Cutler Consulting, Inc.
Strategic Mortgage Partners
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Looking in the Rear View Mirror

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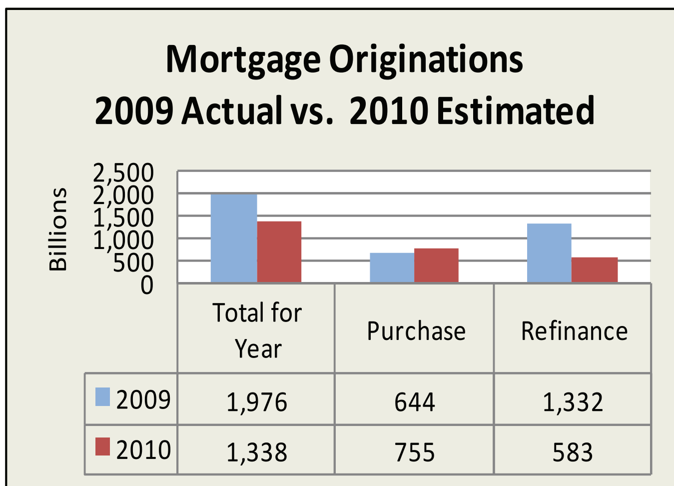
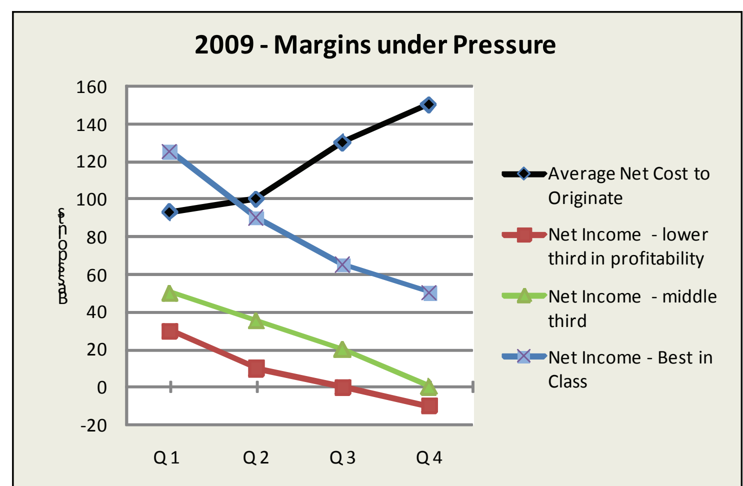
A substantial increase in mortgage income for 2009 was a bright spot for many banks and financial institutions still struggling with problem loans. Most mortgage companies aced 2009 as a result of high volumes of refinance loans originated primarily in the first and second quarters of the year at large profit margins. As the year progressed, refinance volume abated and expenses increased as a result of regulatory changes and continued repurchases. Margins contracted and the year ended with a whimper.





Are You Positioned to Succeed in 2010?

2010 is expected to be a challenging year for mortgage originators. Rates are likely to increase from current levels. Fannie Mae predicts originations will decline 30% from 2009 levels, mainly because of a huge drop in refinances. Most homeowners able to refinance have already done so.

RESPA reforms and continued tweaking of investor guidelines will add costs and risks to mortgage operations. High levels of repurchase and reimbursement requests from investors will continue in 2010. This will add to expenses at the same time that volume is decreasing.

The first three months of 2010 have not been kind to most mortgage companies. Depressed originations placed against plan numbers based on 2009 origination volumes have many companies below plan as we start the second quarter.

Many companies have cut rates to generate business. Others will follow to keep their sales staff and customers happy. While the better companies will be making less money than they made in 2009, the marginal performers will be relegated to making little or no money.

In tough economic times, most businesses' first inclination is to cut expenses as a way to increase profitability. This is a natural response as there are some expenses that can always be cut. Unfortunately, it is almost impossible for a company to cut enough expenses to achieve an acceptable level of profitability.

The most desirable option to increase profitability lies in increasing revenue. However, it is also the most difficult to achieve. How do you maximize profits when volume levels are lower? While fees may be increased, companies cannot afford to be market leaders in fees charged and hope to maintain or increase market share. That leaves gain on sale as the primary driver to increase profitability.

Gain on sale (GOS) is the difference between the closed loan price and the selling price of the loan, net of loan level pricing adjustments. Servicing values are included in gain on sale.

Keep reading to find out if your mortgage operation is prepared to take on the challenges you will face in the coming year.

Focus 2010: Increasing Revenues

The most important factor to making money in a mortgage operation is maximizing the price obtained for your mortgage production.

Based on industry statistics and anecdotal evidence furnished by knowledgeable mortgage professionals, net income varied widely from company to company in 2009.

Top performing mortgage operations achieved 75 to 100 basis points in net income on total originations. Better than average performers made between 50 and 75 basis points in net income.

The primary differences between these companies and the rest are as follows:

- Top performers consistently sell their loans at the highest price available in the secondary market.
- The ability to capture a targeted profit margin 99% of the time. If their targeted GOS is 75 basis points, top performers realize a 75 basis points gain when their loans are funded by the end investor.
- Top performers identify and execute a secondary marketing strategy that maximizes gain on sale and mitigates risks.

Unless you work for one of the companies who made 90 to 100 basis points in net income in 2009, there are most certainly adjustments to your current pricing and selling strategy that can be made to increase revenues.

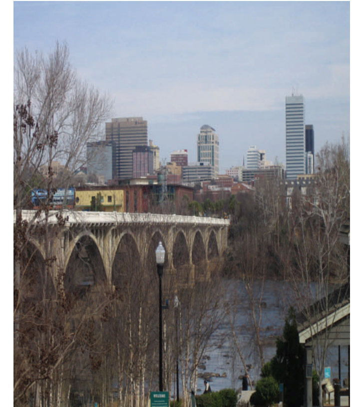
- Centralize your pricing and registrations.
- Improve your selling price by selecting the right investors.
- Reduce exceptions to policy.
- Update pipeline information daily.
- Eliminate slippage - set a profit margin and make sure you achieve it.
- Establish proper reporting to effectively manage pricing, delivery, aged inventory and follow-up documentation.

Well run mortgage operations generally experience controlled decreases in income when volumes decrease. Others may experience wide swings in earnings as price cutting, process inefficiencies and outdated secondary marketing strategies take their toll.

Most companies operate in the most cost efficient manner that they can given their resources and experience level. The mortgage business is a complex business. The issue is whether or not a company has the experience level necessary to produce and close loans in accordance with industry best practices. It is no secret that some companies are able to produce mortgage loans much more efficiently than others. While some of the reasons relate to cost to source loans and systems capabilities, more often than not it is the secondary marketing piece of the equation that differentiates the best companies from the others.

Cutler Consulting can work with your staff to identify inefficiencies and missed opportunities. We will examine your current secondary processes and procedures and recommend changes to ensure capture of your targeted GOS margin. We assess current counterparty risks, perform profitability analysis on current and available executions tailored to your tolerance for risk, and develop management reporting to maximize profitability and properly manage risks.

We are here to assist you with the critical decisions and tasks impacting the success of your business.



Controlling Expenses - taken to a new level

"Due to budget constraints, the following corporate policy is announced regarding employees traveling on official business.

Lodging

All employees are encouraged to stay with relatives or friends while on company business. If weather permits, public areas such as parks and parking lots should be used for temporary lodging sites. Bridges may provide shelter in periods of inclement weather. "

Memos from the Chairman

By Alan C. Greenberg

The Mortgage Risk Assessment Matrix

Many companies are struggling with the "new normal" in mortgage originations. The blowback from poorly originated loans, inadequate underwriting guidelines and the bursting housing bubble is severe. Repurchase risk continues to increase. Senior managers routinely try to predict the benefits or damage that might be caused by implementing or failing to implement proper risk controls. The Risk Assessment Matrix (RAM) can be viewed as a logical extension of that process. -- *Professor Mort Gage*

The Risk Assessment Process

Mortgage companies are subject to many types of risk. The RAM provides a compliance document to properly identify, measure, and prioritize the significant risks across all functions of the mortgage process and list specific controls to properly mitigate these risks.

An effective RAM should be easy to understand, have clear objectives and purpose and not require extensive risk assessment knowledge to use. When done properly, a RAM gives managers and employees an easy tool to use to discuss inherent risks to the operation and a way to control them.

Building a RAM

The initial risk assessment should involve employees with direct knowledge of the work being performed. The steps to build a RAM include:

- Develop a list of risks that can affect the successful achievement of the company's goals.
- Determine the risk level (High, Medium, Low) and describe the potential risk or exposure to the company.
- Identify the operating and oversight controls (reports) required to measure and manage the risks and the frequency of measurement.
- Review and assign responsibility for each control.

Example of a Risk Assessment Matrix

Department: Secondary Marketing

Function: Secondary Marketing

Risk Type: Operational

Risk Level	Potential Risk/ Exposure	Control	Responsibility	Measurement	Frequency
HIGH	Loans cannot be delivered to end investor due to operational issues	Temporary unsaleable report prepared by RLO for review by Secondary Marketing and Risk Committee	Operations Manager	Temporary Unsaleable Report	Weekly
		Aged inventory report prepared by RLO for review by Secondary Marketing and Risk Committee	Operations Manager	Aged Inventory Report	Monthly
HIGH	Backlog in registrations results in loans not being hedged	Work flow reports prepared by the registration desk	Operations Manager	Registration and processing key indicators report	Weekly

Risk Type: Fallout

Risk Level	Potential Risk/ Exposure	Control	Responsibility	Measurement	Frequency
HIGH	Loans do not close or are not delivered due to downward rate movement	Fallout reports to measure historical trends by business channel, by total, by product	Secondary Marketing Manager	Fallout Report	Monthly