STRATMOR GROUP

FEATURING

MANAGING BY THE NUMBERS

STRATMOR INSIGHTS

Volume 2, Issue 1
January, 2017

HERE WE GO AGAIN!

Put — and Keep — Productive LOs in their seats

The New Year is upon us, and it promises to be...well... interesting, to say the least. From my vantage point, the industry watchword is: "Uncertainty." Just about everything is up for grabs, from taxes to the future of the Agencies, Obamacare, Dodd-Frank and, of course, along with Dodd-Frank, the future of the CFPB. Frankly, I don't think anyone really knows where things are likely to land.

Unfortunately, uncertainty can result in paralysis, insofar as lenders are reluctant to make investments and effect big changes until the lender landscape — especially as regards taxes and regulation — becomes more clear. While such risk-averse behavior is understandable, we think that lenders who sit on their haunches will be making a big mistake. There is so much improvement that can be achieved irrespective of the tax and regulatory environment.

One key way in which lenders can and should improve is by managing by the numbers, the topic of this month's "In-Focus" article written by STRATMOR Senior Partner and Founder Dr. Matt Lind. In this piece, Matt lays out the case and challenges involved in using performance benchmarking as the core basis for managing a lending operation, drawing upon a chapter on financial benchmarking that he wrote for *The Mortgage Professional's Handbook*, published in January, 2016.

This month's "Mortgage Metrics Matters" focuses on LO turnover data. With the advent of new compensation rules, lenders have increased their focus on sales management. Because many originators are now subject to minimum wage regulations, companies will incur real costs for non-producing and non-productive sales people.

Continuing this focus on the retail sales force, January's "In the Spotlight" section looks at select results of a recent Spotlight Survey researching lender strategies for both recruiting and retaining seasoned LOs. In a slower-growth mortgage industry, a key strategy for growing origination volume and market share is to recruit seasoned originators and, where possible, whole branches from competitors while, at the same time, retaining productive originators.

Finally, in "Speaking Borrower Satisfaction," a survey that draws upon 2016 MortgageSAT data covering almost 100,000 borrowers, we address the question: Are all borrowers treated the same? You may find the results surprising.

Lisa Springer, CEO

IN THIS ISSUE

STRATMOR INSIGHTS

MANAGING BY THE NUMBERS

By Matt Lind, PhD

This In-Focus article draws upon a chapter on Financial Benchmarking that I wrote for *The Mortgage Professional's Handbook*, the first comprehensive resource written since the Mortgage Meltdown that covers every aspect of the mortgage business.

Following the industry meltdown during the latter part of the last decade, the size of the mortgage industry got substantially smaller; and today, both short and longer-term growth prospects are smaller relative to earlier decades. While immigration remains a positive growth factor, core demographics, tighter underwriting standards, stagnant income growth and later marriage coupled with smaller desired family size all point to slower growth. There is also evidence that the traditional "American Dream" of home ownership has lost some of its luster among millennials.

In such a business environment, the watchword for achieving superior growth in the mortgage industry is "stealing-share" from competitors. And stealing share is a result of "being better than competitors" across a wide list of key success factors. At STRATMOR, we believe that one of these key success factors is *managing by the numbers*.

Performance Factors

More than just financial management, managing by the numbers encompasses the ongoing measurement of a wide range of financial, operating, and non-financial factors. For example, there is a growing belief that a non-financial measure such as borrower satisfaction is key to generating originations from borrower referrals — including social media — and repeat business, i.e., customer retention. Yet, today, relatively few lenders measure borrower satisfaction in such a way that they can take action to correct individual staff, department, or systemic problems, or intervene and mitigate the potential reputational damage that can result from an unhappy borrower.

Further, most lenders measure their own financial and operating performance without regard to how other lenders are doing. To the extent they engage in performance comparisons, they are generally internal; for example: this quarter's results versus last quarter's, or the same quarter a year ago; or the sales performance in Region A versus Region B.

Such comparisons are both interesting and often useful, but they leave the really key questions unanswered. Okay, our income is up; but is it up as much as the rest of the industry? Yes, we reduced our cost to produce a loan, but did we reduce our cost by as much as our competitors?

In a world where success generally requires doing things faster, cheaper, and better than competitors, you simply MUST compare your performance against competitors. You must benchmark.

What is Benchmarking?

For the mortgage industry, benchmarking is the analytic process by which a lender compares its key performance metrics to the performance of other lenders or groups of lenders. Benchmarking comes in two flavors. First, we have *best-practices benchmarking*, where a lender wants to compare themselves to the lenders they aspire to be like. The hope here is that by choosing lenders that are top performers in the industry, they can identify practices that may help improve their own performance.

Second, there is *peer* benchmarking, which occurs when a lender wants to compare themselves with similar lenders, with the goal of making sure that they are competitive with lenders that look like themselves.

In the real world, however, most lenders do not have the luxury of choosing their competition. Therefore, it's generally insufficient to compare yourself to just "similar lenders" or peers when you are competing, say, with giant national lenders. So, for example, mid-sized lenders — even the best performers — typically have a keen interest in the performance of both large bank and large independent lenders. But, larger lenders often show a lack of real interest in smaller competitors, whom they are likely to regard as "nuisances" who nibble around the edges (an unfavorable characterization of "niche" competitors).

Why Benchmark?

Lenders primarily use benchmarking as a *Diagnostic Tool* by which they can gauge their competitive performance with an eye towards identifying areas in which they are underperforming and may need to improve. Indeed, a key step in both annual strategic and operational planning is to perform a clear-eyed self-assessment — an *Annual Wellness Checkup* — designed to identify both strengths and weaknesses and provide a truer picture of how a lender is really doing. Such diagnostics typically provide the basis for strategic actions or *Prescriptions* that target areas of weakness needing remedial action or areas of strength that can be leveraged or built upon.

Second, lenders can use benchmarking results within their compensation plans. While absolute performance has its place within incentive compensation plans, basing a significant component of the incentive compensation of executives and managers on competitive performance will generally better align compensation with company goals and objectives. Benchmarked performance can also be a driver of incentive compensation for back-office fulfillment and post-closing personnel.

Third, buyers and sellers of mortgage companies will typically use benchmarking analyses as part of company valuations and due diligence. Buyers, in particular, should want valuations in which projections of future cash flow take into account competitive weaknesses, the cost of fixing various operational problems, and what operations should be continued, consolidated, or shut-down.

Sellers, too, should benchmark a potential buyer. They should understand what they're getting themselves into, especially when a significant portion of the sale "consideration" is structured as an earn-out or contingent payments based on future performance of the combined entities.

Potential sellers should also benchmark their performance as part of a periodic *Wellness Checkup* that includes both an assessment of their fair-market value and a consideration of what improvements or upgrades they should be making to better position themselves to attract more buyers and a higher price. In this regard, STRATMOR has advised many sell-side clients to hold off putting themselves up for sale until they have "fixed" operating areas in which they are underperforming.

More generally, we believe that an annual valuation based in part on annual benchmarking analyses should be a standard component of every lender's financial management. While it's fine to measure profits, we think it's even more important to assess by how much the value of a lender has increased or decreased in relation to competitors.

Apples Versus Oranges

Perhaps the biggest challenge in benchmarking analysis is to make the right inferences from performance differences. Too often a lender, or, in the case of bank-affiliated lenders its parent bank, will draw the wrong conclusions from benchmarking results. What may seem to be a fair comparison between a lender and its peers may really be a comparison between apples and oranges.

Lenders face a myriad of choices in how they position themselves in the market, and each of these decisions will affect growth, profitability, and returns. For example, assume that retail Lender A is materially less profitable than Lender B. The natural tendency is to assume that Lender A is a weaker performer than Lender B. But what if Lender A operates in low-loan-balance markets? To compensate for low-balance loans, Lender A will undoubtedly need to institute loan-level price premiums so as to increase absolute revenues. However, Fair Lending and HPML considerations may limit the degree to which such pricing premiums can cover origination costs and generate superior or even average margins. To accomplish that, Lender A will typically have to achieve significantly lower end-to-end origination cost per loan (in dollars) than its peers.

But even low origination costs may not be enough for Lender A to achieve even average margins. The reality of the situation is that Lender A might just have to live with lower margins and returns than its peers unless it is prepared to implement major strategic changes. Were Lender A an independent, for example, it could, among other strategies, consider transitioning out of or beyond low-loan-balance markets into markets with higher average loan balances. But, if Lender A is affiliated with a bank that simply wants to serve consumers within its footprint, Lender A may have little choice but to stay where it is.

As another example, assume that: Lender A and Lender B operate consumer-direct platforms; that Lender A does not service loans but Lender B does;

and that Lender B originated a substantial volume of HARP refinances. Would it surprise anyone if Lender B's production margins were much higher than Lender A's? Of course not! We all know that HARP servicers had a virtual lock on HARP refinances that allowed them to charge-up for such refinancing, thereby producing very high revenues and margins for HARP loans.

Finally, consider a situation where Lender A has higher origination costs and lower back-office productivity, but superior cycle times, e.g., average application-to-closing times, and higher borrower-satisfaction scores. Perhaps Lender A's strategy is to trade-off higher productivity and lower origination costs against the benefits of more satisfied customers — more referrals, more favorable comments on social media and higher retention rates existing customers.

Generally, as a consequence of the CFPB's focus on the borrower's experience, more lenders are interested in measuring borrower satisfaction as part of their performance and value proposition to consumers. While loan products may be commodities, the experience of getting a loan is decidedly not a commodity. But to do this, lenders need tools for both measuring and benchmarking borrower satisfaction along with the analytics that allows them to gauge how satisfaction affects the trade-off between price and origination volume. In this regard, STRATMOR's MortgageSAT borrower satisfaction tool represents a major step forward.

An interesting real-world example that comes to mind here involved a lender that purposely positioned itself as the lender of choice for purchase borrowers who needed a quick closing. For this lender, because it staffed up its back office for quick turn-times, fulfillment productivity was competitively low, which resulted in higher fulfillment costs. But these higher costs were easily covered by the higher prices this lender could charge borrowers who needed a quick closing. And real estate agents within this lender's served markets would frequently refer their buy-side clients to them when a quick fulfillment was needed to meet the closing date of the purchase and sale agreement on the house. Basically, this lender carved-out a unique value proposition: higher-prices in exchange for reliably quick closings of purchase loans.

Conclusions

In conclusion, the obvious take-away here is that high-level benchmarking results need to be interpreted with a keen eye for the larger picture of factors that drive individual lender results: strategy, markets, product, borrower satisfaction, pricing, risk-tolerance, technology, capital, etc.

Metaphorically speaking, every lender is dealt a hand that they then play out with more or less skill. The "art" in managing by the numbers is to understand both the hand you've been dealt, and the best way to play it.

LEARN MORE

To contact Matt Lind for more information, click here.

HOW DOES YOUR SALESFORCE COMPARE?

Insights from the ORIGINATOR CENSUS SURVEY

The STRATMOR Originator Census Survey is a unique survey that allows lenders to gain valuable insights into the makeup of their sales force and how it compares to peer lenders.

The participant report includes 15+ pages of individualzed results, including:

- **Productivity in units and dollars**
- **Age of Originator**
- **Turnover by Quintile, Age and Tenure**
- **Tenure**
- **Ethnicity**
- **Classification**

The more you can understand and measure the key attributes of your sales force, the better you will be able to proactively manage them. This, more than anything else, will improve the franchise value of your company.

The 2015 results include input from 40 lenders — 23 Independents and 17 Bank Owned/Affiliated mortgage companies. They range in size from under $500 Million in annual production to over $10 Billion. The sample includes results from 16,766 Retail Originators. What follows is an excerpt of the wider data set.

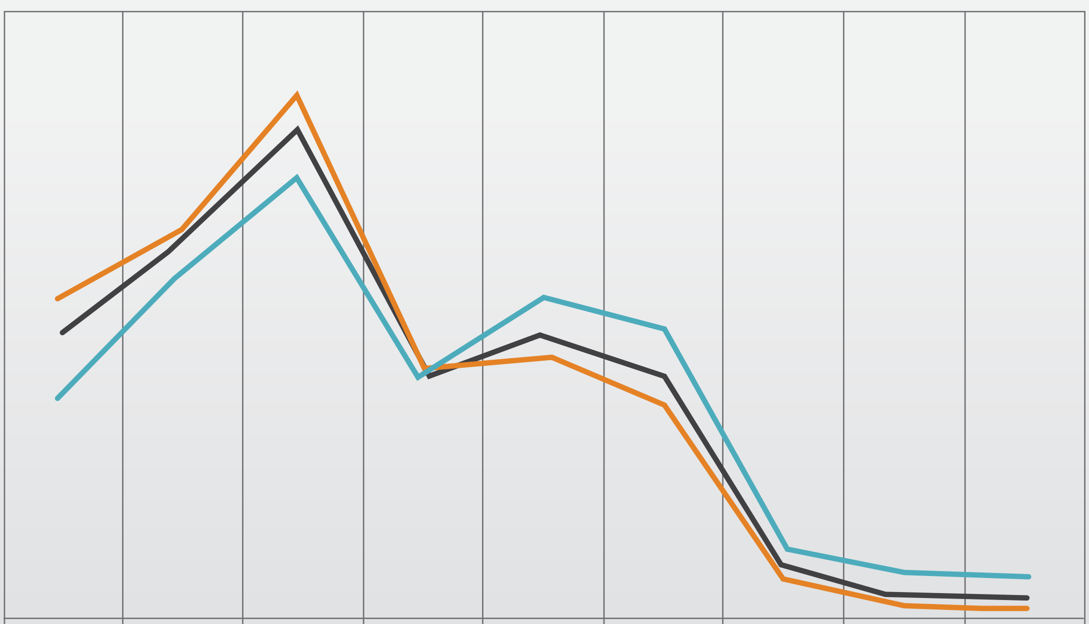
Excerpts From the Survey Results

Q **What is the average tenure of an Originator?**

A **Our survey collects tenure information for Originators at their current company and not tenure within the mortgage banking industry. Based on the 2015 results:**

- **Originators had been with their current company 3.1 years.** Interestingly, the distribution is not a bell shaped curve around the mean.
- **56.9% of Originators have been with their current company for 2 years or less.**
- **The largest tenure category was between 1 and 2 years** at the current lender. While there are examples of Originators with over 20 years of tenure at their current company, they are the exception. This data underscores what any industry veteran knows: Originators like to change companies.

Originator Tenure Distribution



	Under 6 months	Between 6 months and 1 year	Between 1 and 2 years	Between 2 and 3 years	Between 3 and 5 years	Between 5 and 10 years	Between 10 and 15 years	Between 15 and 20 years	Over 20 years
Total Population	13.9%	18.5%	24.5%	12.1%	14.2%	12.1%	2.4%	1.3%	1.0%
Independents	15.7%	19.4%	26.0%	12.2%	13.1%	10.7%	1.8%	0.7%	0.4%
Banks	11.0%	16.9%	22.0%	11.8%	16.0%	16.0%	3.5%	2.3%	1.9%

Q **How much of Originator turnover is voluntary versus company initiated?**

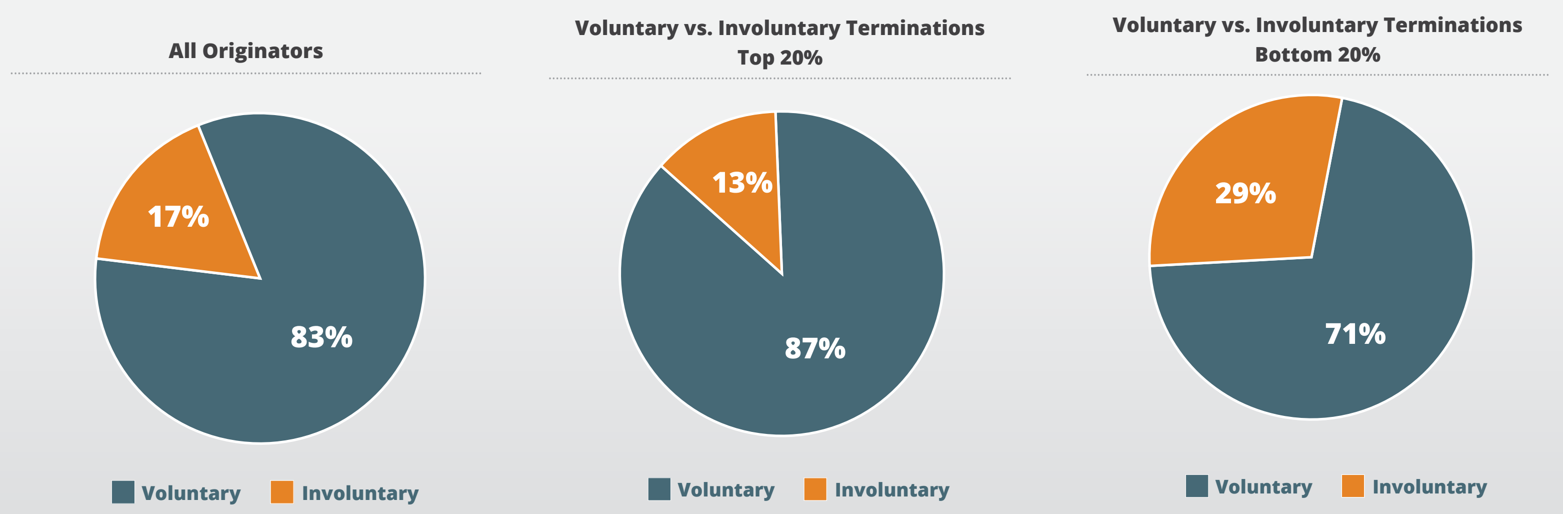
A **With the advent of new compensation rules, lenders have increased their focus on Sales Management. Because many originators are subject to minimum wage regulations, companies incur real costs for non-producing sales people.**

Given these increased negative financial ramifications of carrying non-producing Originators, STRATMOR expected that the rate of company initiated or involuntary turnover would be higher among lower productivity producers as companies aggressively manage out these non-producers.

Looking across all Originators (see the chart below), we see that voluntary terminations constituted 83.3% of all terminations with involuntary terminations making up the remaining 16.7%.

If we dive deeper into the data, it shows that Originators in the top 20% of producers of their company have a higher rate of voluntary turnover of approximately 87%. If we look to the bottom quintile, we see that voluntary turnover drops to 71%.

These results suggest that lenders are managing out the non-producers; but it appears that these Originators also largely self-select out. While the data shows that there is some self-regulation of Originators, lenders have an opportunity to better manage their costs by more aggressively terminating non-producers.



PARTICPATE

The *2017 Originator Census*, which covers 2016 results, is now open for registration. If you're interested in learning more about the survey or would like to participate, click here.

SEASONED LOAN ORIGINATOR RECRUITMENT INSIGHTS

In a slower-growth mortgage industry, a key strategy for growing origination volume and market share is to recruit seasoned originators and, where possible, whole branches from competitors while, at the same, retaining productive originators. This month's In The Spotlight focuses on select results regarding the recruitment of seasoned LOs only.

ABOUT THE SURVEY

The STRATMOR *Spotlight Survey* addressing how lenders were recruiting LOs (both seasoned LOs and rookies) and Branch Managers was conducted in September of 2016. Seventy two (72) lenders, consisting of 40 Independents (including Builder/Realtor lenders) and 32 Banks (including Credit Unions), participated in the survey.

In The Spotlight

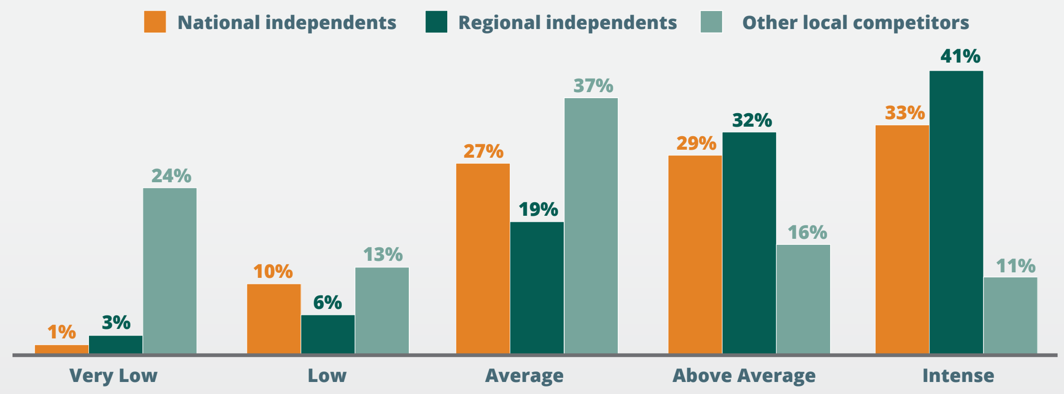
SEASONED LOAN ORIGINATOR RECRUITMENT INSIGHTS

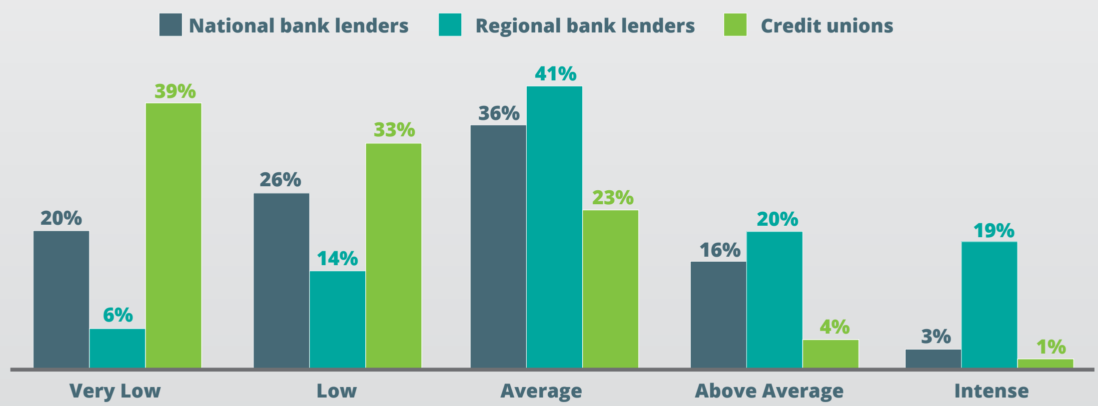
The following are select results from the STRATMOR *Spotlight Survey* about how lenders are recruiting Loan Originators.

Q **In competing to attract or retain seasoned Originators, how intense is the competition you experience with various lender segments?**

A **The most intense competition is seen coming from regional and national independent lenders.**

- 71% of respondents rated Regional Independents as either above average (32%) or intense (31%) competitors.
- For national independents, 62% of respondents rated them as either above average (29%) or intense (33%) competitors.
- By comparison, banks and credit unions were not frequently viewed as either above average or intense competitors.





STRATMOR believes that this result reflects the focus of Independents on highly-prized "Hunter" LOs versus the focus of Banks on "Gatherer" LOs who can feed-off of Bank referrals.

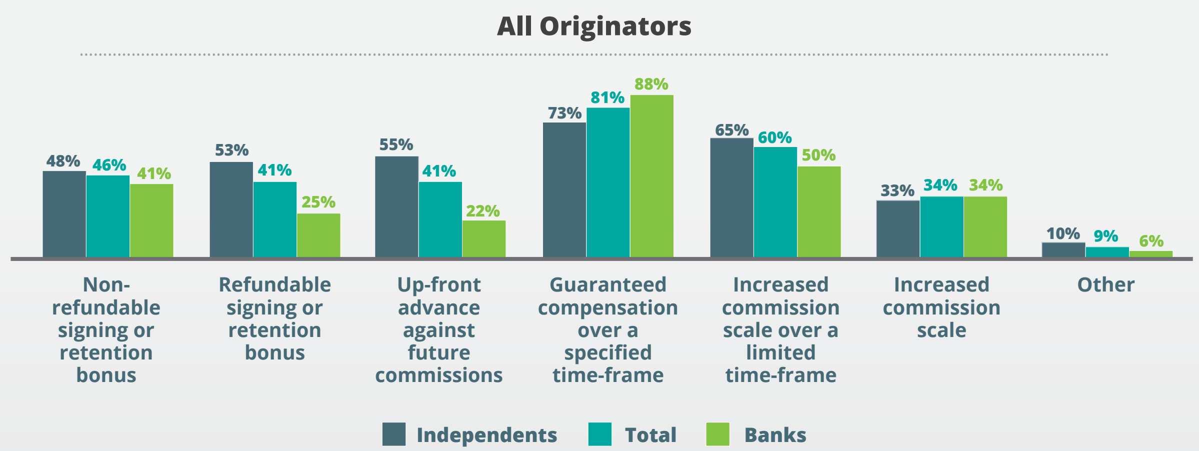
In The Spotlight

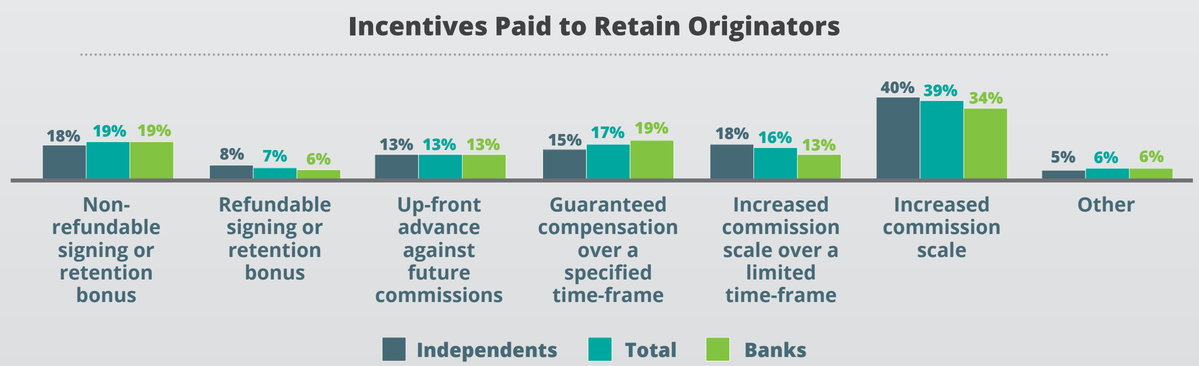
SEASONED LOAN ORIGINATOR RECRUITMENT INSIGHTS

Q **During the past 12 months, what recruitment incentives did your firm use to recruit and retain seasoned Originators?**

A **Banks and Independents are more likely to pay incentives to recruit seasoned LOs than they are to retain LOs.**

- We attribute this to the asymmetry that exists between recruiting and retaining LOs. In the former case, the lender must typically replace lost pipelines and overcome the inertia and risk-aversion that LOs exhibit at the prospect of changing lenders.
- In recruiting seasoned LOs, lenders focus on guarantees and increased commissions over a limited time frame which incentivize LOs to come-over, but does not commit them to higher compensation long-term.
- While lenders use a variety of incentives to retain LOs, they favor increasing commissions, which can be offered to LOs who have proved their value.





In The Spotlight

SEASONED LOAN ORIGINATOR RECRUITMENT INSIGHTS

Q **For each type of incentive to RECRUIT originators from other lenders, how would you rate its cost-effectiveness?**

A **Key findings are that:**

- Both Banks and Independents rated increased commissions over a limited time-frame or on a permanent basis to be the most cost-effective incentives in recruiting LOs
- Non-refundable signing bonuses were rated as unattractive from a cost-effectiveness perspective by 59% of Independent lender respondents who use incentives to recruit Originators

	Banks			Independents			Total		
	Highly Unattractive / Unattractive	Attractive	Highly Attractive / More Attractive	Highly Unattractive / Unattractive	Attractive	Highly Attractive / More Attractive	Highly Unattractive / Unattractive	Attractive	Highly Attractive / More Attractive
Non-refundable signing or retention bonus	30%	26%	43%	59%	19%	22%	46%	22%	32%
Refundable signing or retention bonus	45%	25%	30%	24%	38%	38%	33%	33%	35%
Up-front advance against future comissions	43%	48%	10%	23%	42%	35%	31%	44%	25%
Guaranteed compensation over a specified time	15%	15%	70%	32%	26%	41%	25%	21%	54%
Increased commission scale over a limited time	17%	26%	57%	13%	26%	61%	15%	26%	59%
Increased commission scale	14%	33%	52%	30%	19%	51%	23%	25%	52%
Other	0%	33%	67%	33%	0%	67%	17%	17%	67%

Q

For each type of incentive to RETAIN seasoned originators, how would you rate its cost-effectiveness?

A

As evidenced by the number of responders, relatively few lenders – and especially Banks – use incentives to retain versus recruit seasoned LOs.

- However, for those that do use retention incentives, the methods judged to be most cost-effective were Increased Commissions on either a permanent basis or over a limited time-frame.
- Retention bonuses or guarantees were not viewed favorably, likely because they do not incent higher performance.

	Banks			Independents			Total		
	Highly Unattractive / Unattractive	Attractive	Highly Attractive / More Attractive	Highly Unattractive / Unattractive	Attractive	Highly Attractive / More Attractive	Highly Unattractive / Unattractive	Attractive	Highly Attractive / More Attractive
Non-refundable signing or retention bonus	56%	22%	22%	64%	0%	36%	60%	10%	30%
Refundable signing or retention bonus	63%	25%	13%	40%	20%	40%	50%	22%	28%
Up-front advance against future comissions	44%	44%	11%	30%	40%	30%	37%	42%	21%
Guaranteed compensation over a specified time	36%	27%	36%	23%	46%	31%	29%	38%	33%
Increased commission scale over a limited time	20%	40%	40%	7%	29%	64%	13%	33%	54%
Increased commission scale	9%	36%	55%	18%	18%	65%	14%	25%	61%
Other	50%	0%	50%	0%	0%	100%	33%	0%	67%

Find Out What Your Peers Are Doing About Key Industry Issues

Do you wish you could quickly find out what your peers at other lenders think about key issues and developments? And what actions they are considering, planning or have taken? If so, then you should consider participating in our STRATMOR Spotlight Surveys program, a fast turnaround, short survey program that gives senior mortgage executives a unique way to obtain the information they need to formulate effective strategy. Click here to learn more.

If you are interested in a free download of the complete Spotlight Surveys or would like to participate in the STRATMOR Spotlight Surveys program, click here. ■

Speaking Borrower Satisfaction

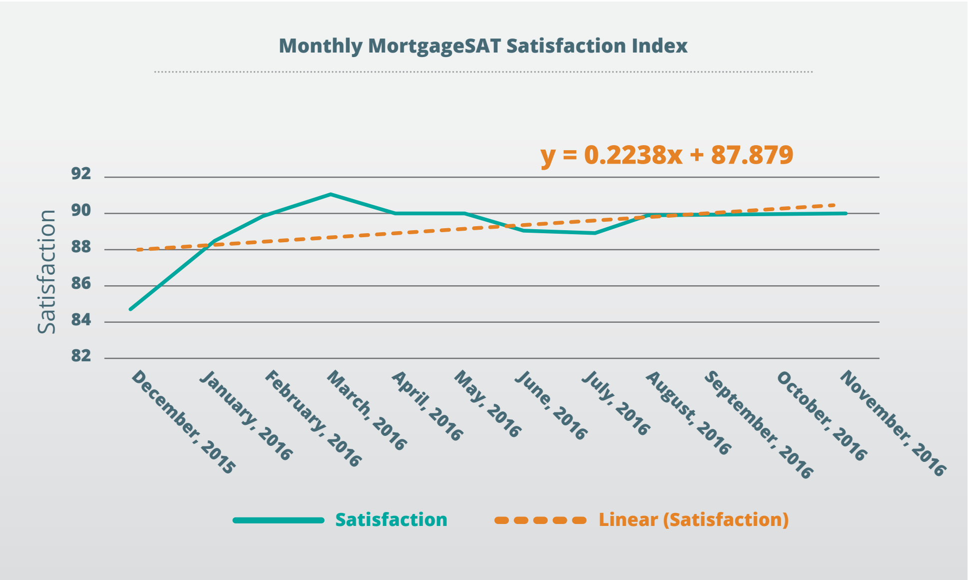
OVERVIEW

Each month's edition of *STRATMOR Insights* includes a "Speaking Borrower Satisfaction" section containing a National Borrower Satisfaction Index plus a Topic of The Month based on data collected by STRATMOR's MortgageSAT Borrower Satisfaction Program.

National Borrower Satisfaction Index

The National Borrower Satisfaction Index Chart below displays the Total Borrower Satisfaction Score for MortgageSAT participating lenders over a 12-month, look-back period — starting the look-back with the November 2016 satisfaction score for this January 2017 edition of STRATMOR Insights.

The Index Chart also includes a best-fit linear trend line along with the equation for that line. For example, in the chart below, we see from the equation defining the orange dashed line of best fit, that from November 2015 through October 2016, the borrower satisfaction score has on-average increased by 0.2832 points per month.



Total Borrower Satisfaction Remained Steady

Total Borrower Satisfaction, which peaked at 91 points in March and then declined to 89 in June and July, increased to 90 in August and has remained at this level ever since. As we have consistently observed, it is remarkable that MortgageSAT lenders have been able to sustain a borrower satisfaction score of 90 since August 2016 insofar as origination volumes in the third and fourth quarters of 2016 were 56% and 34% higher respectively than during the first.

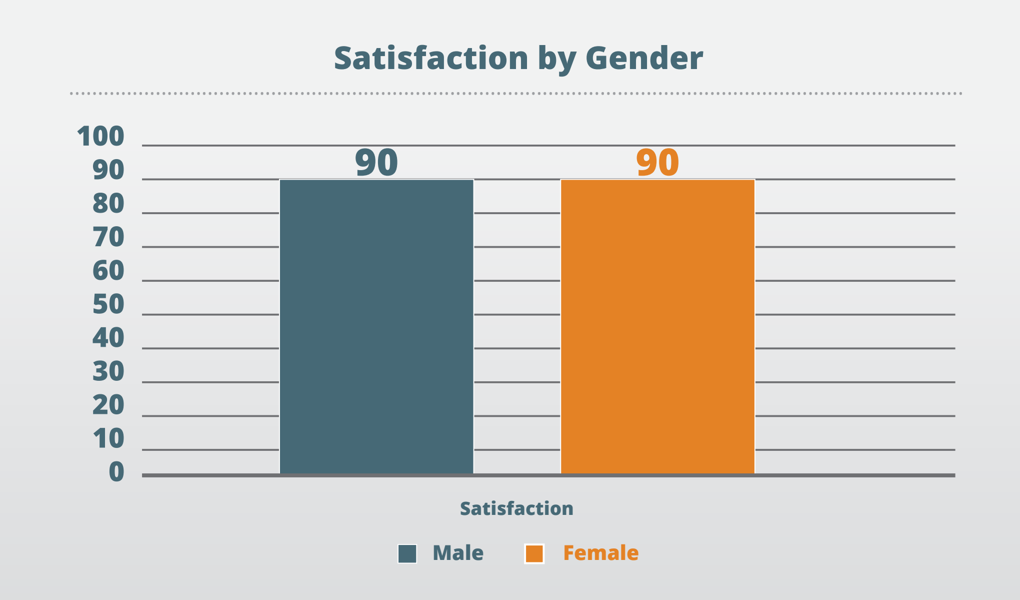
Speaking Borrower Satisfaction

TOPIC OF THE MONTH: ARE ALL BORROWERS TREATED THE SAME?

From time to time, the mortgage industry is subject to charges of bias; by gender, ethnicity, age and other borrower characteristics that should have nothing to do with the origination process.

Of course, many of these charges are made with respect to underwriting practices — whether a loan is approved or not. But there are also claims that the borrowing experience varies by borrower characteristics. Are such claims true? Does the data lend support to such claims?

The MortgageSAT borrower satisfaction data tells us about the borrowing experience of borrowers whose loans have closed. It does not tell us about the experience of borrowers whose applications were rejected or who dropped out after their loans were approved because of how they were treated. So, in that sense, we would expect MortgageSAT data to exhibit an upward bias. Nonetheless, it is not unreasonable to ask whether the borrowing experience among borrowers whose loan closed shows bias.



Satisfaction By Gender

Do men and women have a different borrowing experience? Across the almost 100 thousand borrowers surveyed by MortgageSAT during 2016, two-thirds of whom were men, one-third women, at a score of 90 (the overall satisfaction average score), satisfaction by gender was virtually identical.

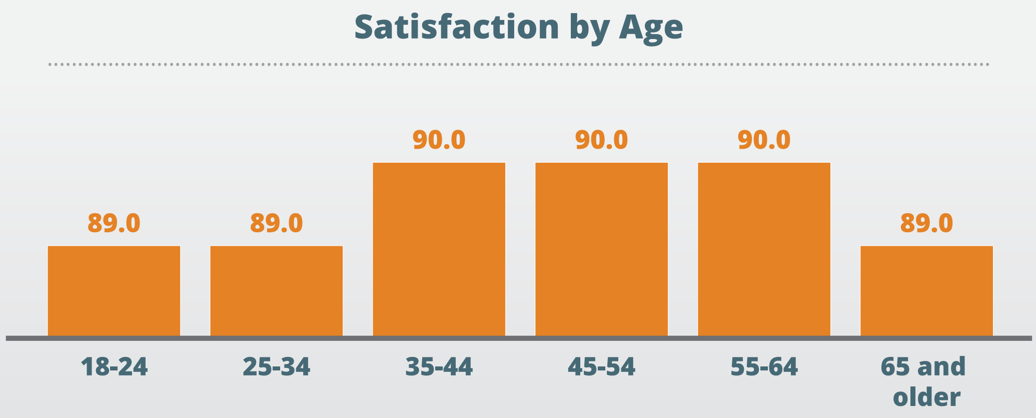
Speaking Borrower Satisfaction

TOPIC OF THE MONTH: ARE ALL BORROWERS TREATED THE SAME?

STRATMOR **INSIGHTS**

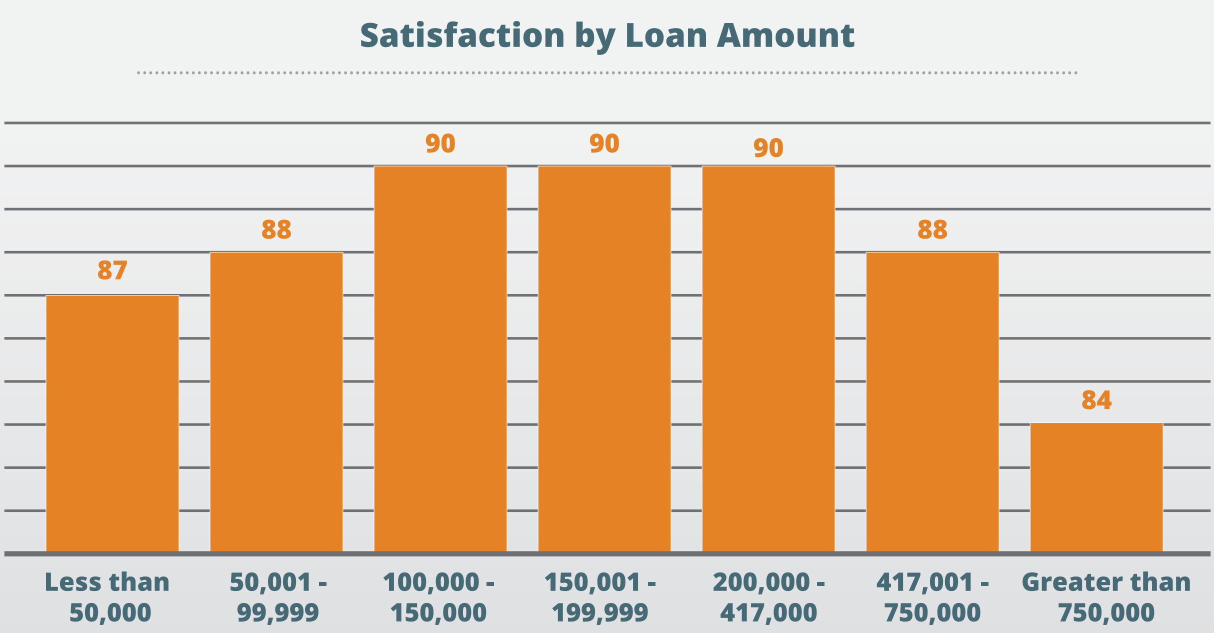
Satisfaction By Age

Are there material differences in satisfaction across different age groups? In the chart below, we see a one-point satisfaction difference, 90 versus 89, between younger or older borrowers and borrowers in the prime home-buying age groups.



Satisfaction By Loan Amount

Does the size of a loan make a difference? After all, smaller loans typically require just as much effort — perhaps even more effort — on the part of the loan officer and back office personnel as a large loan for arguably a lower loan officer commission.



Here, with reference to the chart above, we see that satisfaction among borrowers seeking smaller loans is up to three points less than the overall national satisfaction average (87 vs. 90).

Does this point difference reflect bias? It may reflect bias based on loan attributes and not on borrower characteristics, e.g., age, gender, ethnicity. Busy loan officers strapped for time may pay more attention to loans that pay a higher commission (note: most lenders have minimum commissions so as to reduce the commission differential between small and large-balance loans).

Also of note, satisfaction is also lower for large balance loans, especially for loans with balances above $750 thousand, for which satisfaction drops to a score of 84. In this instance, borrowers seeking large balance loans — typically higher income borrowers — may have higher expectations.

Speaking Borrower Satisfaction

TOPIC OF THE MONTH: ARE ALL BORROWERS TREATED THE SAME?

Satisfaction By Income

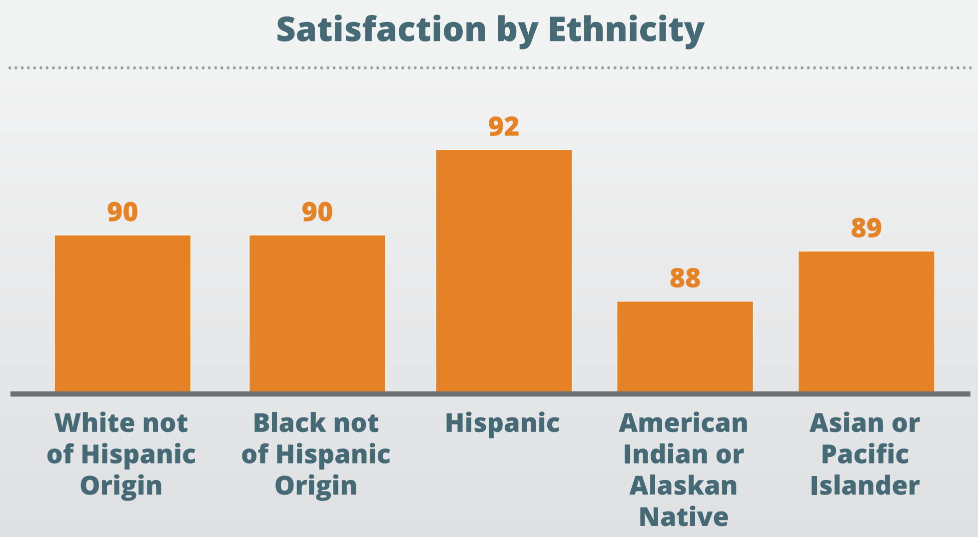
The survey indicates that borrower satisfaction decreases as the borrower's monthly income increases.

Speaking Borrower Satisfaction

TOPIC OF THE MONTH: ARE ALL BORROWERS TREATED THE SAME?

Satisfaction By Ethnicity

When we speak of bias in lending, the discussion often focuses on ethnicity. Our survey indicates a four point difference between the highest and lowest satisfaction scores by ethnic group. Hispanic borrowers rated their experience highest overall, at 92.



Conclusion

Overall, the closed loan MortgageSAT satisfaction data indicates the mortgage industry is meeting borrowers satisfaction expectations at near equal rates across age, gender income and ethnicity characteristics. We would caution, however, that the data does not consider the treatment of borrowers whose approved loans failed to close or whose applications were rejected.

If you are interested in learning more about STRATMOR's *MortgageSAT Borrower Satisfaction Program*, click here. Or to reach out directly to Mike Seminari, Director of MortgageSAT, at 614.284.4030 or mike.seminari@stratmorgroup.com

STRATMOR **INSIGHTS**

GET THE **DATA-DRIVEN** ADVANTAGE

STRATMOR Group offers a suite of data products and mortgage advisory services to power your performance.

SURVEYS

We invite you to download survey results or learn more about open surveys.

SPOTLIGHT SURVEYS

Download Free Spotlight Survey Results

CLICK HERE