A Technology Response to the Great Recession:

It's no secret how difficult it has been for mortgage lenders to survive the credit crisis of 2008 and the Great Recession caused by lack of liquidity. The greatest impact on the average lender from the recession is a scarcity of loan volume.

In MORTECH LLC's survey research (*MORTECH* annual surveys of lender use of mortgage technology), we find lenders are perfectly clear that their greatest need is to build loan production. Lender reactions to unusual conditions are pretty basic: Build by expanding their distribution capabilities—add offices and hire loan officers. Leases and laptops.

Along with the effects of the recession, a radical restructuring of the mortgage industry has put great pressure on the average lender. Lenders have a difficult time finding a way to win business through differentiation.

Lenders now are competing with two government-created oligopolies—the megaservicers (Bank of America, Charlotte, North Carolina; Wells Fargo & Co., San Francisco; JPMorgan Chase & Co., New York; and CitiMortgage Inc., O'Fallon, Missouri); and the two government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac, along with Ginnie Mae.

The emergence of dual oligopolies (the GSEs and Ginnie Mae investing in mortgages, and the four very large servicers) in the mortgage industry saps the bargaining power of the average mortgage lender. Bargaining power belongs to the industry giants. The average mortgage lender now has scant ability to control product definition or pricing. Much of the operating freedom needed to meet business objectives has been siphoned away from lenders.

One thing lenders can control is the design of their operations and their choice of technology architectures. Given the uncommon changes in the market today, lender technology platforms require both configuration flexibility and operating reliability. With the extreme uncertainty in demand that lenders face, their tactical positions are stronger if they are able to provide a large variety of product and service configurations to satisfy consumer and investor demand.

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Technology promises to be a major factor in what remains in lenders' competitive tool kit. Success in an uncommonly constrained market depends on the ultimate satisfaction of consumers (borrower, investor, regulators) with the "whole product" as delivered through lender operations. An important objective of technology in an uncertain environment is the delivery of predictable operating results. Once delivery outcomes are more predictable, overall productivity increases and the lender becomes more competitive.

Economic environment

Some economists such as Mark Zandi of Moodys Economy.com, West Chester, Pennsylvania, think that repair of the U.S. economy is a long-term process. In testimony to the Financial Crisis Inquiry Commission in January 2010, Zandi had this to say: "The fallout from the financial crisis will likely weigh on the economy through the coming decade. GDP [gross domestic product] and employment will be lower and unemployment higher for years to come."

Indeed, regulators are experimenting with economic policy intended to mitigate and control the aftermath of the liquidity crisis of 2008. No government official in his or her lifetime has experienced the breadth and depth of the recent credit market shutdown. Policy responses have ranged from underestimating the severity of the crisis, thinking it was a conventional cyclical problem; and creating asset-purchase programs that have bloated the balance sheet of the Federal Reserve. This they have done to prop up the mortgage market.

Uncertain government readings of the problem have deepened a disruption in the functions of the country's basic economic institutions. The disruptions deepened into a "structural break" in the financial industry's operating environment. Structural breaks lead to hard times.

The economic environment is one that will make it difficult for the average mortgage bank to rebuild its book of business.

Households are in the process of "deleveraging" their own balance sheets. This simply means that while once they built debt at prodigious rates, households are now holding back and letting their debt load run off.

Demand for purchase-money mortgages will be quieted by the level and mix of unemployment. The unemployment

The Case of DMD

rate grew from under 5 percent to just in excess of 10 percent at its peak. Some economic repair has the rate in the past few months edging down to 9.9 percent.

It's important to note that lenders cannot control the effects of economic and structural forces.

The business environment

The GSEs are buying or guaranteeing 80 percent or more of loans originated in the country. This concentration leaves lenders with narrower product diversity than they have had in a generation.

From the lender's viewpoint, the current state of the secondary market has made it difficult to qualify a marginal or an uncommon applicant. This state of affairs diminishes lender customer service and constricts origination volume.

According to *MORTECH 2009,* 92 percent of respondents say that it is now more difficult to fit loans to the idiosyncratic characteristics of mortgage applicants.

Given this environment, achieving the one objective that stands apart from all other business needs—the lender's need for increasing loan volume—is more remote.

MORTECH data tell us that lenders think they should be focused on the following:

- Loan officer effectiveness; and
- Channels of distribution—loan office location, loan office workflow and decision technologies.

Indeed, lenders are right to focus on the business factors within their control. Technology vendors do well when they gear their products to support what lenders rate as being of the highest importance to their operations.

Workflow and Industrialization: Enter DMD Inc.

In a concentrated industry with few buyers of mortgage assets, originator functions increasingly focus on producing high-quality information about potential borrowers. They also monitor borrowers and may control selection of loans, too, as new information dictates. This production process increasingly must be supported by the appropriate technology and organization.

Management at DMD Inc., San Diego, are advocates of workflow industrialization (as we call it). In its systems architecture, the company is working toward a realization of error-free or "zero-defect" lending.

To achieve an error-free workflow, DMD counsels lenders to implement systems "that ensure i's are dotted and t's are crossed in real time as the loan flows through the process."

Lenders generally organize workflow in an "assembly-line" configuration. The direction of workflow is linear with individual work stations performing tasks, each being dependent on the completion of the immediately preceding task.

In fact, Rob Katz, president of DMD, uses the manufacturing metaphor when he describes the process of creating a mortgage.

To meet business objectives in current market conditions, lenders are hustling to make their loan product offerings flexible. At the same time, they are building operational platforms that accommodate changing business requirements.

The crucial point lenders make about managing their operations is the need to respond to uncharacteristically volatile market conditions. These are just the business objectives supported by DMD's suite of technology products.

DMD's technology platform is built "appropriately" to meet the needs of its target market. DMD's open-database architecture is designed to easily modify functionality, to allow added capability and to remove outmoded modules. Users report in a survey commissioned by the company that DMD's new releases are uncommonly reliable and do not disrupt the flow of business. Clients achieve significant time and cost efficiencies, reduce errors and reallocate resources to support their core business functions.

From the same DMD study, the core benefits clients report from DMD implementation include:

- Good systems security;
- Effective workflow control;
- Reliable data quality;
- Reduced operating cost;
- Better management control; and
- High labor productivity.

According to DMD's commissioned study, its clients enjoy significant returns to scale while employing the DMD product suite. Enhanced scale management obviates the need for DMD users to expand and contract their work force as loan demand varies. Thus, the stability of work design reduces organization volatility and aids the lender in coping with abrupt changes in origination volume. A stable operation helps lenders compete on quality (data and service) and focus on increasing demand for their services. This is, after all, what they can control.

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