

INSIDE MORTGAGE PROFITABILITY

PHH Sees Opportunity in Tight Times

Times are tough to make a profit in the mortgage business. Margins in the wholesale channel are squeezed so tight that light barely makes it through, volumes are down and competition for borrowers remains fierce. But that's good news for PHH Mortgage.

One of the nation's most successful private label mortgage providers, the Mount Laurel, NJ-based PHH thinks hard times will convince more companies to take advantage of its end-to-end outsourcing services as a way to remain profitable and keep their branding and reputation.

Mortgage firms are willing to give up their origination platforms, back office functions and employees for three reasons: strategic, economic and operational, Paul McCarthy, vice president of private label solutions, told us. "They're looking at profitability," he said.

PHH has banks, credit unions and independent companies as clients, including Merrill Lynch Credit Corp., Charles Schwab and Provident Bank. In addition, PHH has a long-term agreement with the realty companies (ERA, CENTURY 21 and Coldwell Banker) owned by its former parent, Cendant. PHH originated \$48 billion in private label loans in 2005 and did about \$59 billion in 2004.

The firm is finding eager prospects especially among banks that have origination platforms mired in fixed costs, which a flat yield curve puts pressure on margins. "Regional banks today are looking at that and wondering if they can make a return given everything that needs to go into a retail mortgage platform, but they very much want to stay in the business," McCarthy said.

By outsourcing, companies can reduce operational and investment risks and earnings volatility. This is true even for firms that outsource only a portion of their operations, but the benefits are more pronounced when outsourcing the entire mortgage process from origination to secondary market delivery.

Many mortgage firms are hesitant to spend the money needed to provide best-in-class technology to enable cross-selling efforts and support products, added Sharon Fuller, senior vice president of business integration.

Many lenders are not familiar with end-to-end mortgage outsourcing, so some of PHH's prospective customers are unsure just what its value proposition is and how the outsourcing works. That's why the company goes to great lengths to explain its business model and educate customers on how they can meet their business objectives.

"It is also critical that we get to the right level in a prospect organization because some of our toughest competition are the internal mortgage divisions that aren't necessarily incented to be as objective about an outsourcing alternative," Fuller said.

No Competition

One of the big hurdles for PHH is making sure that executives understand they are not giving up oversight of their brand. “They always control the strategic direction of their mortgage business,” McCarthy said. “Our objective is to make sure we can support any channel that they are looking to source through.” This effort results in stabilizing margins so their costs become variable, he added.

Mortgage companies also want to make sure that borrowers have the best customer service, which is why PHH guarantees service performance levels. Another value proposition is that PHH will act as a mortgage company’s conduit to the secondary market.

“We’ll buy that loan, servicing released. But we will continue to express their brand on the documentation,” McCarthy said. Moreover, PHH allows companies to cross-sell their financial services to their servicing customers, promising to stay completely out of the way. “We are not a competitor. We are not a bank and we do not cross-sell services, like other companies that buy servicing,” he said.

PHH believes companies, especially banks, want that kind of business model so they don’t get the feeling that they are “throwing their customers away.” And they get all the benefits of a lifetime relationship with customers, but without having to carry loans on their balance sheet, which frees up capital for use elsewhere.

From the moment a mortgage company signs on with PHH, it would take about 90 days for the transition. That includes setting up Web and phone channels, putting loan officers in place and providing a point-of-sale tool so that retail branches can refer borrowers. PHH now takes about 12,000 inbound calls per day.

“We support our Web with the inbound phone platform,” McCarthy noted. PHH believes this is just one example of what a true end-to-end mortgage platform should be, whereas many other outsource providers only provide the technology but not the support.

PHH is now a bigger fish in the mortgage origination outsourcing pond. Its active competitors have changed focus or have gone out of business. That includes Genpac buying Moneyline and Bank of America shutting down NexStar after buying its parent MBNA.

While PHH lost some high profile customers immediately after its spin off in early 2005, the company had a strong 2006 and expects to be “very active” this year in adding new customers to its roster. ►

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