The Millennium Challenge
By David Lereah

As we enter the new millennium, mortgage lending companies leave behind perhaps the two greatest years in the history of mortgage lending—1998 and 1999. During the past two years, mortgage originations skyrocketed to an unprecedented $1.5 trillion in 1998, followed by an equally remarkable $1.3 trillion (estimated) in 1999. Looking forward, the industry is bracing for a cyclical downturn in 2000, which hopefully will be short-lived. Perhaps more telling is that the new millennium promises to present a changing landscape for conducting mortgage lending and servicing activities, prompting companies to meet the challenges of a changing business model.
The industry has already begun a metamorphosis that promises to change the mortgage lending landscape forever. Advances in technology have resulted in substantial consolidation in both the origination and servicing processes of the mortgage business. In turn, larger companies have experienced significant productivity gains, resulting in further consolidation as well as a changing emphasis on the distribution channels for mortgage loans.

Furthermore, the advent of the Internet has given birth to a new brand of "online companies" that represent a formidable challenge to the more established mortgage companies adhering to their traditional mortgage lending business models. Technology has also heightened the roles of Fannie Mae and Freddie Mac in the mortgage lending process as they expend significant dollars and effort in technology innovation.

Today, the lending landscape is comprised of a handful of mortgage aggregators (i.e., mega-lenders), thousands of small mortgage banking companies and mortgage brokers and a handful of Internet specialists. As a result, emphasis among the different distribution channels is changing. Wholesale (purchase) business is rising relative to the traditional retail business. In fact there is now an observable split in the industry: wholesalers versus correspondent/brokers.

On the servicing side, the landscape has evolved into a simple one: there are now a handful of mega-servicers and a few hundred small servicers. In fact, the top 25 servicers now control about 51 percent of the market. The trend line for the next decade suggests that the top 25 servicers by the end of the decade will control 91 percent of the servicing marketplace.

The implications of this new competitive model are significant. Mortgage aggregators are large and thus, have the resources and abilities to build brand recognition, placing smaller companies at a competitive disadvantage. The aggregators are and will continue to place strong emphasis on cross-selling and retention strategies. They also have the resources, (along with Fannie Mae and Freddie Mac) to create and offer a new, varied menu of mortgage products that are more customized to specific customer groups than in the past. And finally, they have the ability to invest heavily in the Internet as a primary distribution channel.

If the US. Internet economy were a country, it would be the 18 largest in the world. At year-end 1998, almost 50 percent of households in the U.S. owned a personal computer and e-commerce sales registered $102 billion. According to Forrester Research, 23 percent of potential homeowners searched for a home online in early 1999, compared with just 2 percent in 1995. By 2002, the top 25 mortgage lenders will provide real-time approval of mortgage applications on the Internet. Earlier this year, Forrester Research projected that Internet originations will grab a 10 percent market share of total industry originations by 2003. On a more optimistic note, a recent Deutsche Bank study projects that Internet originations will grab a 25 percent market share of total industry originations.

If the above prognostications are close to reality, the Internet will become a major distribution channel for the mortgage lending business. Companies must alter their business models to include e-commerce as a solution. Strategic alliances and joint ventures with the major Web portals and other Internet specialists may become a necessary way of doing business in the years to come. The consumer-to-business Internet model may eventually be adopted by most mortgage lenders during the next decade.
Similarly, this decade's competitive environment promises to force companies to focus on business-to-business Internet solutions as well. Much of the business transactions (i.e., operations and consumer-related) will be in the virtual world (electronic) rather than the physical world. As the industry continues to replace paper with electronics, the costs of doing business drops, lowering the price to consumers. As a matter of survival, lenders will have to engage their business-to-business solutions (e.g., appraisals, title search, etc.) on Internet platforms.

With the new Millennium brings new challenges for mortgage banking companies. It is likely that the composition of the top 10 mortgage lenders and servicers today may be different in 2010. The challenge is for companies to acknowledge the changing lending landscape and meet the demands of the new dynamic marketplace head on.

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