Putting the profit back into mortgage lending

How to combat the rising cost of origination by finding efficiencies in valuation and title

INTRODUCTION

Mortgage lenders are facing a host of challenges in the current market. Rising interest rates and a shortage of housing inventory have reduced the number of loans being written, at the same time total loan production expenses have increased.[1]

Lenders are definitely feeling the pain. In Fannie Mae's Q2 2018 Lender Sentiment Survey, few lenders said they are expecting growth as they look ahead to the rest of the year. "Lenders remain bearish this quarter as they continue to face headwinds from rising mortgage rates, tight supply, and strong home price appreciation, which have drastically reduced refinance activity and restrained home purchase affordability," said Doug Duncan, senior vice president and chief economist at Fannie Mae. "These factors have combined to squeeze mortgage origination volumes and have increased competitive pressures."[2]

The increase in both interest rates and home values have shifted the market away from purchase and refinance loans and created an ideal environment for home equity loan products. In the first quarter of 2018, the number of purchase loans decreased 16 percent from the fourth quarter and refinance loans decreased 2 percent, but HELOC originations increased by 18 percent.[3]

Clearly, lenders who want to compete effectively in this market are going to have to be faster and more efficient than ever before. Over the last several years, the mortgage industry has seen a number of new products and services aimed at automating every part of the loan process, from mobile loan application technology to real-time product and pricing engines for the secondary market. But despite progress in other areas, many lenders aren't taking advantage of the efficiencies to be gained in two key parts of the process, especially in a home equity market: appraisal and title.

NEW APPRAISAL AND TITLE OPTIONS

After the financial crisis, the appraisal process was changed to ensure appraisal independence and increase the accuracy of property valuations. The new rules tightened up what valuation level was needed for different loan products and introduced appraisal management companies into the mix. But as the housing market started to recover, the appraisal process became a bottleneck, lengthening time to close and stalling loan production for many lenders.

An accurate property valuation is critical to any mortgage loan. At the same time, how long it takes to get the appraisal done and how much it costs are both factors that impact the borrower's experience and the lender's loan production. Balancing both customer satisfaction and the need for compliance presents a challenge for lenders — one that is best met by technology-enabled solutions.

Fortunately, depending on loan type, there are a variety of valuation options open to lenders:

Full Appraisal

A traditional appraisal done by a certified appraiser, requiring a physical inspection of the property that includes all relevant attributes and photos. Required for most purchase mortgage loans and any high-risk loans.

Desktop Valuation and Hybrid Valuation

These types of valuations use either real estate agents for a physical inspection of the property and report or internal valuations specialists that take a closer look at the property and its comparables. Both of these valuation options save time and money.

Automated Valuation Model (AVM)

This method offers a completely automated valuation that calculates property value by leveraging mathematical modeling and data on similar property types. Because it does not require human input, an AVM can generate a property value instantly. However, because these valuations don't include property condition, their use in underwriting has been limited under some GSE guidelines.

In the aftermath of the financial crisis, lenders were limited in their ability to use alternatives to traditional full appraisals. However, both Government Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac have expanded their guidelines over the last year to include various methods as part of a compliant underwriting process.

The GSEs have been accepting no-appraisal refinance loans for years through the Home Affordable Refinance Program (HARP), but they increased the options for lenders to offer refinances without appraisals in 2016.[5] In 2017, the GSEs extended the no-appraisal option to a select group of purchase loans.[6] This represents a huge step toward automation from one of the country's biggest investors, and may signal an openness to even more loans without appraisals. In May 2018, one news outlet reported that Fannie Mae is running a pilot program that accepts alternative appraisals for loans that in the past would require a full appraisal.[7]

Having multiple valuation solutions available for a wide variety of loans is tremendously beneficial to both lenders and consumers. Commenting on the appraisal waiver program offered by the GSEs, the Washington Post reported in May: "During 2017, Fannie Mae acquired roughly 60,000 no-appraisal mortgages — 5 percent of its total 1.2 million home-loan acquisitions. Assuming an average appraisal costs about $500, the combined savings to buyers and refinancers totaled somewhere near $30 million. Freddie Mac declined to estimate specific savings but said through a spokesman that by accepting appraisal waivers, 'borrowers may have saved millions.'"[8]

Lenders also benefit, as closing times can improve significantly depending on which valuation method they choose. Moody's Investor Service outlined the time and cost differential in a February report:[9]

- Traditional appraisal: Takes 3-30 days and costs $450 or more
- Hybrid appraisal: Takes 3-7 days and costs $125-$450
- Broker Price Opinion: Takes 3-5 days and costs $75-$150

Leveraging data is also driving automation in the title space. As with appraisals, not every loan needs the same level of title documentation or title insurance. Using tech solutions to automatically match the necessary title options to each loan is much more efficient than a manual process where every mistake could be costly. For origination shops looking to make loan officers more productive, this automation could be significant.

For example, automation software can distinguish between loans that need ownership and encumbrance property reports and those that need a manual property report, legal and vesting reports or full ALTA or Jr. ALTA title insurance.

THE BENEFITS OF AUTOMATION

Historically, the mortgage industry has been a late adopter of new technology solutions. Facing steep fines for stepping outside the lines drawn by regulation, the industry as a whole developed a reactive rather than proactive stance toward innovation. This only increased with the regulatory burden of Dodd-Frank requirements, which required the industry to significantly change operations and processes to be compliant. Satisfying regulators, rather than customers, was the focus of much of their efforts.

However, after years of diverting resources into compliance, financial institutions realized some of the infrastructure they built could also further their automation. Simultaneously, consumer expectations for speed and efficiency in all their transactions continue to increase. For all these reasons, lenders now see the ability to automate as critical to their success.

But where to start?

International management consulting firm Oliver Wyman has identified three places in the origination process where technology can help create a distinctive client experience, while also helping lenders with other important priorities such as regulatory compliance, efficiency, and cycle time.[10]

These three areas are: 1. Application intake 2. Decision making 3. Processing and Closing

Many lenders have embraced technology for application intake, but are just now implementing systems for the other two areas. Valuations are a critical part of the decision-making process and title is an essential, but often overlooked, part of closing. Automating those two areas can affect a lender's bottom line at the same time it creates a better experience for the borrower.

"It is an ideal time for mortgage institutions to create a distinctive way of interacting with their customers, differentiating themselves from their competitors, while also making their internal operations more efficient and adaptable to changing regulation. With the appropriate use of technology, a 'wow' experience for consumers doesn't have to be incompatible with reduced costs, accelerated processing, and improved compliance."

Knowing the importance of technology to the overall customer experience and being able to implement it — especially if that involves the legacy systems many lenders have — are two separate things. For most lenders, it's not feasible to build and maintain solutions internally so they look to trusted third-party vendors to supply the technology they need.

These partnerships allow lenders to focus on what they do best — originating loans — while leveraging the expertise of vendors to be efficient and compliant. And with the right technology partner, implementation can be a seamless, painless experience.

CONCLUSION

The switch to automation not only saves lenders time and money, but benefits consumers too. Compliance does not have to be sacrificed by using valuation and title technology options and making this change can increase profits.

One company leveraging technology in valuation and title is FirstClose, which developed the FirstClose Report, a comprehensive home equity and refi tool. FirstClose can generate instant reports covering credit, valuation, flood, tax and title, or where that information is not publically available, can automatically order manual reports or title services.[11]

As Oliver Wyman notes in its report: "The winners in the current environment will be the ones that leverage technology to work both sides of the equation—consumer-facing and internal operations—to stand out from the crowd."

Sources:

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