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Branching Out

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As the market continues to both evolve and consolidate we see a number of firms growing their branch platforms to sustain volume and reach new markets. These opportunities seem enticing at inception, who wouldn't want an additional $5, $10, or $20MM of volume? Well, even if a branch is acquired at no costs (there always are) there are a number of operational risks that need to be understood for a smooth branch transition.

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.

Branching Out: Volume is nice, but it comes with a price

Brand Risk

The new branch is now taking on the company's name and brand. This is not just for business cards, an email signature and letterhead; it is ensuring that the corporate culture is understood and expectations for supporting the brand are understood. Training, consistency and brand presentation is key. It's common to see personnel within the same company with business cards, email signatures, and marketing materials with different fonts and slightly different logos. If the basics of branding cannot be mastered, then how can the client experience be mastered? Why aren't all marketing materials 'on brand'? Is it so hard to have a consistent corporate email signature that everyone uses?

Once these little things are addressed it's crucial that the way these new branches conduct business is audited.

How does sales interact with clients?:

A few bad reviews can be detrimental to an online lender. If tapping into a new market, it will only take a few transactions to batter the brand in a new footprint.

What is their pricing model?:

We see many branch models play right into the hands of a point bank or P&L that is destined to either create CFPB exposure or fail with the first few months. The latter creates stress for everyone, unexpected financial support from corporate, hands-on management and modeling and aggressive business practices.

How are originations sourced?:

How often do very successful branches move from lender to lender or firm to firm. This occurs more often with flawed business models. Managers who are really strong in sales, but not business and have unrealistic volume forecasts. Everyone seems to come with a pipeline of 10-20MM in volume and most originate half of that. Others have no problem delivering their anticipated volume, but it's because they have questionable relationships with Realtors - watch out for flips, fair lending and affiliated businesses! We have multiple clients who have struggles with all of the above over the last six months and they are certainly not alone.

Operational Risk

More often than not companies are taking over new business models for the sake of diversity. The current flavor of the day is for refi shops looking for purchase centric branches. This is simple common sense. The operational differences in these models is great. From client interaction, additional parties in the transaction (realtors, attorneys, etc) pipeline dwell time, preapproval requests, closing and funding process, and lock pull through, the differences should not be underestimated. Just ask the countless firms whose hedging profits took a nose dive over the last 30-90 days. New branches with new business models and more purchase business left many firms under-hedged. If operations are centralized and refi based, they need to understand the nuances of handling purchases. If new personnel is acquired along with sales, both old-guard and the new blood need to understand the processes and work together. How many teams in sports are filled with talent, but management fails to adjusting roles in a constructive manner and place serious emphasis on cohesiveness and teamwork? The most efficient and successful groups are not necessarily compromised with the most talent, but rather those who buy in to the greater goal, embracing the systems that management is deploying and working with the current rather than against it, believing their own way is best.

LOS Risk

We often say that the LOS is the heart of any banking operation. If bringing on a branch means IT sends new hires a link to download the LOS and then watch a few tutorial videos, then we have a problem. While video tutorials are great, they are not sufficient when introducing an LOS to a new user. The LOS, if built correctly, should enforce many of the corporate policies and procedures and thus the new branch should be fully trained on the LOS and understand how and why it supports the business model. We are pretty confident that sales personnel does not do well with long classroom sessions and webex tutorials. Training is essential, especially as many LOS's are customized and poor training leads to inefficient workflow and an over-reliance on assistance from others.

Volume Concentration Risk

When looking at a branch, while the overall volume is compelling, it is wise to see what the volume breakout is for the branch. If acquiring twenty originators and $15MM in volume, how many lenders are looking at how this allocation is broken out? Does $12MM come from two originators? How much volume is of vanilla conventional or government programs? Do they fit the hedging model which many are relying on for net revenue in these acquisitions? Or are they focusing on ARMs, 203K's etc? Is the volume sourced through one or two highly sensitive and costly marketing campaigns? We wouldn't expect the new manager to highlight these exposure items; the onus is on the lenders due diligence team.

Legacy Risk

The historical banking production risk should have been flushed out via multiple channels standard channels like MARI, investor scorecards and interviews with investors, but there are some other items to focus on. Whose vendors are being used and how are they being implemented into the new workflow for sales and ops? Are there any contractual obligations with third parties and potential risks in them? Is there a cancellation fee for closing out an old vendor? It is important to explore the potential liability from all angles as there may be some surprises waiting to pop up in the accounting room; which is the last place surprises are welcome.

New Platform Development

In addition to the branch acquisition trend there is also a trend in firms looking to develop new origination platforms, i.e. Wholesale and/or Correspondent or Mini Corr. These new platforms also pose multiple operational challenges which cannot be underestimated. The development of these new platforms usually begins with a new hire who is responsible for the new platform, which usually translates to increasing volume. While that is crucial to the success of the platform, the operations differences in the platforms do not always seem to be fully flushed out and only get highlighted when the volume is in the door and someone is ringing the five alarm fire bell. Here is a sampling of the operational exposure items that are often overlooked:

- Broker/ New Lender approval process and management
- NMLS and licensing management
- Disclosure review and issuance process
- File submission and their requirements and expectations
- AUS capability, access, and costs
- Product offerings and updates
- Rate sheets or PPE access for locking loans
- Flow or bulk locking options for Correspondent
- Warehouse and investor approval

- External communication methods for external clients
- Potential reallocation of hedging assumptions
- External commitment letters and files updates
- Efficient process to submit conditions
- Funding and commission changes and ongoing management
- Closing agent approval process
- New process of due diligence review in Underwriting
- Increased due diligence on Quality Control Plan
- Purchase advice and servicing software needs for Correspondent

We are just scratching the surface here, but these are just a few of the many items that need to be researched and implemented when creating a new platform. As with everything, volume is nice, but it does come at a price and with a substantial investment. On a final note, while we're focusing on volume, let's not lose perspective on margins which are arguably more important to the bottom line. Maybe the focus for most is Step 1: originate volume Step 2: create a model to net a worthwhile profit. We'll try to continue on this path next newsletter.

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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