



# A Bridge to Somewhere

**B**uilding a bridge can be a political hot potato in so many ways. Are you attempting to clear the way for a new destination to jump-start prospective development at the other end? Or are you trying to replace a highly utilized but perhaps worn (out) connection between two already developed arenas? Are you betting short-term costs against longer-term and hopefully higher revenues? Will your political capital last?

So as we close out 2009, bridge construction seems like an appropriate metaphor for retail and wholesale production. Where are we headed—to some place of innovation? Or are we building a retail/wholesale production bridge that is wider and higher, but positioned over a known body of water?

Despite lingering low rates and some remarkable production volumes in 2009, both our 2010 destination and the known body of water seem fuzzy. The benchmarks we used to define “normal” are history. Industry innovators are doing workouts, not production. A \$2 trillion origination year barely bubbles up on “how are you doing?” exchanges.

Given the unrest in the overall financial markets, a 2010 origination projection of \$1.5 trillion comes with its own funeral music. Market leaders include the Federal Housing Administration (FHA) and Ginnie Mae. None of these factors are new developments, but which ones are most relevant for constructing a 2010 direction?

A little pre-construction cleansing is in order. Specifically, what issues would we like to “bridge?”

- **Product shortage:** Recent trends suggest 51 percent of originations are conventional (whatever that means) and 44 percent are FHA. While one would

think fewer products would engender greater clarity, just the opposite is true: There are fewer loan types available than there are legitimate borrower needs. Where will these borrowers find product?

- **Policy variations:** Lenders are managing proprietary policy variations imposed by investors beyond the Desktop Underwriter® (DU)/Loan Prospector® (LP)/FHA decision. Despite apparent sim-

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plification in mortgage products, originators face challenges in the standards for loan acceptance that exceed the definitions of DU and LP. Further, these standards are under constant change.

- **Guidelines are just guidelines:** An often-heard observation is that approvals from DU and LP are required but are not sufficient to originate a loan. Whether one is originating in the retail or the wholesale channel, FICO® requirements, debt-to-income (DTI) ratio thresholds and documentation standards from investors are often more conservative than those that DU or LP or their respective agency’s guidelines require.

- **Running in place:** Lenders’ attempts to match products to borrowers earlier in the process are often thwarted by ever-tightening investor standards.

- **Heightening credit consciousness:** Originators are learning from their loan

workout brethren that more data is better. Lenders are increasing their scrutiny of credit files to account for all reported debts, liens and judgments in an attempt to limit the impact of misrepresentations and buybacks.

- **No surprises in delivery:** Despite some fuzziness in the process, investors want no surprises in pricing/fees, compliance and eligibility when a loan is delivered. No surprises—zip, zero.

- **Operational zig-zags:** To ensure no surprises in delivery, lenders are underwriting loans two, three and four times, often manually. The trade-off is operational inefficiencies against perfect delivery and quicker funding, hopefully at a profit.

- **Über compliance:** Investors and agencies are performing real-time loan-level audits of each loan to enforce their credit terms and protect their capital base.

- **Fraud patrols:** There appears to be no limit to creativity in committing fraud, particularly as credit tightens. Checking the checkers who check the checkers, and then some, is the norm—not the exception.

- **Less automation:** There is increasing use of manual, paper-based processes rather than more use of vastly comprehensive data and information capabilities. The more lenders rely on paper, the more manual the process.

Yet even with all these 2009 speed bumps, the Mortgage Bankers Association (MBA) reported that 96 percent of 292 independent mortgage banking firms reported an average increase of 28 percent in their origination profits in the second quarter of 2009 compared with 85 percent in the first quarter

of 2009 and 53 percent in the fourth quarter of 2008. While these increases do not include any of the megalenders, it is notable that independent mortgage bankers were able to increase their profitability by spreading their fixed costs across more volume.

Historically, the independent mortgage bankers have been less focused on market leadership and more focused on nimbleness and innovation. Have they already figured out a better 2010 destination or are they effectively building a higher, wider bridge to the same destination?

Ever on the prowl for relevant parallels in other industries, are there similar stories of effectively building a bridge around a seemingly fuzzy situation—such as Toyota figuring out 10 years ago that a hybrid product would be the car in demand today while American car manufacturers built sport-utility vehicles (SUVs), the vehicle in demand then? Or how Billy Beane bridged the baseball industry's smallest budget with a new set of "effectiveness" benchmarks to create a new—and now proven—way to make the Oakland Athletics® a regular Major League Baseball® (MLB) playoff-caliber (though not World Series®-caliber) baseball team?

Or maybe it is the story of the Millennium Bridge itself. Officially named the London Millennium Footbridge, the expanse that spans the Thames River between the Tate Modern museum and St. Paul's Cathedral is a \$32 million design marvel opened on June 10, 2000, by Queen Elizabeth II herself. Along with participants in a Save the Children® charitable event, tens of thousands of people lined up that day to cross the narrow 370-meter aluminum footbridge accented by obtuse-angled steel projections.

But minutes after the official opening, a slightly swaying footway turned into a tilting, shaking nightmare with some pedestrians forced to cling to its siderails. Authorities shut the bridge, explaining that while the structure had been extensively tested

for both flexibility and wind, the first-day pedestrian traffic was too much. The bridge reopened the next day with strict foot traffic limitations, but the shake, rattle and roll continued. The "Wobbly Bridge" closed two days after its opening.

After ruling out the bridge's foundations and wind anomalies as culprits, the real problem turned out to be crowd behavioral dynamics and their impact on the footway. It turns out the lifting and placement of each human foot produces not only a vertical force, but a slight sideways one as well. Even a handful of people walking in a confined space can generate enough horizontal movement to create some sway in a suspended walkway.

While the initial foot traffic was certainly not organized and quite naturally random, it only took a couple of pedestrians walking with the same stride to initiate instability. The natural response to instability is to achieve stability, which, on a swaying bridge, is to adopt the same stride. The unscripted crowd dynamic did just that, with more and more pedestrians adopting the same stride. This, of course, only made the problem worse, causing the bridge to lurch.

Nearly \$9 million, two years and dozens of strategically located shock absorbers later, the Millennium Bridge reopened. To this day it is a higher, sturdier path between an old and a new London landmark, having overcome how humans stay balanced while performing a seemingly simple natural act—walking.

For 2010, in the mortgage business, both retail and wholesale lending need to invest in bridging what made 2009 fuzzy with innovation and with less attention to crowd dynamics. There are certainly plenty of shock absorbers available to lenders to take the wobble out of the business. Specifically, lenders should consider the following:

- **Leverage data and information.** A number of vendors have done a superb job of taking raw data and turning them

into robust information about borrowers, property values, income, identity and behavioral characteristics. So much of this easily attainable data and information could serve to orchestrate the lending process (e.g., determine what paper is needed rather than ask for every possible document upfront) and provide lenders with an optimal outcome for every borrower, not just the ones with the "best" paperwork.

- **Automate decisioning.** Take control of your best execution with a highly transparent, extremely consistent, completely defensible approach to every decision you make in the lending process. Underwriting is one of many decisions made between application and delivery, but usually the last one using some form of automated decisioning. If you apply some form of policy for suitability, pre-funding, post-close, quality control, data or even data and document alignment, you can automate those decisions.

- **Execute with eDocuments.** Quit looking for sheets of paper. Go green. Save the expense of paper, energy, file folders and filing time and use the Web. Put an end to the endless nuances of paper-based compliance.

Whether you are headed someplace new or trying to streamline the route between two known arenas, there is a lot out there to make 2010 a breakthrough year—for the lender, the borrower and the investor. As an industry we've been wobbling like the Millennium Bridge for a couple of years now, yet the solutions are all around us. If indeed the independent mortgage bankers have already figured out how to break stride, it should be a very interesting year.

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