

## Home Equity Lending Growth Trends in Origination Volumes and Portfolio Totals

James T. Leath, Jr.  
BenchMark Consulting International

### *Forecast for Growth ?*

The entire mortgage industry experienced unprecedented success in 2002 and to date in 2003. The wave of refinance volume fueled by the attractive rate market led consumers in record numbers to tap into the equity in their homes. Planning for 2004 leaves many lenders wondering if the borrower's appetite for loans can possibly continue at this pace. Reports are mixed, in that consumer confidence is weakening and unemployment continues to be on the upswing. One recent study recorded the biggest drop in the consumer confidence index, a critical economic predictor, in the past ten years.<sup>1</sup> Many experts predict a slower pace for growth in originations. So, while the mortgage industry may see a reduction in the record numbers posted, the home equity segment is still expected to perform quite well.

There are several factors to consider in planning for sustained growth in this arena. Home improvement and debt consolidation remain the top reasons homeowners give

for obtaining a home equity product. Both of these will continue to figure in importance, especially in a down economy. As homeowners are placed in a "remodel position" as opposed to a "move-up position", they will capitalize on the readily available cash from their equity. The trend for the next 24 months will be for borrowers to focus on staying in their current homes and making home improvements. Likewise, as consumers worry more about their financial futures they are very interested in lowering their total monthly payments and getting a grip on their household budgets. Rolling consumer debt into one lower payment with tax advantages will remain an attractive option for many homeowners.

After hitting bottom, at some point mortgage rates will tick upward. Most who were watching the rate market closely in order to appropriately time their re-finance have already made their move. As always, when refis decline, home equity products experience a surge. Historically, refinancing has made up as much as 60% -80% of all mortgage loans. Going forward, that number should normalize in the 30% range

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<sup>1</sup> U.S. Department of Labor, Bureau of Labor Statistics, *Consumer Confidence Survey*.

This alone should result in many lenders experiencing strong performance for their home equity product set.

Managing delinquencies will also be part of the story in late 2003 and beyond. As unemployment continues to be a concern, consumer credit is poised to be the next major challenge facing banks. Deteriorating credit quality is already a significant problem in the lower-end market, such as FHA, VA and sub-prime mortgages. This trend may begin to impact the home equity lending market as well.

### *Channel Importance*

To capitalize on the opportunities and guard appropriately against the pitfalls, one needs to recognize the value of channel management. The branch will continue to be the largest source of originations and across-the-desk lending will remain the number one way consumers wish to do business. In many respects, non-branch channels have become a different way to access a customer's funds with most still wanting and needing some face-to-face service from financial services. It is, as expected, also the segment that experiences the best performance in terms of default. While the branch is usually the most expensive channel, there are strategies for integration of workflow processes that can significantly impact origination cost.

In-house telemarketing of your own files is an excellent supplement to the branch business. Banks who have ramped up their call centers to serve as sales centers have experienced good returns. The numbers fall way off when hiring outside agencies to contact customers, as consumers continue to tire of intrusive and impersonal calls.

Using the call center for direct mail follow-up adds upwards of 40% to response rates from a mail campaign.

Reports indicate that banks continue to consider the mail an important resource for selling product and we will see record numbers of home equity lending solicitations in 2003. Response rates continue to hover around .5% and the key is ensuring your process is primed to convert those responses to booked deals.<sup>2</sup>

Lastly, the Internet and on-line banking have not lived up to the hype in terms of generating new business. Over ninety percent of consumers say they are not yet comfortable submitting a loan application on-line. The numbers are much stronger for existing customers who check balances, pay bills and manage their accounts via on-line banking. But, even those cyber-savvy individuals would prefer to request information and talk with a lender either in-person or on the telephone. As a channel for generating deals, the internet is not expected to generate more than 10% of all closed loans.

### *Capitalizing in a Down Market*

In these uncertain times, there are several approaches banks can take to sharpen their focus in four critical areas. The design and implementation of your plan in Organization, Marketing, Process Improvement and Technology can solidify your bank's performance.

#### *Organization*

Where is the staff, what are they doing and when are they doing it are the key questions

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<sup>2</sup> Financial Services Marketing Research, January 2002.

in designing optimal organizations. Using industry best practices, we have identified many opportunities for leveraging your biggest expense – the people behind the engine. You have to take apart your existing structure to understand the workflow, including non-value added steps, and analyze each stage of the process from the application to the closing table.

One of BenchMark’s core competencies lies in taking the designs and processes of high performance institutions and crafting staffing models to work for any organization. Measuring the volume of work and relating staff to volume by the hour, time of day or day of week is vital. This approach requires increased management capacity, but the results speak for themselves. Seeing what is possible by industry leaders will enable you to set goals for your institution and implement strategies for achieving results.

#### *Marketing Strategy*

Cost containment is a buzzword that is not likely to fade away any time soon. As budgets get squeezed, the first line items to go are usually in staff support functions. Marketing is another popular division to suffer cuts. Today’s environment is ripe for marketing expenditures, not cuts. The business is out there and it will go to the ones who go after it. Improving your ROI on your marketing investment can be achieved through strategic targeting of your message and your audience. Most large banks report they are planning home equity campaigns including mass advertising, direct mail and in-branch promotion. We predict we will see pre-approved campaigns and rate promotions and gimmicks, but largely the focus will be on the basics of product benefits. Too many banks have been

burned lately with too-good-to-be-true teasers that backfired. The smart balance of margin, market and message will triumph.

#### *Process Improvement*

The three basic components of process are efficiency, effectiveness and cost. Top performers are able to maintain the delicate balance among these three. A review of the application processing function can result in significant savings and improved acquisition costs. A complete review would entail the assessment of the following:

- Product Offerings and Delivery Configuration
- Application and Vendor Document Processing
- Underwriting
- Document Preparation and Closing
- Home Equity Turn Around Time
- Loan Review, Booking and Funding
- Account Set-up
- Account Administration
- Consumer Lending Customer Service
- Collections
- Foreclosure and Recovery

Knowing where you as an organization rank in each of these measures against the best performers will help you chart your course. If you don’t know how you stand, you should. In this ever-changing marketplace that offers consumers a wide array of choices it is increasingly important that Home Equity lenders provide seamless and streamlined process for attracting, evaluating and booking new applicants.

#### *Technology*

New and improved doesn’t matter much, if it doesn’t contribute to the bottom line. It is easy to be impressed with the automation

of a labor intensive business process , or the ease of an application processing system. The key to successful integration is managing the entire workflow to take full advantage of the efficiencies the combination of business process and technology can offer. An upgrade or a new

technology installation that does not encompass an entire business improvement plan is not likely to produce the desired results and in our experience will only get an organization 50 to 55% of the benefit available from the planned enhancement.

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**James T. Leath** holds extensive experience in consumer banking management, reengineering and streamlining operations, product and project management, mergers and consolidations. Since joining Benchmark in 1995, Leath has executed consulting engagements in consumer loan operations, consolidations and in the review and analysis of consumer collections. He is the Consumer Practice Manager.

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**BENCHMARK CONSULTING INTERNATIONAL**  
3535 Piedmont Road, Suite 950  
Atlanta, Georgia 30305  
(404) 442-4100