The Right Perspective Changes Everything

EFFICIENT COLLATERAL VALUATION KEY TO SUCCESS IN 2018

A Whitepaper

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Just one quarter into this new year, we're already seeing financial institutions experience stress in the face of diminishing mortgage loan origination levels and increasing competition. The Mortgage Bankers Association, among others, predicted this drop in business last fall. It appears that they were correct.

The results we're seeing in the market now indicate that many smaller institutions are finding it more difficult to generate revenue through their mortgage lending operations. This is negatively impacting industry profits. According to the MBA's Annual Mortgage Bankers Performance Report, independent mortgage banks and mortgage subsidiaries of chartered banks saw their profit per loan cut nearly in half in 2017, earning only $711 on each loan they originated last year, down from $1,346 per loan in 2016.[1]

While 2018 will be a tougher year for lenders, it will still be possible for originators to generate solid revenue and profit for their institutions with effective marketing and loan fulfillment programs. Better than that, by focusing their efforts on the right products, they will also have the opportunity to build stronger relationships with existing bank customers and credit union members, positioning themselves well for securing additional purchase money business when volume levels increase in the future.

The keys to success this year will be the same as they always are in this business: (1) excellent customer service, (2) good marketing to uncover the loan products in demand in the bank or credit union's service area and (3) efficient operations to ensure a good customer experience and to reduce costs and increase profitability.

In this white paper, we'll explore the trends that will tell us where the new business currently is for mortgage originators and then explore the efficiencies lenders must build into their processes in order to capitalize on them.

[1] Gaffney, Jacob (2018). *Show me less money? MBA reports mortgage profits nearly slashed in half*. *Housingwire.com*. https://www.housingwire.com/blogs/1-rewired/post/43125-show-me-less-moneymba-reports-mortgage-profits-per-loan-nearly-slashed-in-half

A more competitive landscape

This March, MBA estimated that the industry would write $1.6 trillion in 1- to 4-family mortgage loan originations in 2018, down from $1.7 trillion last year, or a 6 percent decrease from 2017's volume. Meanwhile, the trade organization said that refinance originations would decrease by 28.3 percent from 2017, to approximately $430 billion[2].

The picture would brighten somewhat by 2019, MBA said last fall, forecasting total originations to rebound to $1.64 trillion, with purchase originations of $1.24 trillion and refinance originations of $395 billion. But in the near term, MBA Chief Economist and Senior Vice President for Research and Industry Technology Michael Fratantoni told attendees of MBA's annual conference last October that purchase money originations would be the most likely source of new business in 2018.

"We are projecting that home purchase originations will increase at a faster clip in 2018, nearly double the rate that they increased in 2017," he said. "All the pieces are in place for stronger growth in 2018 and beyond."

Naturally, lenders began to gear up to attract more purchase money transactions and now, four months into the new year, competition for this business has heated up significantly. Larger lenders are putting a great deal of money into television and radio ads and that's putting pressure on smaller institutions that want to compete for this business.

But there is another opportunity for lenders, especially for those that know their customers well or service their own loan portfolios.

The home equity opportunity

Last fall, as the current administration was working out the 2018 budget with legislators, many feared that the deduction for home equity loan interest would be going away in 2018, doing severe damage to that line of business for mortgage lenders. That didn't happen, which was good news for millions of home equity borrowers -- and for mortgage lenders.[3]

The tax law was modified, however, reducing the overall amount of interest borrowers can write off depending upon the amount of total qualified residence loans they carry. The new law also clarified what home equity loans could be written off the consumer's taxes based on their use of the funds.

[2] MBA Mortgage Finance Forecast, March 20, 2018, Mortgage Bankers Association
[3] Frankel, M. (2018). *Great News for Millions of Home Equity Borrowers in 2018*. *The Motley Fool*. https://www.fool.com/taxes/2018/02/23/great-news-for-millions-of-home-equity-borrowers-i.aspx

The good news for both borrowers and the industry is that for the vast majority of home equity borrowers, the loans still make excellent sense. While cash out refis are hot today,[4] this is likely because borrowers fear higher interest rates in the future[5] will make this too expensive.

Most experts agree that interest rates will continue to rise, which will make increasing lending business with cash out refis unsustainable. This will make home equity more attractive because they will be the best, lowest cost option for homeowners, even if the interest isn't tax deductible.[6]

Yardeni Research and others have estimated that there is currently about $5 trillion in untapped home equity in the market, making it one of the largest pools of consumer-accessible credit available.[7] This could be an excellent source of new business for mortgage lenders.

But will consumers want to tap their equity? Current research suggests that they will. A recent study by TransUnion showed that despite rising rates consumers are still tapping credit cards, with business in that sector continuing to rise. Further, the credit reporting agency said it still sees strong demand for home equity lines of credit (HELOCs).

> "While increased interest rates will likely slow down refinancing activity, with rising home prices TransUnion expects to see many more homeowners tapping into their home equity. TransUnion forecasts approximately 1.6 million HELOC originations in 2018 and about 10 million through 2022. This is in stark contrast to the previous five-year period, when less than half that number were originated—4.8 million HELOCs were opened between 2012 and 2016. TransUnion believes the three largest uses for these new HELOCs will be: 1) debt consolidation to a lower interest rate; 2) financing a large expense, such as a home improvement, and 3) refinancing an existing HELOC or Home Equity Loan."[8]

This can be a critically important sector of the business for community lenders and credit unions, allowing them to remain profitable in an increasingly competitive market. Meeting the consumer's

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[4] Riquier, A. (2018). *Cash-out mortgage refis are back — will homes become ATMs again?* . *MarketWatch*. https://www.marketwatch.com/story/cash-out-mortgage-refis-are-back-will-homes-become-atms-again-2018-03-30
[5] *Mortgage rates rise for the third consecutive week*. (2018). *Washington Post*. https://www.washingtonpost.com/news/where-we-live/wp/2018/01/25/mortgage-rates-rise-for-the-third-consecutive-week/?noredirect=on&utm_term=.fadd329758a7
[6] Harney, K. (2018). *Did the tax code overhaul kill home equity loans? Washington Post*. https://www.washingtonpost.com/realestate/did-the-tax-code-overhaul-kill-home-equity-loans/2018/01/16/626f8054-facf-11e7-ad8c-ecbb62019393_story.html?utm_term=.19098f73ba99
[7] Yardeni, Edward, and Quintana, Mali. (2018) US Economic Indicators: Homeowner's Equity. https://www.yardeni.com/pub/homeowneq.pdf
[8] *TransUnion Consumer Credit Forecast* (2018). *Consumer Credit Market Expected to Remain Strong in 2018 Even in a Rising Rate Environment*. https://newsroom.transunion.com/consumer-credit-market-expected-to-remain-strong-in-2018--even-in-a-rising-rate-environment/

needs for cash with home equity loans will be one of the most successful growth strategies for these businesses in 2018.

Making home equity lending work

As discussed in the introduction to this paper, there are three keys to success in this business. The first, excellent customer service, is beyond the scope of this paper. Fortunately, those lenders that have survived this far into the recovery understand what it means to offer a good borrower experience and run a customer-focused lending operation. This will continue to be incredibly important for the success of any financial services company for the foreseeable future.

The other two keys have to do with marketing and with efficient operations. We'll discuss both of these keys in this section.

Effective marketing for home equity

Professional marketers know that success comes from having the product that the consumer wants to purchase at a price the consumer is willing to pay when that consumer is ready to buy. We have already demonstrated that consumers are taking out more credit and that home equity lines of credit are competitive, from a pricing perspective, with credit cards. Experts are seeing growth all along this spectrum.

When it comes to home equity, the consumer is not in a position to take out a home equity loan or line unless they have sufficient equity in their home to enable the transaction. While this can be researched and determined by virtually any mortgage lender regardless of whether or not they control servicing by using a combination of public record data and AVMs, credit unions and community banks often have an advantage here because in many cases they do service their own loans. They know a great deal about their borrowers and the amount of equity they have in their homes, at least in terms of the initial loan-to-value. But there is no need to guess.

While any lender can compete for home equity loan business, community banks and credit unions that already have a relationship with a borrower are in the best position to get their borrowers' home equity business, but they still must approach them first. Approaching them with an offer that they cannot use because they have insufficient equity in their homes will damage the relationship.

There currently exists a wide range of collateral valuation tools that lenders can use to affordably determine whether their borrowers have sufficient equity to approach for home equity business. Failure to make this assessment will leave the doors open for a competitor to market to these consumers. Even if they cannot easily determine the value of borrower's equity, larger lenders have the resources to use shotgun marketing to unseat smaller institutions.

Efficient processes for home equity lending

And this is where the third key comes into play. Lenders must have an efficient method for determining which borrowers within their portfolios have sufficient equity in their homes to qualify for a home equity loan or line of credit. To accomplish this, lenders need access to a platform that can meet three key requirements: (a) it must provide easy access to a great many valuation tools, (b) it must be a compliant tool that offers the transparency lenders need to demonstrate that compliance to regulators, and (c) it must not require the lender to staff up to take advantage of the technology.

For the remainder of this white paper, our discussion will focus on the industry's leading valuation platform, VeroSELECT, which meets all of the above requirements.

VeroSELECT is a web-based order management platform designed for use by mortgage industry participants who are ordering, managing or supplying a variety of collateral valuation products. VeroSELECT allows users to manage a range of valuation tools through a centralized system, offering the flexibility, scalability, control and compliance that today's mortgage industry requires.

A valuation platform with the power home equity lenders need now

To be effective, the lender needs a strategy that will allow them to know what product to use in which instance to get the valuation they need with sufficient confidence to render a quick decision. In addition, lenders need instant access to valuation tools that provide real insight into the local market.

There are a number of such valuation tools available now, but only VeroSELECT provides a centralized ordering and management process, providing lenders with the flexibility to take their property valuation strategies to the next level with instant access to the most accurate AVM models, trusted Broker Price Opinions (BPOs), and detailed Property Condition Reports (PCRs) within a single platform – everything you need to make the best lending and risk-controlled decisions in one complete solution.

VeroSELECT provides access to the industry's top performing AVMs - including the company's flagship offering, VeroVALUE. Fueled by real-time data integration and advanced validation, VeroSELECT's complete suite of AVMs offers the greatest geographic coverage, hit rate and accuracy in the industry, based on third party testing. Independent experts point to VeroSELECT to give lenders access to fast, unbiased and cost-effective AVMs in configurable cascade logic—designed to produce accurate value estimates, instantaneously.

VeroSELECT's advantage is in its ability to provide full transparency into the lender's cascade with highly detailed reporting and usage reports accessible on-demand. The platform offers pre-set or customizable rules, dynamic cascades that put the lender in control of a myriad of variables including geography, property characteristics price range, confidence score cut-offs and forecasted standard deviation.

The platform offers:

- Controlled flexibility to manage AVMs in all cascades
- Single or cascading AVM approaches
- Customizable logic to streamline workflow based on business rules
- Extraordinary control with cascade options such as
  - Value Range
  - FSD
  - Thresholds
  - County
  - City
  - State
  - Geographical to ZIP Code

In addition, the platform optimizes and accelerates the portfolio review process by:

- Incorporating first mortgage data to determine current equity
- Forecasting future property values with VeroFORECAST, looking 6-, 12-, 18- or 24-months into the future
- Utilizing VeroSCORE, Veros' proprietary appraisal review and scoring technology that delivers in-depth analysis to facilitate better decision making and reduce valuation-related risk
- Incorporating Home Price Index Values from VeroINDEX™ Plus
- Providing retroactive valuations, and more!

A valuation platform that can be defended to industry regulators

Automated Valution Models (AVMs) have now been available to the market for at least two decades now. For much of that time, they have primarily been employed to perform QC work on appraisals. But over the last several years, these tools have become much more accurate and reliable (for more information on this, see our recent white paper on AVMs and Precision). AVMs have always been among the most affordable valuation tools available to lenders.

One key to AVM precision and accuracy is determining in advance whether an automation valuation model should even be employed for a specific property. Solutions exist today that utilize advanced AI technology to make this determination at the beginning of the process, dramatically increasing the possibility that the resulting AVM value will be acceptable to the lender.

Today, we're seeing more lenders employ these tools to affordably identify home equity lending opportunities. While banking regulators have become comfortable with many of the ways lenders have employed these tools, they still take a keen interest in lenders that use them to make lending decisions. This is not to say that they frown upon it, just that they require the lender to explain why they are using these tools and how they are making their underwriting decisions.

First, the home equity need not rely on the AVM to make the underwriting decision for a home equity loan. They could simply use it as a tool for prospecting within their database. But when the lender does choose to use the AVM result in its loan decision, VeroSELECT makes explaining that decision to regulators easy for the lender.

AVMs are more accurate than ever before. Anyone taking a hard look at this technology and performs even a cursory analysis will see that they are powerful tools that the industry should be using. To demonstrate this to regulators, lenders can employ a good testing and platform partner who can continue to feed the lender supporting information that will allow them to make modifications to their business rules to ensure good decision making.

Because VeroSELECT is designed to make it easy for the lender to collaborate with outside partners, there is no need to staff up to run the platform effectively. That's the third required element of a usable valuation platform.

A valuation platform that is easy for the lender to use

VeroSELECT allows lenders to implement their own business rules, whether they develop those in house or with the help of an outside consultant, and then originate with confidence according to the institution's particular risk tolerance. The lender can easily monitor the system, making adjustments and interact with it as required to effectively mitigate risk.

The addition of VeroPRECISION, built into the platform, lets lenders leverage case-based reasoning, data-driven automation and sophisticated data analysis at the property level to generate a Veros AVM Suitability Score. This informs the lender as the appropriateness of the AVM as a valuation method and further reduces overall collateral risk. Our data indicate that in 70 to

80 percent of all cases an AVM is an appropriate valuation tool. (For more information, request our white paper on this topic).

Not all lenders fully understand everything about today's modern valuation tools and how to employ them. Fortunately, there are a number of valuation service providers who are well-versed in this process and can help lenders evaluate valuation methods, take them through the testing process and then assist them in setting up cascades that make sense for their business and to their regulators. This empowers the lending department to discuss their valuation methods internally with upper management or successfully field any questions their regulators ask.

Find out more

VeroSELECT was created to help originators manage the time-consuming ordering and management tasks across every valuation tool. In the current market, the tool has become essential for the development of an efficient home equity lending operation. It provides instant access to VeroVALUE AVM, as well as other top performing AVMs, property condition reports (PCRs), and broker price opinions (BPOs). It's simple interface, gives VeroSELECT users access to a complete range of valuation solutions with flexible options, innovative technology and a focus on supporting the lender's compliance requirements.

VeroSELECT is a powerful, enterprise platform that delivers critical valuation intelligence to enable decision makers to reach informed risk decisions quickly and with a high degree of confidence.

Driven to deliver the highest quality valuation tools in the industry, Veros continues to outperform industry standards in quality, accuracy and timeliness. Request a free demo today or simply contact us for more information: 866.458.3767.

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