STRATMOR GROUP

In-Focus

WHAT LENDERS SAY: TOP OF MIND TOPICS IN 2017

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By Dr. Matt Lind

Every year, STRATMOR talks to hundreds of industry professionals, both lenders and vendors. As unique as each individual and each company is, they often share similar concerns and asked related questions about our industry.

STRATMOR Insights asked our principals and partners to address the common topics that are "top of mind" with mortgage industry leaders, particularly those we met with during the recent MBA Annual Convention in Denver, Colorado. After STRATMOR's many meetings at this event, and including our ongoing engagement activities, four issues stood out: **Housing Inventory, The Market, Growth,** and **Technology**. In this article, we share STRATMOR's perspective on each of these topics.

Housing Inventory

Lack of inventory is currently the biggest concern in the housing market and has been for all of 2017. And, lenders are asking: "What is at the root of the shortage that is restraining the purchase market?"

"This is the big question the MBA has been working on, and it is a difficult one to answer," says Senior Partner Jeff Babcock. "One partial explanation is that, with home values rising as fast as they are, the incentive to sell your home in order to move-up is watered down by the fact that you then have to go out and replace it at a high-cost, not to mention the possibility of a higher mortgage interest rate. Conversely, sellers looking to downsize — think empty nesters and retirees — may simply delay selling if they think they can get a substantially higher price by waiting six months or a year. But the real issue — and the concern — is that no one sees any economic forces that will change this situation soon.

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"The housing shortage is an ongoing problem, and this has a direct impact on the purchase market. We aren't getting back to a $2 trillion market any time soon," says Babcock. "Lack of growth in the purchase market is going to constrain volume and we're more like a $1.6 to $1.7 trillion market as opposed to $1.8 to $2 trillion in 2018."

In their third quarter 2017 report, The National Association of Realtors® showed home prices climbed and sales declined. Single-family home prices in the third quarter increased in 92 percent of 177 metropolitan areas, and the NAR noted the pace of new listings was unable to replace what was quickly sold.

"Basically, there is a mismatch between the nature of the housing inventory available versus demand," says Senior Partner, Jim Cameron. "In certain locations, the high-end market is soft — there is less demand, more supply and prices are not appreciating as quickly. Moderately priced homes — they're flying off the market.

"Especially in certain areas of the country, builders struggle because they can't profitably price and sell their low-to-moderately valued inventory," says Cameron. "The fixed cost of starting a new home of any size pushes the cost up for the builder, who says, 'I can't make money on a $150,000 home so I have to do $350,000 plus to be profitable.' This limits supply of houses in the more moderately-priced range and makes it tough for the upcoming Millennial market and first-time home buyers in general to buy a home."

The two demographics that lenders point to as having the greatest impact on the inventory issue: **Baby Boomers and Millennials**.

Says Babcock, "Baby Boomers are aging in place, saying 'I don't want to move. I have a low rate mortgage. I have roots. Sure, my house is too big, but what I might gain financially by selling may not be worth the personal give-ups.' "

According to the NAR, 85 percent of Baby Boomers say they have no plans to sell in the next year and homeownership among Boomers is at 78 percent. If they don't sell, others can't buy and they don't sell for the same reasons Millennial borrowers can't buy: supply, price and the nature of the existing housing stock. With more than 83 million Millennials (born 1982 to 2000) and 75.4 million boomers (born 1946 to 1964), the two groups are bound to keep bumping in to each other in the housing market.

"Research shows Millennials aspire to home ownership but aren't as willing to buy in the suburbs or exurbs as earlier generations," says Senior Partner Garth Graham. "So even if builders build in these areas, first-time homebuyers aren't necessarily buying. Until there are homes to buy that they want, Boomers will stay in their homes and the Millennials will continue to rent."

The Market

In a word: flat.

"With the lack of growth in the purchase market constraining volume, the margin compression that lenders experience in a flat market is widespread," says Babcock. "Different regions seem to be experiencing it at different levels, and it's more pronounced in some markets than others. Still, we're hearing lenders say, 'We'll compensate for the falloff in the market because of the recruiting we're doing or have done.' Everyone thinks they are going to steal

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share or that they are going to hold flat. Very few believe they will actually shrink.

"Lenders really need to look at the reality of how challenging the market will be next year," says Babcock. The MBA says the market will be down 6 percent in 2018, after being down 17 percent in 2017, a total of roughly 22-23 percent down over 2016. The questions lenders should be asking are: 'How much should we be downsizing to lower costs in line with anticipated lower volume?' What can we do to increase our share of a smaller market?'"

One risk few lenders seem concerned about is an acceleration in CFPB enforcement in 2018. Babcock hopes lenders will not let the January 1, 2018 HMDA change slip beneath the radar. "As one lender pointed out, HMDA will be able to look at Fair Lending violations via data at both a loan officer and a loan level," says Babcock. "Lenders should recognize that it will be easier for the CFPB to use big data and develop algorithms to look for Fair Lending violations."

A regional issue with national impact is the lack of competitive Jumbo pricing. Babcock says the domination of this market segment by a just a few large banks affects business in the West, Mid-Atlantic and Northeast regions most, but is also a factor in Chicago, Minneapolis and Denver as well. Jumbo loans account for 10-plus percent of the market, and for many lenders in a shrinking market, that's business that is not there for them to begin with.

"A very large branch of a lender I talked with lost 40 Jumbos in the last year," says Babcock. "They took the app, did processing and then lost to a 'Big Bank' on pricing. When you're doing $400 million a year and the average Jumbo volume is often $40 million plus, that's 10 percent of your business. We're also hearing that lenders are losing loan officers as their originators are migrating to where they feel that they might have a better Jumbo product."

The issue of Jumbo loans is complicated by potential Federal income tax reforms currently being considered by Congress. Lowering the cap on mortgage interest deductions, adding caps to real estate tax deductions and eliminating state tax deductions will lower the prices of higher-end homes and therefore the demand for Jumbo loans, especially in metropolitan coastal markets where real estate and state taxes are typically much higher than national averages.

Growth

To make up for lost Refi production and lower purchase volume, lenders are looking at a variety of ways to "grow through it." According to the MBA and STRATMOR Peer Group Roundtable (PGR) data, large lenders are interested in growing through acquisition and leveraging their mortgage factories to backfill lost production efficiently. Sales force quality and productivity are the biggest drivers in the acquisition picture.

"Give me a sales force with long tenure, that's purchase-loan driven, and has good, well-distributed sales results across the sales force and I'm good," says Cameron. "Getting the sales force to fire on all cylinders will put some big numbers on the board before going to market."

Entering new channels, offering new products, expanding into servicing and entering ancillary lines of business comprise other growth tactics being considered by many lenders. STRATMOR Principal Tom Finnegan says the overarching topics in his discussions with lenders focused on how to grow market share and improve or at least maintain profits in the face of an overall decline in market volume.

"Banks, in particular, are talking about ancillary lines of business that complement pure production," says Finnegan. "One bank I talked with is looking at expanding into warehouse lending as a complementary business. Many banks are thinking 'If we're not in a certain channel, should we be?' And a number of independents have expressed interest in doing reverse mortgages.

"If you were set up going into 2017 with above 80 percent purchase money business as a component of your overall production, then you are down a bit but not suffering in 2017," says Finnegan. "But if you went in lower, you have some ground to make up, and for those who have an opportunity to tap other channels or other sources of business from ancillary lines, that's what's on their minds."

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As noted previously, reverse mortgages are also on the mind of many lenders. "We've been tracking the growing interest in HECM lending among traditional lenders for some time now," says Cameron. "The activity appears to be driven by a variety of factors, including favorable economic conditions and the growth in the HECM's core demographic. Baby Boomers are aging in place — staying in their homes — and lenders can add value by offering reverse mortgages as a financial planning alternative to this age group as they contemplate their financial plans for retirement." But FHA's recently announced losses on HECMs have hit the reserve fund very hard, and it is not yet clear how this will affect the future of the reverse channel.

Consumer Direct is also one of the most discussed growth opportunities among lenders this year.

"CD research shows that over the years, in addition to its large share of refinance production, CD units of purchase production have steadily grown," says Cameron. "CD works for both retention and acquisition of new customers, and lenders want to get better at it. They know that they need to play ball in the CD space or risk losing share. If you retain servicing, you need to have a good CD channel to be able to price competitively and maintain attractive production margins."

Among banks of varying size, Consumer Direct is considered strategically important. The techniques of digital mortgage are heavily utilized in CD. "When I talk channel expansion with banks, it's part of the mix," says Finnegan. "They're asking: 'Could I improve Consumer Direct and get to my non-mortgage customer base better?' Perhaps yes, if they have the channel but it isn't doing much right now. CD is on their minds, and the question is whether they can leverage it more effectively."

Technology

Technology is always on lenders minds and digital mortgage is where the conversation goes.

"Digital mortgage is the hot topic, including review of all the new solutions available. However, picking the right products are only part of the story," says Graham. "You also need to retool your processes and be sure your people are motivated and educated on the change to successfully leverage the new tools. A lot of lenders have begun to have the experience that just buying the product — the shining tool — without designing a process or having the right change management discipline in place will not lead to great results.

"Lenders have got to figure out how to pick digital mortgage solutions that can integrate into their sales and fulfillment operations, or lenders have to be good at integration themselves," says Graham. "All of these solutions might do one part of the process really well, but if it's not integrated with the other processes, it is very problematic."

Senior Partner Len Tichy says that lenders regularly share their LOS frustrations with him. He says lenders are feeling the challenge of managing increasing levels of complexity and risk in an information environment where dependence on third-party applications, services and data tightly integrated with the LOS is growing rapidly.

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LOS vendors are migrating away from traditional proprietary LOS SDK's (Software Development Kits) toward more open API (Application Program Interface) strategies as their primary tool to enable systems integration and lender flexibility," says Tichy. "But for many LOS vendors and lenders, the implications of this new shift are not yet fully understood. For instance, who, exactly, will pay for API development and/or usage, and how much? Vendors are still trying to figure it out. Lenders also face effort and cost converting legacy SDK custom integrations to API."

Mastering the mechanics of API development (especially for smaller lender IT organizations) may require new technical skills to manage the API maintenance burden across many integrations. Assuring performance reliability and data integrity will require close collaboration among two or three entities to diagnose and cure problems when they arise.

Senior Partner Nicole Yung cites, "We just got the data from our latest 2017 Technology Insight Survey which notes that Customer Experience and Integrations have risen to the top the list of key technology developments that are important to lenders. This represents a significant shift in priorities as Compliance Tools, now rated fifth in importance, were the top concern in both our 2015 and 2016 studies. Integrations are the top concern for these lenders, followed closely by the inability to support customization and then poor customer support."

"Our industry is looking for something big, something disruptive," says Tichy. "This is a great time to be an aggressive lender that wants to grow and is willing to invest in innovative technologies and the internal talent needed to orchestrate innovation and overcome the inevitable challenges that come with it." The new STRATMOR Tech survey results are now available for purchase. Click this link for more information.

In Summary

STRATMOR's consultants see mortgage market that is likely to shrink near-term and cannot depend on the traditionally reliable drivers of longer-term growth, e.g., demographics, income growth, immigration, improved affordability, etc. In such a challenging go-forward business environment, we believe that the watchwords for success will be "stealing share" and improving the "borrower experience," both of which will require a combination of superior sales management and use of technology. And based on our recent large-lender PGR and MBA Annual Convention meetings, some lenders get-it, and many more don't.

WE WELCOME YOUR FEEDBACK

Would you like to talk with a STRATMOR team member about a "top of mind" topic? Contact us and we'll set up a time to talk with you. ■