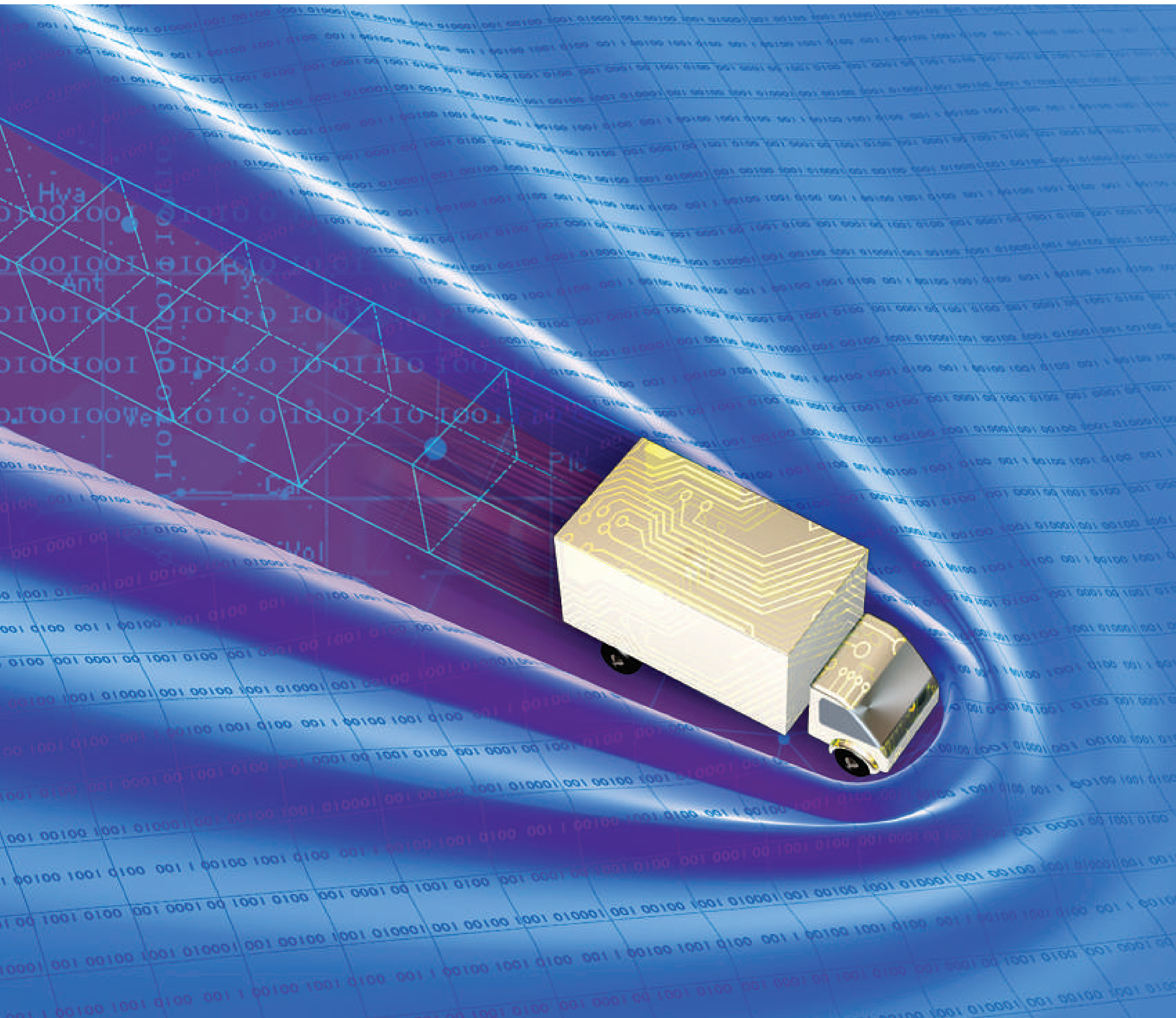
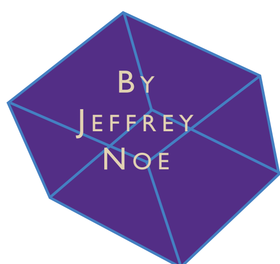
MODERN MORTGAGE



MANUFACTURING

CONSUMER PRODUCTS MANUFACTURERS AND RETAILERS HAVE BEEN working for decades to reduce production costs by proactively managing suppliers and vendors. By contrast, mortgage lenders are only beginning to understand how supply-chain and vendor-management excellence can generate higher margins, more efficient customer service and faster growth. ■ Computer manufacturer Dell Inc. averts the cost of unwanted inventory by managing its suppliers and production lines to enable just-in-time delivery of custom-built computers. Mass retailer Wal-Mart Stores Inc. uses sophisticated analysis of store and shopper data to ensure that its vast international network of suppliers deliver the exact goods consumers want at the lowest possible price. ■ These companies, and others like them, understand how long each step in the production and delivery process takes to complete and what it costs. As a result, they have successfully eliminated many hidden costs—and they constantly strive for even greater efficiency. ■ Mortgage lenders have a long way to go to realize a similar level of operational excellence in the origination, processing and fulfillment of a loan. Those in the industry would be the first to tell you this. ■ "The mortgage industry needs to evolve to the standards of other business sectors if it is going to gain optimal efficiency," says Terry Wakefield, president of The Wakefield Company LLC, Grafton, Wisconsin, a mortgage economics and process architecture consultancy.



Bundled settlement-services platforms may hold the key to optimal workflow and supply-chain efficiency. Lenders need to get a better handle on where time and costs are concentrated, before they can develop a workable solution.

ILLUSTRATION BY BRYAN LEISTER

"Our client studies show that approximately 30 percent to 40 percent of the cost of originating a conventional mortgage loan can be tracked back to the tasks involved in ordering, tracking, evaluating and paying for settlement services. The mortgage industry, in general, has lagged behind other sectors in using automation to shorten [its] supply chains and gain greater control over [its] vendors and costs," says Wakefield.

Controlling the supply chain

Numerous vendor-management technologies and platforms are available in the marketplace. But choosing the best technology solution and maximizing the benefits of these innovations require a close look at an institution's existing operations.

"Until lenders can understand the all-in costs, they cannot effectively evaluate vendor technology," Wakefield says. Accordingly, mortgage lenders should gain a fundamental understanding of where quality improvement is most critical and needed in their business.

Wakefield's company employs a unique quality-improvement methodology to help lender clients:

- Gain direct control of the supply chain that delivers the "raw materials" necessary to produce loans;
- Create the process-architecture documentation that is required to streamline operations and determine the most judicious application of technology; and
- Evaluate and implement technology that will automate many segments of the mortgage loan production process.

Wakefield's model is patterned after the "Six Sigma" quality-improvement protocol pioneered at GE in the 1990s that now is widely imitated throughout the industrial sector. Specifically, Wakefield uses a mortgage production auditing and analysis approach that he refers to as the "production pathway." As part of his analysis, he maps the time and cost of each task in a lender's loan origination and fulfillment process—from the initial borrower inquiry through the recording of the loan.

For example, Wakefield explains that a typical cash-out refinancing requires the lender to perform anywhere from 400 to 600 tasks. But just 10 to 20 of these tasks often consume up to 30 percent of the total production time.

Generally, procedures that must be performed manually result in slower production times and higher costs than automated functions. These labor-intensive tasks—which are predominately related to settlement services—provide the greatest opportunity for process improvement and cost savings, Wakefield says.

"Lenders are surprised because they don't typically ask a lot of questions about what their costs are for managing settlement services," he says.

It is clear that the steps associated with managing settlement-service providers remain inefficient compared with other parts of the mortgage process. Mortgage lenders traditionally have had to navigate a disconnected system of procedures and vendors. Additionally, many lenders and their vendors have been unable to smoothly integrate their varied data systems.

Industry innovators are addressing these problems by developing technology-based solutions to enable fully electronic mortgage settlement services.

Today, various electronic platforms are making the lender-vendor relationship more productive. Through these platforms, lenders can select service providers and auto-assign orders. In turn, vendors gain a single, electronic connection to multiple lending institutions.

With some of the more advanced settlement-services platforms, lenders also can monitor task-level status and maintain a smart, rules-based workflow system that can help maximize productivity and allow for the bundling of settlement services.

"The important thing is that the lender chooses a platform that empowers them to gain control over their supply chain," says Wakefield.

The best platforms are vendor-neutral—meaning lenders can work with the vendors of their choosing—and have robust management-reporting capabilities that enable lenders to measure vendor performance, he adds. Using performance data, lenders can establish best practices and create an environment of continuous quality improvement.

For large lenders, vendor management captives (VMCs) may be the best solution for managing mortgage settlement services.

Emerging technology

For large lenders—those that originate more than 200 loans monthly—vendor management captives (VMCs) may be the best solution for managing mortgage settlement services.

Large lenders have been turning to settlement services and vendor management technology companies to help them build their own VMCs. Among the leading builders of VMCs are three Pittsburgh-based companies: ValueAmerica Inc.; ATM Corporation of America; and General American Corporation, which is owned by Brookfield, Wisconsin–based Fiserv Inc.

One lender taking the VMC route is Option One Mortgage Corporation, Irvine, California, which late last year announced it is working with ValuAmerica Inc. to develop a new VMC.

Because VMCs are set up as wholly owned subsidiaries,

lenders are able to capture the revenue generated through the various settlement services needed to manufacture a loan, or they may opt to pass on the savings to borrowers. The most common revenue-generating services are title, appraisal, flood and closing.

According to ValuAmerica, VMCs also can help lenders ensure compliance with the Real Estate Settlement Procedures Act (RESPA). Because VMCs are set up as separate entities that contract with vendors, it is the VMC—not the lender—that negotiates, buys and resells the services.

Consequently, several top-20 originators are operating VMCs to manage their supply chains, improve customer service, cut costs and boost profits. In turn, these lenders have been able to concentrate more of their attention on growing loan volume.

"You want to focus internal staff on making loans rather than tracking data," says Tom Murphy, ValuAmerica's chief operating officer. His company's ValuNet platform has enabled lender clients to substantially increase their efficiency and cut costs by outsourcing key functions.

For instance, ValuAmerica asked The Wakefield Company to measure the time and cost of originating a cash-out refinancing before and after ValuNet implementation. The subject for this case study was a large regional bank holding company that serves 13 southeastern states. The bank originates $25 billion in mortgages annually.

Before ValuNet, the total time necessary to originate the loan was 486 minutes, of which 162 minutes—or 34 percent—involved settlement services. Using a ValuNet-enabled VMC, the lender in the case study was able to reduce settlement-services time to 96 minutes. Assuming a fully loaded cost of $1.25 per minute, the savings was $82 per loan. For a $25 billion lender, this translated into a $7 million savings in just six months.

Beyond the considerable cost savings, lenders can reduce the time it takes to get to closing, thereby boosting their loan production capacity. As vendor-management technology continues to evolve, smaller lenders are beginning to enjoy similar benefits.

To serve the next tier of mortgage lenders, ValuAmerica has introduced a Web version of its ValuNet settlement-services platform. The new software, called ValuNet xsp, is designed to deliver the same functionality and efficiency as large, lender-owned VMCs, but without the high startup costs and level of commitment.

"Vendor management captives are the most efficient, strategic and profitable way to source settlement services, but have been an option for only the largest lenders and title companies," says Murphy. "ValuNet xsp levels the playing field in terms of speed, ease of use, product and vendor choice, and supply chain and cost control. It gives medium-sized and smaller lenders a powerful tool to order services, monitor vendor performance and quality, and access and configure new products and packages."

ValuAmerica says ValuNet xsp gives lenders access to "thousands" of embedded settlement-services providers, including appraisers, title underwriters, and credit, flood and tax services. A key feature of the new software is a 50-state, ZIP code–specific bundled pricing calculator that enables lenders to offer customized settlement-services packages.

"Lenders can give consumers a quote that doesn't change [at the settlement table]," notes Murphy.

Other companies—such as RealEC Technologies®, Santa Ana, California, and Ocwen Financial Corporation, West Palm Beach, Florida—are also providing electronic vendor management solutions for small and midsized lenders.

RealEC recently announced it has added new loan closing and escrow management capabilities to its SolutionSelect suite of software tools, which automate a comprehensive list of settlement services. Ocwen, too, has enhanced its REALTrans® vendor-management product with a new offering called Quality Inspector (QI). QI enables lenders to specify preset data-evaluation criteria for settlement services ordered and managed online, ensuring that vendors are meeting service-level requirements.

The all-in cost of originating a loan continues to rise due to fragmentation in the mortgage business.

Affiliation-centric platforms

In a marketplace in which the top five originators produce nearly 50 percent of all mortgages, new business models designed to level the playing field for small to midsized lenders are taking shape.

"The big aggregators in the mortgage industry are squeezing the smaller guys out of business," says Tim Anderson, executive vice president of Edina, Minnesota–based Dexma Inc., a mortgage technology company. "Smaller lenders are facing shrinking [profit] margins, and [the profit margins] are not going to come back. If they don't fundamentally change the way they do business, they are not going to survive."

Anderson says that even though most lenders are continuously increasing their technology investments, the technology often does not reduce the overall cost of producing a loan. The all-in cost of originating a loan continues to rise due to fragmentation in the mortgage business.

"Unless you're a top-five or top-10 lender, you just don't

have the economies of scale to compete—technology by itself cannot change this reality," he says. "You have to outsource your fixed costs."

One way to gain economies of scale is by creating affiliation-centric mortgage-services platforms that enable groups or consortiums of originators to negotiate more favorable rates and fees with service providers.

In general, the consortium approach is nothing new for groups of smaller financial institutions that want to pool their market power to strengthen their individual business positions. A group of institutions will typically establish a separate, limited liability corporation to sell products and services that they cannot competively provide on their own. For instance, in recent years community banks have formed consortiums to offer their customers mutual funds and other investment products to compete with large, money-center banks that have their own investment-company subsidiaries.

In principle, the consortium model could be used to more cost-effectively bargain for mortgage settlement services. Non-traditional mortgage lenders, such as credit unions, are the natural forerunners to test this business approach because they do not have existing loan-fulfillment infrastructures.

Dexma and Prime Alliance Solutions Inc., Tukwila, Washington, a credit union service organization, joined forces to form Prime Alliance Services Co. LLC. The new entity provides credit unions with a preferred network of mortgage service providers.

In return for guaranteed volume, Prime Alliance Services is able to negotiate favorable rates on behalf of Prime Alliance's 64 credit union members. These savings then can be passed on to the credit unions' customers.

Driving the relationship is Dexma's Loan Fulfillment Center, a Web-based mortgage fulfillment platform that helps users manage workflow and connect to preferred service providers.

President and chief operating officer of Prime Alliance Services, John Barnes, says Dexma's platform is unique because it has an "intelligent, conditions-based" processing system that generates a roadmap dictated by the underwriting conditions that are returned for each individual loan. This roadmap includes everything the originator needs to know to process the loan through fulfillment, closing and delivery to the investor, according to Barnes.

Prime Alliance says its mission is to use its collective-bargaining power for mortgage services to help position credit unions as their members' "lender of choice." This strategy may help credit unions to compete on price with the nation's top lenders. Prime Alliance claims its affiliates account for 40 percent of all credit union–originated mortgages, roughly equaling the volume of a top-12 retail lender.

"We're optimistic the Loan Fulfillment Center will help us lower origination costs as well as shorten turnaround times," says Gregory Wirth, assistant vice president of lending at Bethpage Federal Credit Union, an affiliate of Prime Alliance. Bethpage serves more than 100,000 members in the Long Island, New York, area.

Because credit unions do not have a long history in mortgage lending, Dexma's Anderson says they have readily embraced outsourcing loan fulfillment rather than trying to build their own infrastructures. He says a similar business model could work for community banks and other smaller mortgage originators struggling to manage loan production costs in a fiercely competitive marketplace.

The bundling of settlement services also will enable another competitive edge: bundled pricing.

Gaining a competitive edge

According to industry consultant Wakefield, lenders that successfully use technology to outsource fixed costs will gain a significant competitive advantage. Because the mortgage business is highly cyclical, moving to a variable cost structure will enable lenders to stay competitive in good times and bad.

The bundling of settlement services also will impact the business relationship between lenders and service providers. "Bundling is going to shift power from the vendor to the lender," Wakefield predicts.

Lenders will be able to use the more technically advanced mortgage-services platforms to closely monitor vendor costs and analyze service levels. As a result, lenders will have added leverage when negotiating pricing and service agreements—the kind of leverage that companies in other industries have enjoyed over their suppliers for some time.

"The industrial sector has dramatically improved productivity and efficiency because they got a handle on their supply chains," notes Wakefield. "The production of loans is going the same way. If you can cut the time to produce a loan from 15 days to seven days, you more than double your capacity at no additional cost."

The bundling of settlement services also will enable another competitive edge: bundled pricing. Savvy lenders that have the right process architecture will find a way to offer consumers all-in, guaranteed settlement-services pricing to differentiate themselves from the competition.

"After RESPA reform, it is going to be competition that drives the development of widespread bundled pricing in the

marketplace," says ValuAmerica's Murphy. "Consumers will demand it, and lenders will have to follow." He adds that a lender that can offer low-cost, guaranteed prices at closing with "no surprises" will increase its competitiveness exponentially.

Telling trends

Within the bundling of settlement services, the production of a mortgage is becoming more data-driven and automated. Tools such as automated valuation models (AVMs) are directing how a loan is processed.

"Every lender we talk to is interested in AVMs and insured AVMs," says Dave Black, president and chief executive officer of SharperLending LLC, Spokane, Washington, a bundled-services-platform provider. "This is an example of the drive in the industry toward more data products. There is more data and [therefore] less service needed for A-paper, easy loans. A lender is now able to determine when a loan bundle should go toward data or toward [manual] services. All good platforms should help lenders guide the process."

Where the process will go next is largely dependent on the industry's continued evolution from a paper-based to an electronic business. The ideal of electronic closings and fully electronic mortgages becoming commonplace remains on the next frontier, most industry observers agree.

"A tremendous amount of progress has been made in loan processing. The slowdown has happened on the closing and post-closing side," says Phil Huff, president and chief executive officer of eLynx Ltd., a Cincinnati-based company specializing in electronic data, document and signature services. The barrier to eClosing remains a lack of dedicated end-to-end integration with lenders, investors, settlement agents and county recorders across the country.

Huff does see progress, however. A survey conducted by eLynx last year found that closing and title agents are increasingly receptive to change. When asked if electronically delivered packages would enhance the efficiency of their work, 93 percent of those surveyed answered "yes." Additionally, 90.5 percent answered "yes" to a related question: "Would it be beneficial for you to deliver documents to your business partners electronically?" (For a full analysis of the survey, see "The Neglected End of End-to-End," *Mortgage Banking,* October 2004.)

Interestingly, the survey found that even though nearly all settlement agents believed it would be beneficial to electronically receive and deliver documents, only about 14 percent actually have closed a loan electronically. Huff says this finding underscores the gap that exists between available technology and its adoption.

"I believe we will see progress in the next five years—even with county recorders," Huff says. "It is just going to be incremental. An eMortgage is an interesting goal. But process efficiency should be the here-and-now goal, because process improvement will always be the ongoing challenge." **MB**

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