STRATMOR GROUP

FEATURING

THE SEARCH FOR BELIEVABLE LOS RETURNS

STRATMOR *INSIGHTS*

Volume 1, Issue 3
September, 2016

WELCOME

Welcome to this third issue of *STRATMOR Insights*, a free monthly Report from STRATMOR Group that will provide you with interesting, data-driven articles that deliver select results and insights from our mortgage industry surveys, programs and consulting experience.

Our featured In-Focus article, written by Senior Partner, Len Tichy, head of our IT and Operations Advisory Services, addresses the failure of our industry to develop a credible methodology for measuring the return on investment for LOS systems. Fortunately, Len goes on to lay out a new and innovative "LOS Shootout" approach for doing this and invites interested lenders to participate in its development.

Our "Mortgage Metrics Matter" section takes a look at LO Compensation plans using data from our Compensation Connection Survey program. You may be surprised by how differently Bank and Independent lenders compensate their LOs.

"In The Spotlight" highlights some of the key findings coming out of our recent LO Hiring Insights survey, including what methods are most effective at recruiting retail LOs, the primary sources targeted and which sources are best at producing successful LOs.

And finally, in "Speaking Borrower Satisfaction," our Topic of the Month presents and discusses 2016 MortgageSAT data regarding why borrowers choose a lender and what reasons are associated with high borrower satisfaction. Very interesting!

All of us at STRATMOR hope that STRATMOR Insights is becoming a monthly staple of what you read to keep up with the mortgage industry. In this regard, your feedback is more than welcome.

Lisa Springer, CEO

MBA ANNUAL 2016

STRATMOR will be attending the MBA's Annual Convention and Expo 2016 in Boston over October 23rd through the 26th. This represents a great opportunity for executives to individually meet with us to discuss specific needs and concerns or to simply learn more about our offerings. At past conventions, available time slots have filled up quickly so contact us early and schedule time with our team.

Meet with STRATMOR

STRATMOR
INSIGHTS

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STRATMOR INSIGHTS

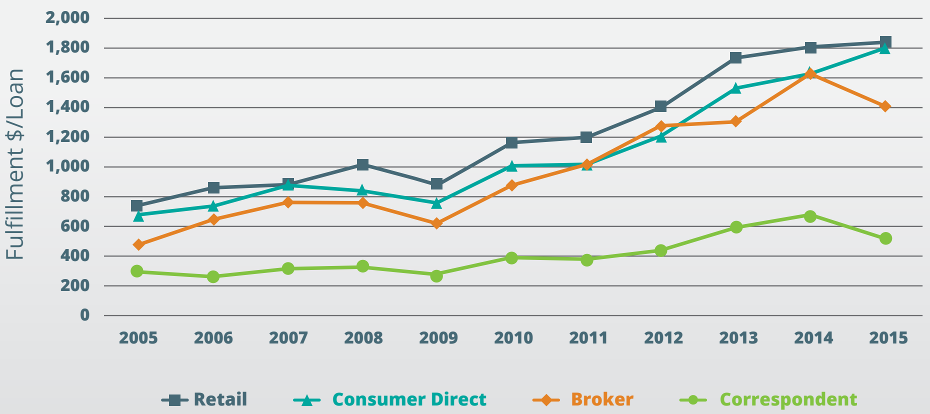
THE SEARCH FOR BELIEVABLE LOS RETURNS

By Len Tichy

In the recent Mortgage Banking Magazine article, *LOS—Through the Lender's Looking-Glass* (June 2016), I noted that from 2005 to 2015 lenders' costs per loan doubled and productivity roughly halved. The increase in fulfillment costs was even worse. Not surprisingly, frustrated lenders seeking to lower costs and increase productivity constantly ask STRATMOR to point them to the LOS solutions that will deliver the best measurable benefits based on our independent analysis of actual historical performance.

Fulfillment Costs by Channel from 2005 to 2015

The chart below displays historical data for fulfillment costs by channel during the past 11 years – ugly statistics that every mortgage executive knows need to be reversed.



Source: PGR: MBA and STRATMOR Peer Group Roundtable Program

- **Retail Lending:** the cost/loan in 2015 was *2.5 times* the cost in 2005
- **Consumer Direct:** the cost/loan in 2015 was *2.66 times* the cost in 2005
- **Correspondent Lending:** the cost/loan in 2015 was *1.82 times* the cost in 2005
- **Broker Lending:** the cost/loan in 2015 was a whopping factor of 3*.02 times* the cost in 2005

What STRATMOR Knows About Measuring ROI for LOS Systems

Lenders are calling on STRATMOR to measure the Return on Investment (ROI) from commercial-off-the-shelf LOS implementations, a call that is growing louder and more frequent. While we cannot measure true ROI from LOS implementations, we can provide our lender clients with forecasted, lender-specific *Total Cost of Ownership* (TCO). These metrics span a comprehensive range of cost inputs, such as per loan subscription fees for hosted solutions, annual maintenance fees if applicable, the cost for selected 3rd party component services, estimated professional services fees for custom development and implementation, and more.

We found that there are too many variables involved to offer credible evidence proving that one LOS has outperformed another for lenders. Even with a defined set of common characteristics over a specified time span, we cannot make a definitive assertion that the *SuperMortgageMaker* LOS made the difference between the P&L performance of Lender A and Lender B. Isolating a single stage of the production process (such as processing, underwriting or closing) does not improve our ability to offer real proof that one LOS has outperformed another in completing all the required tasks.

STRATMOR offers operational cost and productivity benchmarks for comparing lenders with certain characteristics, but we cannot prove how much the LOS systems are responsible for notable differences in each respective company's back office costs and productivity. Many other factors are in play, such as process flows, back office personnel training, incentive compensation, loan mix, etc.

As a result, this article looks at the challenges of creating a practical and believable ROI measurement methodology that lenders can use to support their enterprise LOS decisions. At STRATMOR, we are facing these challenges head-on as we develop a new approach to evaluating and comparing LOS systems in the future.

Challenges of Measuring ROI for LOS Systems

Today, when it comes to attributing measurable benefits to a given LOS, we can only report what lenders subjectively think the reasons are for their performance – end-to-end or in any given stage in the lifecycle of a loan – mainly for three reasons:

- **THE HUMAN FACTOR:** One is that human performance and the process design elements are so tightly coupled with the system that the LOS cannot be objectively isolated as the root cause of the lender's performance outcomes.
- **PROCESS VARIATIONS:** Another is that there is too much variation among lenders' definitions of the tasks assigned to a particular domain, such as "processing" or "post-closing" which undermines the applicability of conclusions taken from ROI studies.
- **IMPLEMENTATION QUALITY:** Yet another complication is that when looking at the ROI claims of an end-to-end LOS solution, the system itself, designed and produced by the vendor as an out of the box technology product, may simply have been implemented very well or very badly by the lender's own internal IT staff – i.e., great execution vs. self-inflicted wounds. Not the software product per se.

When ROI analysis is more narrowly focused on a very small subset of defined tasks, such as condition-clearing by an underwriter, the key problem becomes one of standardizing the measurement technique. Otherwise, the published analysis may be too easily dismissed as having simply shifted tasks to some other domain or process flow, giving the false impression that performance has improved in the process under examination.

Another challenge in measuring the ROI contributed by a discrete subset of tasks is establishing an accurate baseline. The lender who wants to compare current system-driven performance against that of a contemplated LOS replacement for a small subset of tasks, should consider the following important questions:

- **How do we control the variables tightly enough to insure accurate comparison to our current state?**
- **Is anyone offering a standardized, formulaic approach that any lender can apply under their own steam and evaluate in the privacy of their own shop?**
- **Has anyone established a set of performance baselines against which lenders can evaluate the claims of vendors who would sell them a "better" solution?**

Addressing these questions during the evaluation will help establish controls and baselines to support the LOS performance measurement.

Announcing STRATMOR's 2017 LOS Independent ROI Study: *An Independent Attempt to Create Standard, Repeatable Measures*

In 2017, STRATMOR will launch an independent ROI study to develop a standardized LOS comparison methodology and invite interested lenders to participate. The core challenge we see in developing a "bankable" methodology will be to make it objective and empirically believable to seasoned mortgage industry professionals who, from past disappointing experiences, have become highly skeptical of hyperbolic LOS vendor cost/benefit claims.

Our target audience for participation is comprised of mortgage bankers who are betting the farm on their LOS replacement decisions – savvy professionals who will quickly smell a phony or sophomoric ROI analysis a mile away and will dismiss it out of hand at the first assumption that rings hollow.

But even if an LOS ROI study appears to be theoretically and empirically sound, if it cannot be easily and credibly compared to a given lender's unique business situation and, more importantly, cannot be repeatedly simulated by the lender in a practical, hands-on setting, then the findings of such studies remain too tenuous to be trusted as a key driver of an LOS purchase decision.

From STRATMOR's perspective, these types of performance-driven ROI studies and their published whitepaper summaries in the past have failed the credibility test due to the following:

- **The research is typically *not* conducted by objective, third-party experts who have "no skin in the game" and/or a sophisticated understanding of the mortgage origination field of play.**
- **Testing protocols have not been easily repeatable; nor are the test scenarios and methods able to be conducted for any given lender's incumbent LOS.**
- **Findings have not been normalized to enable meaningful apples-to-apples comparisons from the lender's perspective.**
- **Reliable historical benchmarking data have not been available to validate granular productivity findings.**

As you might expect, when LOS vendors promote their own system's virtues in talking to lenders, the conversation centers around increasing revenue and lowering production costs. Studies are cited that claim X dollars in labor costs have been removed from many areas of the production process. But there is no methodology offered that the lender can self-administer to validate the ROI claims promised by vendor sales teams, or that enable the lender to compare competing LOS vendors' performance against each other, or against their own incumbent system's performance. Thus, while vendor intentions may be good, and lenders want to believe the claims, there is no reliable way to prove that any LOS delivers ROI that lenders can take to the bank.

At STRATMOR, we are convinced that some form of useful, credible, readily repeatable method for comparing LOS ROI is essential for lenders who are considering replacement of their current systems – even if it is less than perfect. We think a self-administered process can be developed that lenders can apply to their own unique situations and produce believable performance comparisons that can be translated into ROI decision support.

A Lesson From The Automobile Industry – The Auto Performance Shootout

For a peek at our envisioned STRATMOR LOS ROI analysis process, suspend disbelief for a moment and think of the LOS buyer as analogous to the high-performance luxury car buyer. You are considering buying or leasing a vehicle that is more than just basic transportation with a price tag. You are looking for performance that you can draw upon at your discretion across a wide range of driving experiences.

You can go to the dealer and take a demonstration drive, with some freedom to really exercise what the car can do if you were to take it for an invigorating spin (with helmet buckled and fireproof suit properly fitted) by yourself at, say, Laguna Seca's 2.2-mile legendary race course. Of course, in a normal

car-buying process, you can't. But if you could, you would want to put your potential new automobile purchase through its paces so as to compare it to your current car and, in an ideal world, to two or three other new replacements you are thinking about. But, to repeat, in a normal car buying process, you can't.

What you can do is obsessively read independent car magazine "performance shootout" comparisons wherein you will find performance statistics across a wide range of tests. Are the comparisons believable? For the most part, emphatically yes. Are there human factors that might skew the zero-to-sixty, or the zero-to-one-hundred-to zero numbers? Yes. But you believe them anyway because you believe that the test is impartial enough, and because each company has brought its own best "A-game" driver to the test. Or, because the magazine uses the same driver or drivers in testing each car brand, you believe the human variability effect is reasonably neutralized.

Are the cars in the performance test delivered as "stock" vehicles (as you would buy them off the showroom floor), thereby neutralizing the implementation effect on results. Yes. They are.

Lastly, are the comparisons done using standardized processes? Emphatically yes! The measurements could be easily repeated by others as reliable experiments and the results compared – though not easily by you, the consumer.

Instead, most car buyers will typically rely on promotional sales information, well-mannered test drives around the block, customer testimonials and, in terms of validating vendor claims, reading unbiased performance comparisons conducted by top drivers under rigorous process controls. These controls intentionally create a level playing field from which you can reliably infer the driving experience you can expect when you hit the freeway entrance ramp or slam the brakes to avoid hitting a child or measure your actual fuel consumption. Not a perfect solution, but one that contributes important inputs that may strongly influence your evaluation of the seller's value proposition and your own buying decision.

A New Approach to Measuring LOS Returns: *The LOS Performance Shootout*

STRATMOR proposes to apply the principles of the "automobile performance shootout" in defining criteria for testing how subject-LOS solutions (including the lender's incumbent system) perform in specific loan production scenarios. Under this approach, a lender's own operations and LOS support team resources will conduct specified time and motion measurements (a la zero-to-sixty) in a carefully prescribed LOS simulation environment that will enable apples to apples comparison between or among LOS solutions.

Our approach will be to provide three to four key task completion scenarios for each of roughly a dozen functional stages or domains in the mortgage origination sales and fulfillment loan lifecycle and subject them to rigorous time and motion measurements and tightly scripted system configuration and test loan variables. We will do the same with two to three LOS global capabilities, such as ease of use, help tools, system admin functions (such as adding a specified product, or specified set of business rules), and measuring key outputs such as reporting. In addition to productivity-focused measurements, we will also monetize the value of performance findings, applying our normalized industry benchmarking data that will allow lenders to adjust for variances in relevant labor market data.

We believe this approach will establish an objective framework for task completion performance testing that lenders can replicate internally to produce comparable data from their incumbent LOS platforms and infer their expected performance using contemplated replacements.

Applying this type of comparison will require the willing cooperation from LOS vendors – and it would not be unreasonable for them to want to charge an acceptable fee to participate – knowing that you want them to bring their A-game. But would it not be worth such a fee to cut down the risk of buying a pig in a poke based on informal testimonials and superficial demos that gloss over the details?

LOS SHOOTOUT

We invite lenders interested in participating in the development of the "LOS Performance Shootout Methodology" to contact us.

LOAN OFFICER INCENTIVE PLANS

Insights from the STRATMOR COMPENSATION CONNECTION SURVEY

Since 2010, STRATMOR's *Compensation Connection Survey* has been providing lenders with valuable insights into not only levels of cash compensation, but more importantly into how incentive plans are structured. Determining compensation amounts and structure is fundamental to ensuring that your organization hires and retains the best talent while simultaneously controlling costs and justifying compensation to your stakeholders.

The *Compensation Connection Survey* is built in modules to allow lenders to choose their level of participation. The Retail Sales module is our most popular and it covers sales positions from the Head of Production through Loan Officer Assistant. This month's analysis looks at the composition of Loan Officer Incentive Plans as well as the number of plans lenders offer. The results reflect lenders from all geographies and origination volumes.

Currently, the compensation survey modules include:

- **Executive Management**
- **Retail Sales**
- **Consumer Direct Sales**
- **TPO Sales**
- **Fulfillment (All Channels)**
- **Production Support**

Excerpts From the Survey Results

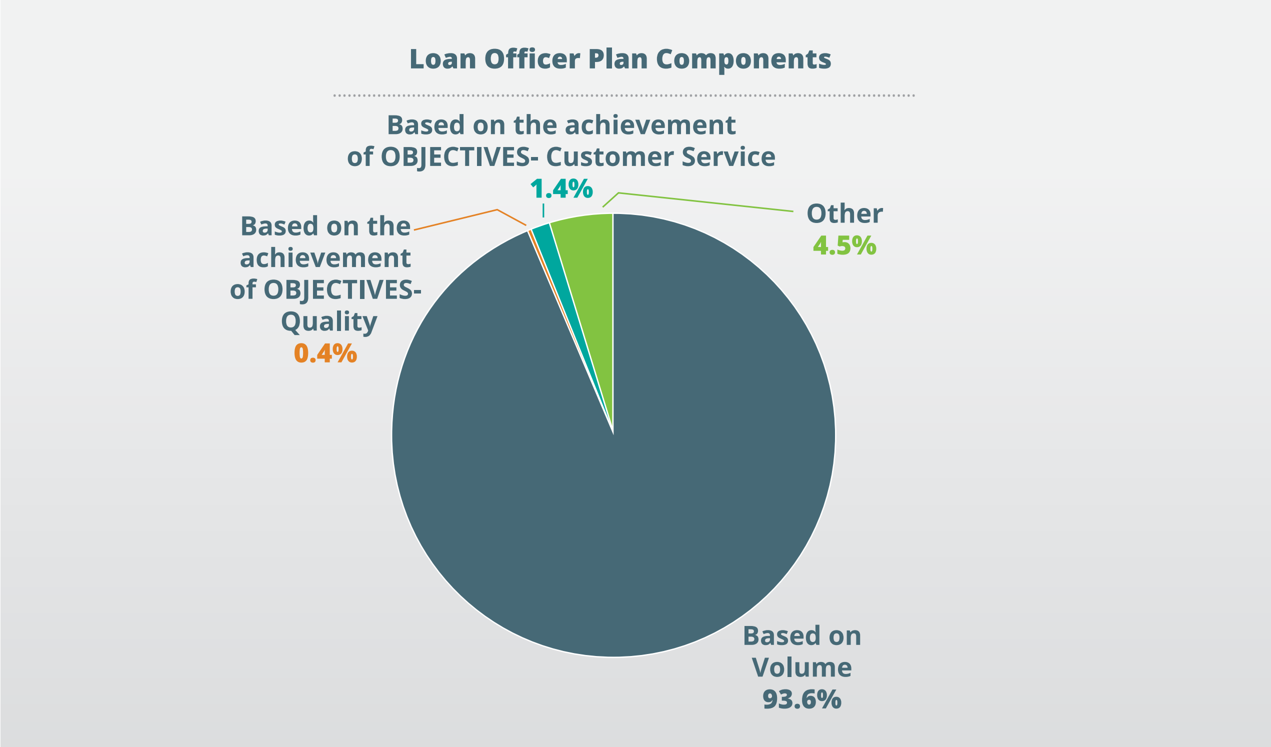
The following are the results from a few of the key questions answered by the most recent *Compensation Connection Survey*:

Q **What are the components of a Retail Loan Officer incentive plan?**

A **The survey indicated that 94% of Loan Officer incentive awards are based on *volume*.**

- **These volume incentives include tiered and flat basis points, tiered and flat dollars per loan and hybrid plans which are the best of units and dollars.**
- **While there has been increasing discussion of non-volume components, such as quality and customer service, less than 2% of incentives paid to Loan Officers in 2015 were based on these factors.**

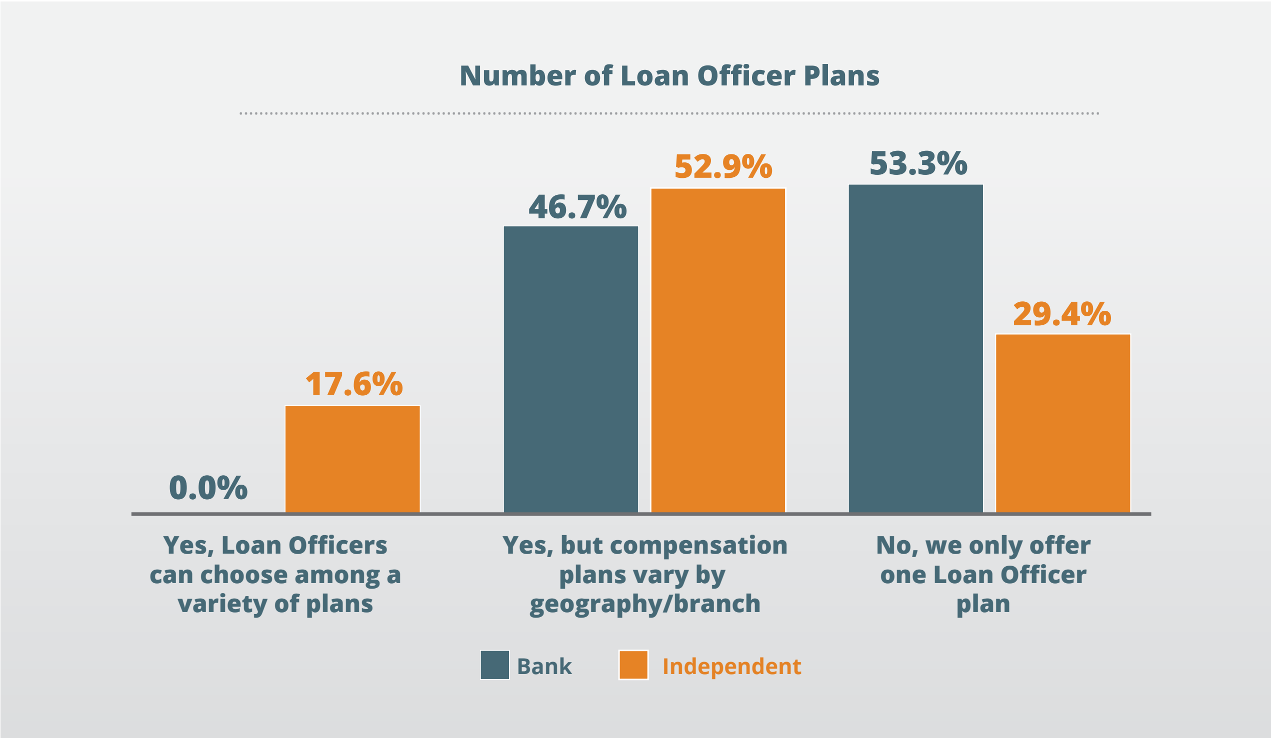
STRATMOR believes that as lenders develop, track and communicate metrics based on *non-volume* factors, these components will become a more significant portion of loan officer compensation.



Q **Do lenders offer more than one Loan Officer compensation plan?**

A **More than half of Bank participants offer a single Loan Officer plan, while only 29% of Independents have a single plan.**

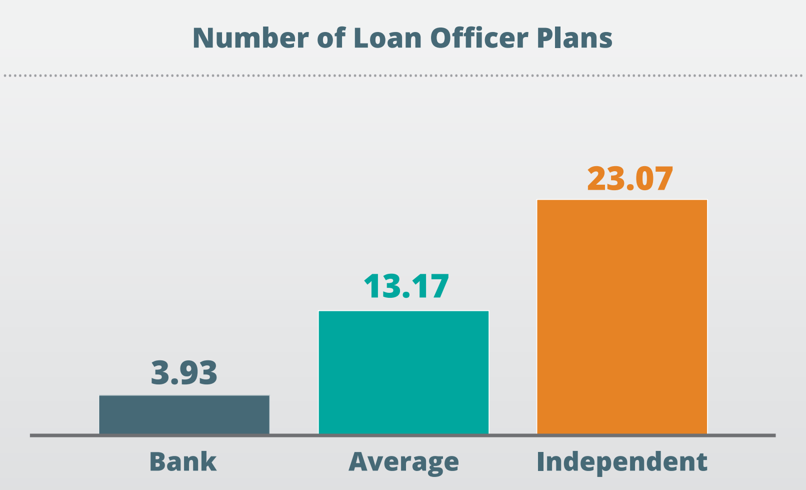
- **Among Independents, the majority of lenders offer multiple plans that vary by region, branch or other geography. Typically, in this scenario, the plans are similar but have different volume thresholds based on the average loan size of the market.**
- **None of the Banks allow their Loan Officers to choose among a variety of plans, but 18% of the Independents operate with this structure.**



Q **How many unique Loan Officer plans do lenders offer?**

A **For lenders who offer more than one plan, the average number of unique plans is 13.**

- **However, on average Banks offer 4 unique plans versus the Independents who average 23.**
- **This difference reflects the cultural differences between the two types of companies. Banks operate in a more corporate and controlled environment where plans are limited whereas the Independents are more likely to offer unique plans when recruiting branches and Loan Officers.**



PARTICPATE IN THE SURVEY NOW

The *Compensation Connection Survey* has reopened for submissions of 2015 data. If you are interested in learning more about the survey or would like to participate, click here.

LOAN OFFICER HIRING INSIGHTS SURVEY

Optimizing performance in today's mortgage marketplace requires attracting top talent. STRATMOR's *Loan Officer Hiring Insights Survey* helps lenders gain valuable insights into how their peers are attracting and recruiting talent – what methods are being used for recruitment and what is working in today's rapidly changing mortgage market.

Recruitment Strategies to Attract the Next Generation of Loan Officers

Today's mortgage loan officer must be prepared to understand and serve the next generation of borrowers – the millennial consumer – making effective recruitment a key success factor. Millennials are the most diverse and technology-savvy generation in the country. Where loan officers in the past relied on personal interaction and their willingness to meet consumers face-to-face at any time, the next generation of consumers is just as comfortable connecting with a loan officer online or via telephone.

Recruitment methods to attract and evaluate loan officers are evolving as fast as the mortgage market. The *Loan Officer Insights Survey* is designed to help provide valuable information to guide recruitment efforts for this critical position.

ABOUT THE SURVEY

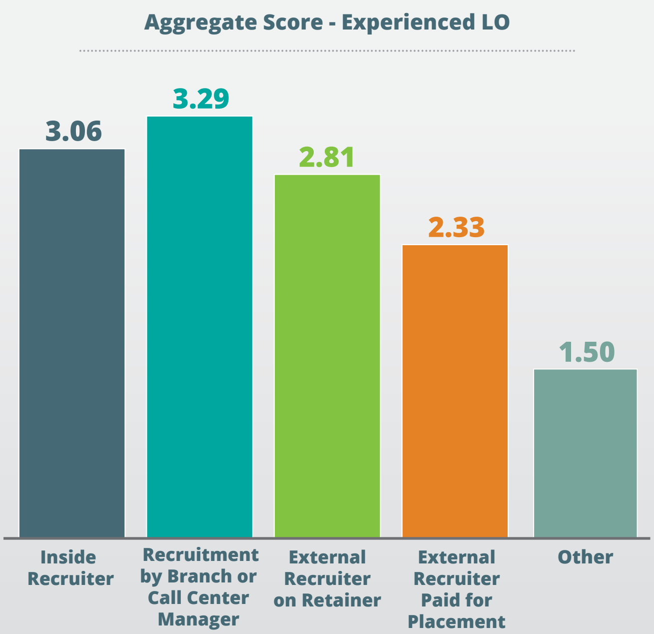
The Loan Officer Hiring Insights Survey was launched on April 15, 2016 and remained open until May 31st. Invitations were sent to 1,618 individuals representing 811 unique lenders. Responses were received from 43 unique lenders.

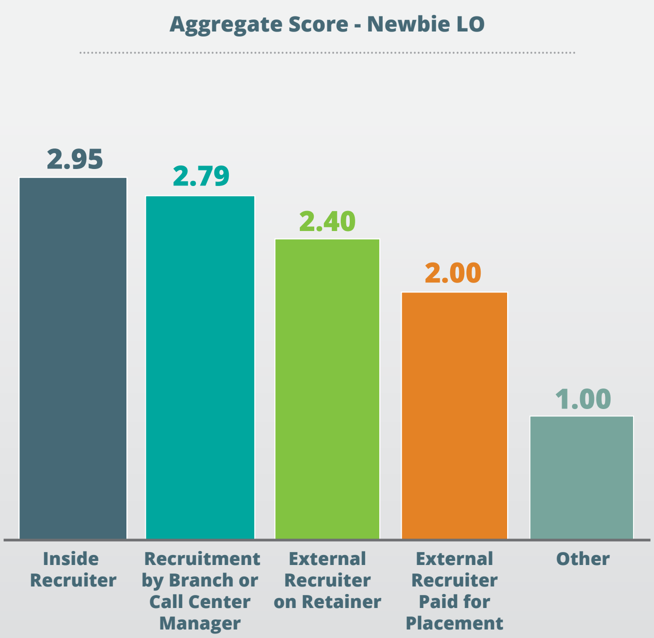
The following are select results from STRATMOR's recent *Loan Officer Hiring Insights Survey*.

Q **How would you rate each of four distinct recruitment methods (inside recruiter, recruitment by branch or call center manager, external recruiter on retainer and external recruiter paid for placement)?**

A Using a scale where 1= Very Unsuccessful and 5 = Very Successful (and therefore, any aggregate score over 3.0 would indicate an effective recruiting strategy), lenders indicated:

- Branch Managers are the most effective method for recruiting *Experienced LOs.*
- While no method for recruiting *Newbie LOs* was deemed effective, the use of Inside Recruiters scored the highest.



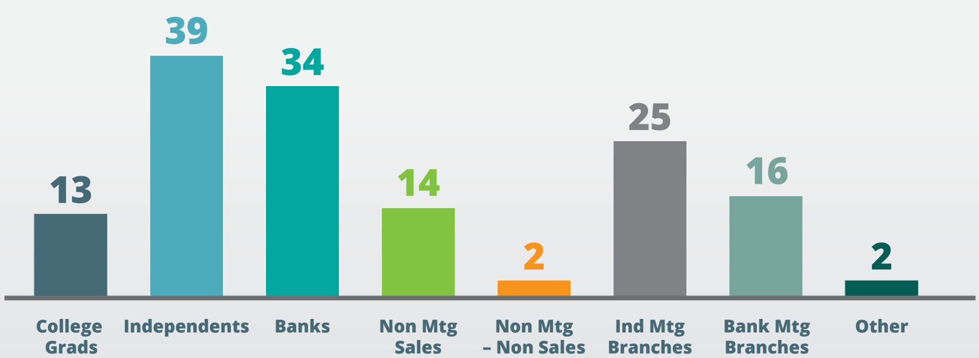


STRATMOR **INSIGHTS**

Q **Which recruitment sources of new Retail LOs does your company target?**

A **The primary source of New Originators are other mortgage companies:**

- **91% recruit Originators from Independent mortgage companies**
- **58% target entire branches**
- **79% recruit from Bank Owned mortgage companies**
- **37% recruit entire bank mortgage branches**



	College Grads	Independents	Banks	Non Mtg Sales	Non Mtg – Non Sales	Ind Mtg Branches	Bank Mtg Branches	Other
% of Total	30%	91%	79%	33%	5%	58%	37%	5%
# of Respondents	13	39	34	14	2	25	16	2

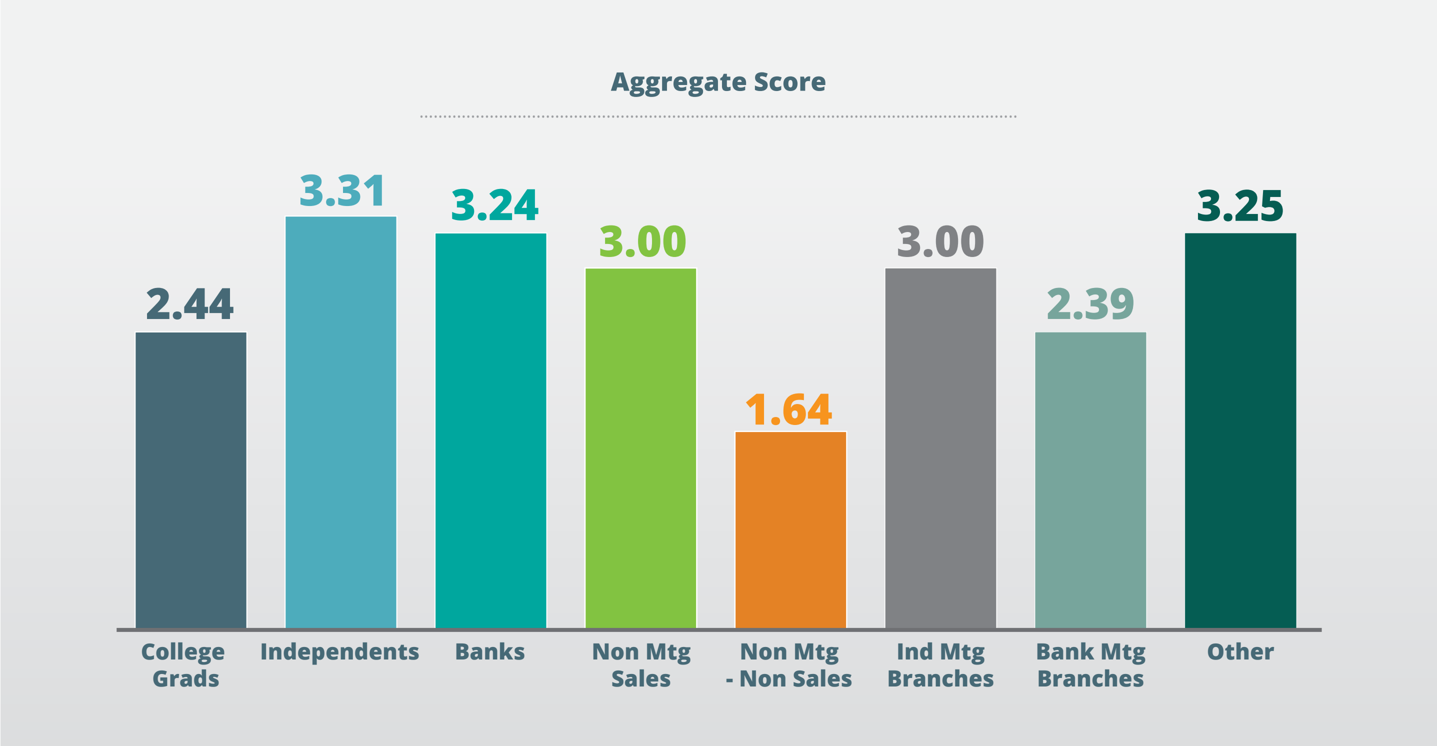
In The Spotlight

LOAN OFFICER HIRING INSIGHTS SURVEY

Q **How would you rate the recruitment sources targeted by your company in terms of producing successful Retail LOs?**

A **Using a scale where 1= Very Unsuccessful and 5 = Very Successful (and therefore, any aggregate score over 3.0 would indicate an effective recruiting strategy):**

- **Recruiting LOs from Independent or Bank Owned mortgage companies were rated the most effective.**
- **Recruiting Sales Professionals from outside the mortgage industry was also ranked as an effective source of new LOs.**



To purchase, view and download the LO *Hiring Insights Survey*, click here.

Speaking Borrower Satisfaction

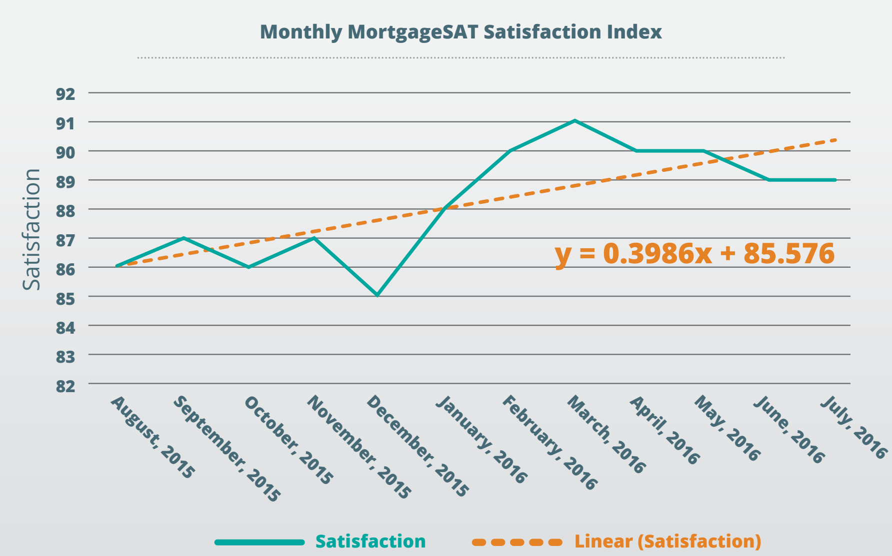
OVERVIEW

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 lookback with the July 2016 satisfaction score for this September's edition of *STRATMOR Insights*.

The chart also includes a best-fit linear trend line along with the equation for that line. So, for example, in the Chart below, we see from the equation for the orange dashed best fit linear trend line, that from August 2015 through July 2016, borrower satisfaction has on-average increased by 0.3986 points per month.



Total Borrower Satisfaction Peak

Total Borrower Satisfaction peaked at 91 in March and has since declined to 89 points, a decline we attribute to an origination volume surge of roughly 20% as the industry entered the peak origination season starting in April and running through August in a very low interest rate environment. As we noted last month, we would not be surprised to see a further decline in August as peak volumes coincide with vacations for back office fulfillment personnel.

We would again note that after remaining fairly level from June through December 2015, *borrower satisfaction rose sharply during 1Q 2016* which, as we noted in our July Insights Report, was just when the new TRID closing disclosure requirements came into effect.

Speaking Borrower Satisfaction

TOPIC OF THE MONTH: LENDER SELECTION AND SATISFACTION DRIVERS

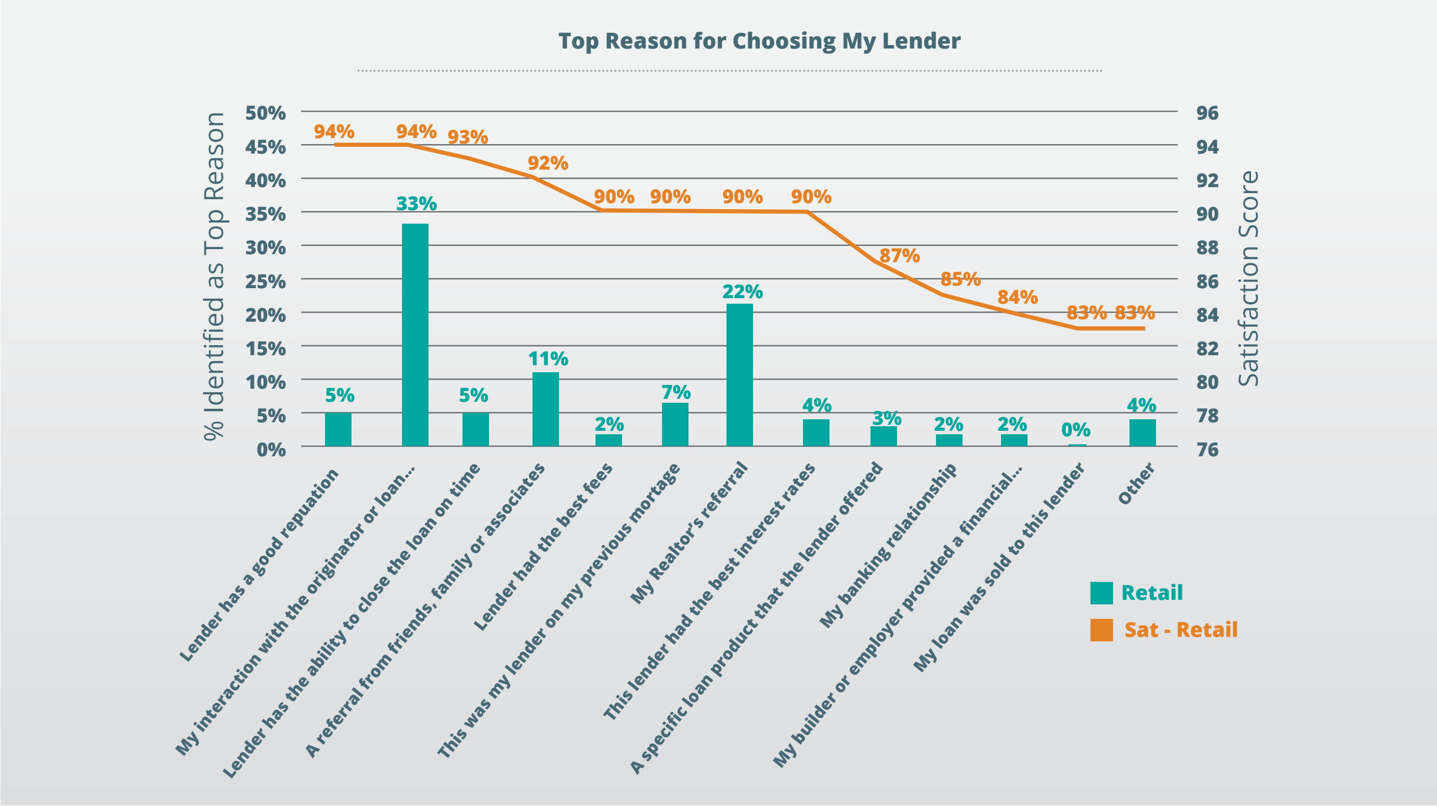
Why Borrowers Choose a Lender And What Drives Satisfaction

When selecting a mortgage lender, borrowers have a number of different factors that play into their decision. In today's competitive environment, bank loyalty is often not the key factor for borrowers in shopping for a mortgage loan. Borrowers tend to select a mortgage originator based on product, price and their expectation for a convenient transaction process.

The chart below summarizes 64,650 borrower responses to the MortgageSAT question for retail loan originations that closed during 2016 through mid-August. Responses are laid-out left to right in order of overall Satisfaction.

Q **What was the most important reason for choosing a lender?**

A **The top reason for choosing a lender, "My interaction with the originator or loan officer," was cited by 33% of borrowers and also was associated with a top satisfaction score of 94. With the exception of "My Realtor®'s referral," which was cited as a top reason by 22% of borrowers (and only applies to purchase transactions), a borrower's interaction with a loan officer was a far more important factor in choosing a lender than any other reason.**



Speaking Borrower Satisfaction

TOPIC OF THE MONTH: LENDER SELECTION AND SATISFACTION DRIVERS

STRATMOR INSIGHTS

What is unclear from the survey, however, is whether the borrower's "interaction with the loan officer" was a first-time interaction or represented a pre-existing relationship, e.g., the loan officer was a friend, a family member or the loan officer for a prior loan originated for the borrower for which the borrower sees him or herself as a customer of the loan officer as opposed to the lender.

The Originator Is the Most Important Driver of Borrower Satisfaction

The high satisfaction rating scored by borrowers who select their lender based on a positive interaction with an originator or loan officer underscores that this is a smart basis for selecting a lender.

And, since high borrower satisfaction is also linked with a high likelihood for a borrower to refer their lender to friends and relatives – the third most important reason for selecting a lender – it is clear that in recruiting, training and motivating loan originators, lenders should be striving to develop originators who can establish personal and positive interactions with prospective borrowers up-front and sustain this relationship throughout the origination process. In this regard, MortgageSAT is a tool by which lenders can directly measure and monitor how individual originators are scoring with borrowers and therefore provide constructive feedback and coaching where needed.

Lender Reputation Plays a Role

The importance of a lender's reputation, including a borrower's prior experience with the lender reputed ability to close a loan on time and referral from a friend or family, appears to account for an additional 28% of the top reasons for selecting a lender.

Fees and Interest Rates Are Not Top Factors

Also noteworthy in the above chart is the low importance that fees (2%) and interest rates (4%) have as top factors driving lender selection. To us, this underscores the fact that, despite the commodity nature of mortgage products, the experience of getting a mortgage is not a commodity and lenders can build competitive advantages by investing in people, processes and systems in ways that make for a superior borrower experience. In other words, being a "low cost producer" may not be a smart strategy if it dramatically takes away from the borrower's experience.

Relationship with the Bank Was Not a Key Driver

Finally, and quite interesting to us, is the low frequency that "My relationship with a bank" received as being the top reason (2%) for choosing a lender (even after we adjust the results for borrowers who chose a non-bank, "My relationship with a bank" rises to only about 5%). We would have thought that a banking relationship with a lender – either directly or with a parent bank – would be a reason why many prospective borrowers would turn to their bank or bank affiliated lender for a mortgage.

This result is consistent with our consulting experience that shows that banks do a relatively poor job of cross-selling mortgage to their bank customers and often do not deliver high levels of customer service from origination to closing. But the potential is there!

To learn more about STRATMOR's *MortgageSAT Borrower Satisfaction Program*, click here.