessions? Were there unusually high numbers of loans re-targeted to different investors for less revenue to clear the lines? How much did that cost???? Did pipeline allocation shift by product, channel, or source? How efficient is underwriting, closing, post-closing? These are all examples of items that are not clear by looking at a report or financial statement, but definitely have an impact on the firm's performance.

If the last few months did not afford the time to really dig into the data, now is the time. Who wants to be one of those sorry souls on Shark Tank who was completely unprepared with failing to truly understand their own business. Just because volume will increase in the coming months does not mean the bottom line will increase as well. As we say good bye to a brutal winter and hello to a hopefully large increase in pent up volume this Spring, you have to know where you have been in order to see if you are really back on track.

Secondary Night Vision

While the above piece spoke mostly to costs, the revenue side of mortgage banking revolves around secondary margin and gain on sale. Sure there is fee income, but that is quite easy to model and pretty static. Pricing, margins, and ultimate execution for Secondary can make or break a firm, especially in a volatile market. Unfortunately, Secondary performance is quite often widely misunderstood. Secondary execution, including policies and concessions, will likely have the largest impact on profit for any lender. It involves a number of moving parts which get more complex as you increase execution outlets. Best efforts is pretty simple, it gets more complex if you are hedging, and gets really complex if you are selling to the agencies, securitizing and servicing.

There are a number of items that impact the ability to gauge performance: The LOS, the PPE, risk management reports, TBA settlements, purchase advice reconciliation, and many others. Additionally, almost all Secondary departments live in a world of one-offs. There are extensions concessions, pricing concessions, fallout and re-locks, investor kicks, re-negotiations, data changes, etc. With all of these variables there are many areas where bps can fall out at the loan level. We often refer to these bps as crumbs. Little tiny crumbs often go unnoticed and certainly unaccounted for, but when you gather them up you can have an entire cracker, piece of bread, or even a loaf. Many have a difficult time seeing those crumbs.

Over the last few months we've been approached by many lenders looking to increase revenue. It's the most simple of questions, "What can we do to make more money?" People are coming right out and asking, but very few look to analyze Secondary performance; which includes trending and forecasting. On average, we have found there is 20-25bps revenue erosion somewhere within a lender's secondary process. In most cases the erosion is 'crumb' size, or 2-5 bps buckets through inconsistent or poor operational procedures. By seeing many business models, we have seen many of the traps that firms fall victim to. If we were in the Navy, you could consider matchbox to be the SEAL team when it comes to identifying areas of profit and Secondary erosion. We can see the leakage when others cannot, while offering an independent strategy and the implementation of a corrective action.

We work with many talented Secondary Managers who agree with our findings, but they have their own struggles in identifying and implementing change. With staffing levels low, spending additional time running analysis on how operational or departmental workflows are impacting execution may not be possible. Technology limitations could make the analysis a struggle. Of course there is often office politics and personalities to acquiesce. Sometimes it's just a new perspective or opportunity that was not on top of the priority list.

This erosion or leakage should NOT be accepted as a cost of doing business. We can find it and find it quickly. If you are not 100% confident that your Secondary execution has been maximized recently, it's time we have a conversation. It may have been off for some time, but margins were large enough to mask the real issues; nobody has this luxury in 2014. Secondary is the one department in a firm that can make the most difference

if minor tweaks are made. Fixing almost any area of erosion can have an exponential benefit because of its impact on mass volume. It is essential for management and secondary to have the lights on and a full perspective of how the current origination, execution and delivery workflows, along with data, reporting, and policies will impact the bottom line. If you have spent the past few months looking and investing in increasing revenue opportunity, why don't you take a look at gaining a true understanding on your gain on sale. There is no reason to look outside for new sources of volume and revenue when there is opportunity at your fingertips, but you just can't see it.

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.

Are you forwarding our Newsletter?

Each week we see a number of readers open and forward our newsletter multiple times. If you like our letter and are forwarding, first of all, **Thank you**! Also ask your contacts to subscribe as we always like to increase our readership!!!