

**MBA CREF 2005**

**Four Case Studies of Commercial Mortgage Servicers**

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## Introduction

*We will present four case studies on the economics of commercial mortgage servicers, comparing:*

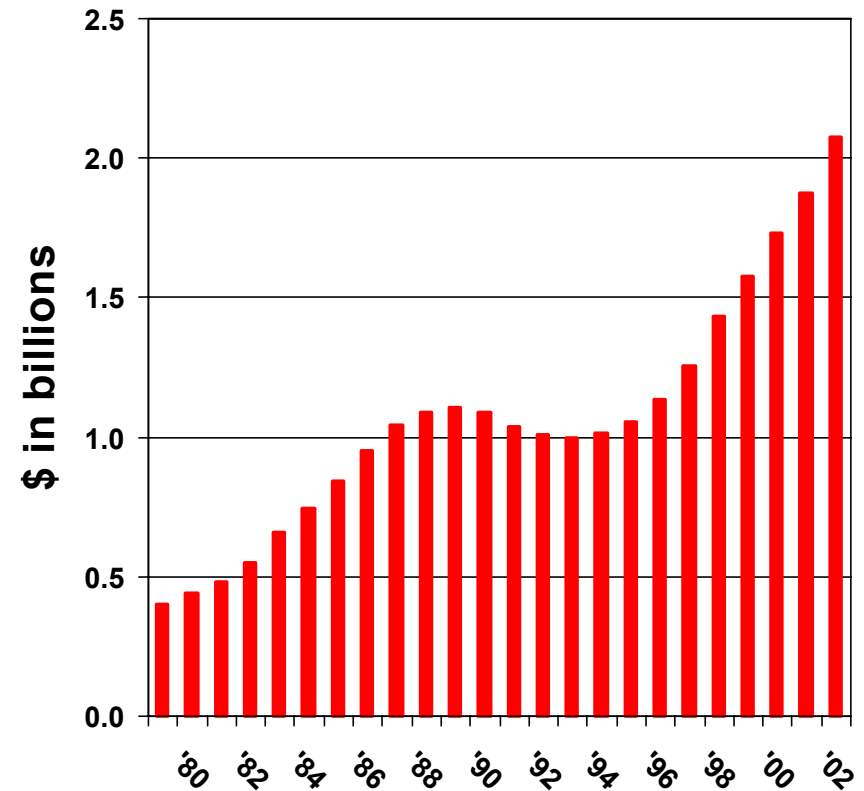
- **COMPANY A – A Portfolio Lender**
- **COMPANY B – A GSE Mortgage Banker**
- **COMPANY C – A Regional Mortgage Banker**
- **COMPANY D – A Large National Servicer**

*We will analyze and contrast among the four companies:*

- **Cost benchmarks**
- **Productivity and efficiency measures**
- **Possibilities of out-sourcing / off-shoring**

## Commercial Mortgage Debt

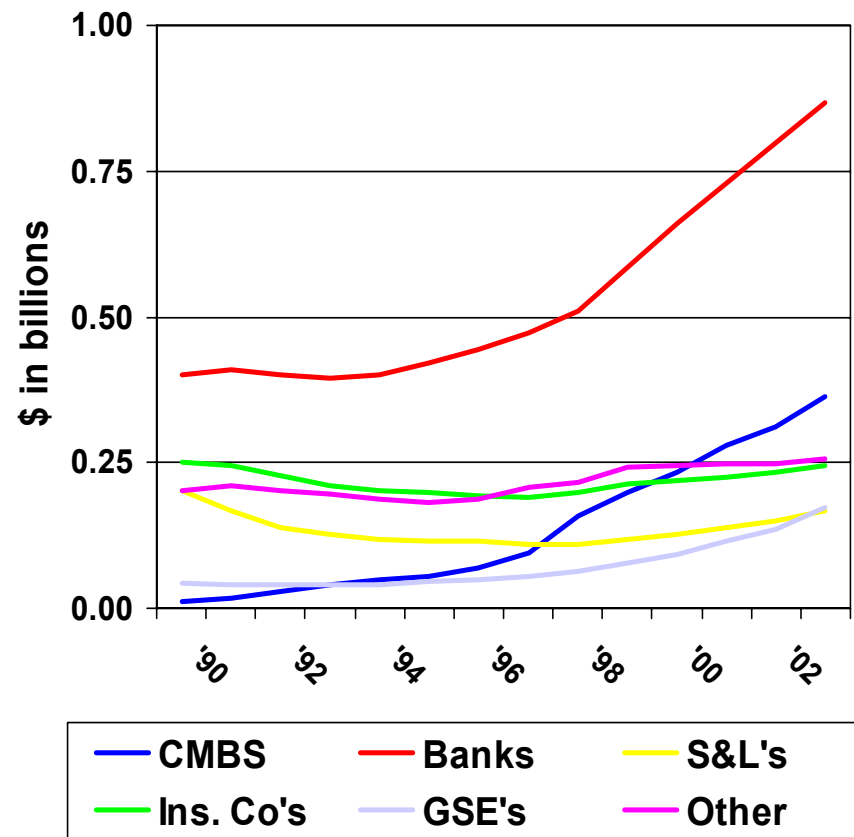
*Total commercial mortgage debt outstanding tops \$2.2 trillion in 3Q2004, up from half a trillion in 1982*



Source: Mortgage Bankers Association & Federal Reserve

## Growth of CMBS

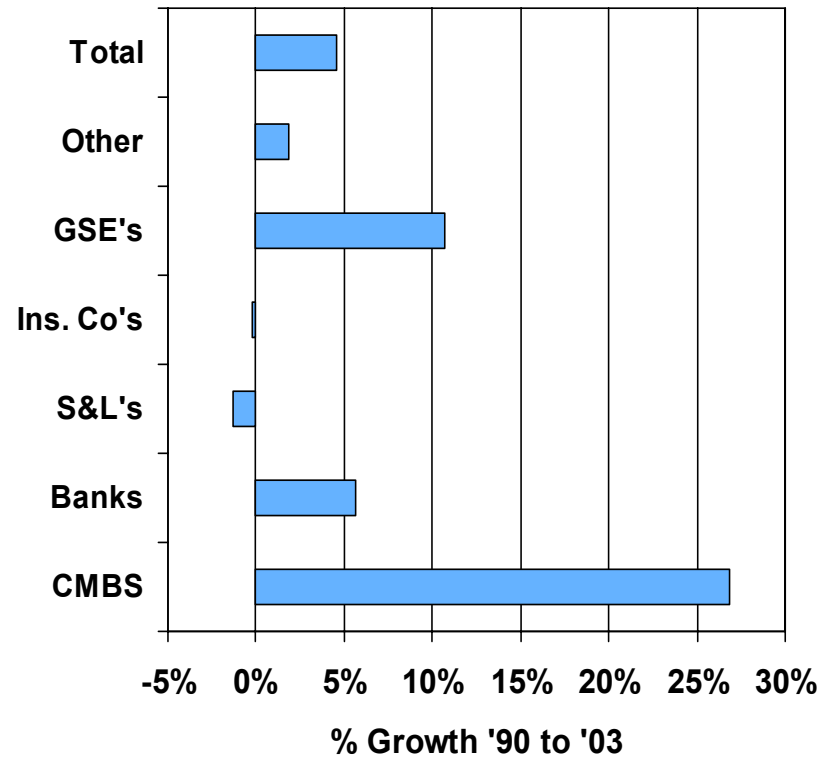
*CMBS has been the fastest growing segment within commercial mortgage debt --- and is now the second largest component of debt outstanding*



Source: Federal Reserve Board

## Growth of CMBS

*In fact, CMBS has grown at a compound annual rate of over 25%*



Source: Federal Reserve Board

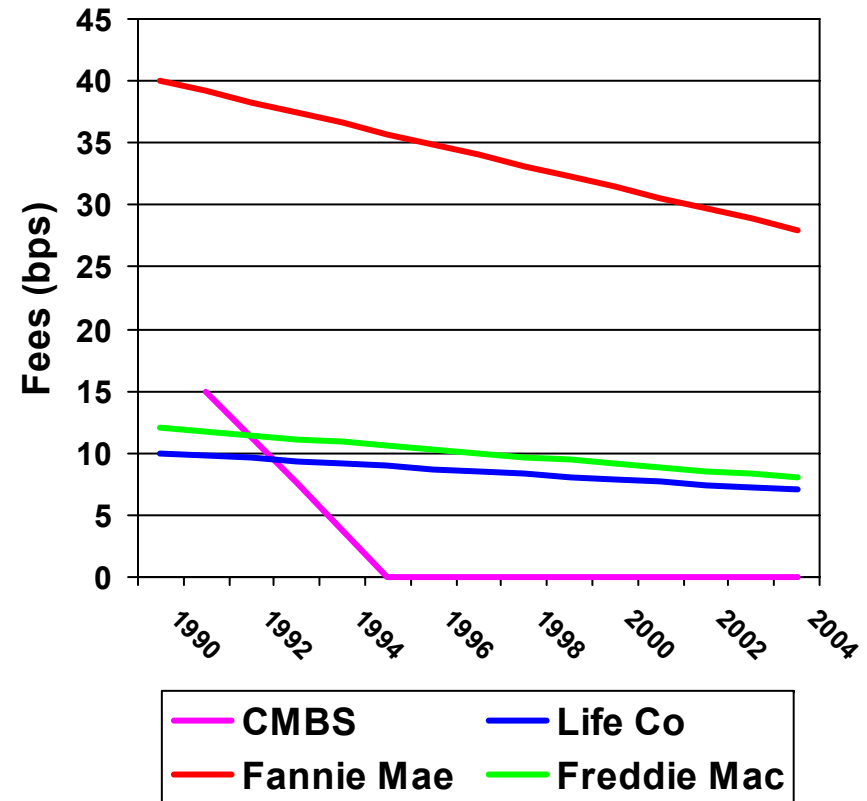
## Increasingly Complex Servicing Requirements

*Servicing requirements have become increasingly complex due to investor demands and increased regulation...*



## Decreasing Servicing Revenues

*.....while fees paid to third-party servicers have gone down over the same period*



## A Decade of Change

**TOP SERVICERS YEAR-END 2004** (those in blue bold were also in the top 15 servicers in 1997, those involved in mergers or acquisitions are noted with \*\*\*)

**GMAC Commercial**\*\*\*

**Wachovia Securities**\*\*\*

**Midland Loan Services**

**GEMSA Loan Services LP**\*\*\*

Wells Fargo Commercial Mortgage Servicing

Prudential Asset Resources\*\*\*

Washington Mutual

**ORIX Capital Markets, LLC**\*\*\*

Bank of America

Key Commercial Mortgage\*\*\*

**NorthMarq Capital**\*\*\*

Berkshire Mortgage Finance\*\*\*

Principal Real Estate Investors

ARCS Commercial Mortgage

**Reilly Mortgage Group, Inc.**

## Rationale for Case Studies

- .....Margins are compressing
- .....Industry is consolidating
- .....Reporting requirements are increasing
- .....Regulatory scrutiny is increasing

**SERVICERS COME IN ALL SHAPES AND SIZES**

*Is there a  
“best business model” for  
commercial mortgage servicing?*

**Assessing the “Best Business Model”**

**Cost per Loan**

**Loan per Headcount**

**Mix of Fixed v. Variable Costs**



***What is efficiency? IT DEPENDS!***

**Efficiency can be realized through a combination of.....**

- ▶ ***Process Re-engineering***
- ▶ ***Upgrading Technology***
- ▶ ***“Out-Sourcing” to Third Party***
- ▶ ***“Off-Shoring” to a Lower Cost Labor Market***

.....and the benefits may include:

- ▶ ***COST REDUCTION***
- ▶ ***SERVICE IMPROVEMENT***
- ▶ ***JOB ENRICHMENT***
- ▶ ***CAPACITY FLEXIBILITY***

## Achieving Process Efficiencies

*A comprehensive approach to achieving process efficiencies includes five steps.....*

Re-Examine Strategy and Goals

**ESTABLISH THE COST BASE**

Set Cost Reduction Targets

Identify Potential Initiatives

Prioritize Initiatives

## Characteristics of the Companies

Company	A Portfolio Lender	B GSE Mortgage Banker	C Regional Mortgage Banker	D Large National Servicer
# Loans	1,000	650	500	15,000
\$ Loans	\$8 billion	\$6 billion	\$2 billion	\$105 billion
Avg \$/Loan	\$8 million	\$9 million	\$4 million	\$7 million
Staff FTE	12	14	5	500
Outsource?	Yes	Minor	Selective, off- book	Minor
# Loans/Staff	83	46	100	30
Types	Primary	GSE Primary	Primary, Sub	Master, Primary, Special

## Findings

Company	A Portfolio Lender	B GSE Mortgage Banker	C Regional Mortgage Banker	D Large National Servicer
COST/LOAN/YEAR	\$6,500	\$3,000	\$1,000	\$2,000
COMPOSITION OF COST				
Personnel		72%	66%	47%
Technology		1%		18%
Occupancy		11%	16%	6%
Other Overhead		8%	12%	16%
Vendors		2%	4%	4%
SUBTOTAL	16%	94%	98%	91%
OUTSOURCED SVCS	84%	6%	2%	9%
ADDITIONAL CAPACITY	25%	5-10%	5%	5-10%

## Initial Assessment of Each Case

### *THEY THINK.....WE THINK*

#### COMPANY A: PORTFOLIO LENDER

→ **HAPPY** .... Cost of current “out-sourcing” model needs review against benefits and alternatives

#### COMPANY B: GSE MORTGAGE BANKER

→ **IMPROVING BUT NOT ENOUGH**  
.... Needs to establish cost base by function, and then invest appropriately in upgraded technology

#### COMPANY C: REGIONAL MORTGAGE BANKER

→ **STRIVING TO BE BETTER**  
.... Wildly efficient, but WHY?

#### COMPANY D: LARGE NATIONAL

→ **NUMBER ONE**  
.... Pilot selective out-sourcing with focus on maintaining quality control

## WHY SO DIVERGENT?

Company	A Portfolio Lender	B GSE Mortgage Banker	C Regional Mortgage Banker	D Large National Servicer
	Cost Center	Profit Center	Profit Center	Profit Center
	Includes Asset Management	Separate Asset Management	No Special Servicing	Includes Asset Management
	Low Tech	Low Tech	Low Tech	High Tech
	Out-Sources	Some Scale	No Scale	Huge Scale
	Excess Capacity	Some Excess Capacity	Little Excess Capacity	Some Excess Capacity
	Borrower Focus	Borrower Focus	Borrower Focus	Less Borrower Focus

## COMPARISON OF ORGANIZATIONAL SCHEME

Company	A Portfolio Lender	B GSE Mortgage Banker	C Regional Mortgage Banker	D Large National Servicer
By Activity	✓	✓		
By Portfolio			✓	
Hybrid				✓

**EACH COMPANY'S BIGGEST CHALLENGE?**

Company	A Portfolio Lender	B GSE Mortgage Banker	C Regional Mortgage Banker	D Large National Servicer
	"It's all manageable"	"Increasingly complex loans"	"Seasonal Peaks"	"Cash mgmt for large, complex loans"
		"Retaining staff"	"Finding staff"	"Ensuring 100% accuracy"
		"Experienced asset mgmt staff"	"Training staff"	"Processing borrower requests"
		"Become scalable"		"Volume of operating statements"
		"Improve technology"		"Monitoring triggers on complex loans"
		"Borrower satisfaction"		

## Current Industry Out-Sourcing Activities

### ***COMMONLY OUTSOURCED***

Property Inspections  
Appraisals  
Tax Processing  
Insurance Administration  
Lock Boxes  
Technology  
Payoff/Defeasance Calculations  
ARM Audits  
Administrative Functions  
Accounting

### ***SOMETIMES OUTSOURCED***

Operating Statement Analysis and Reporting  
Loan Assumptions and Modifications Processing  
Investor Reporting Packages  
Covenant Compliance  
Asset Plans for Special Serviced Loans

## Potential for Re-Engineering or Out-Sourcing

Company	A Portfolio Lender	B GSE Mortgage Banker	C Regional Mortgage Banker	D Large National Servicer
	Change model	Re-engineer processes	Out-source seasonal peaks	Out-source peaks
	Possible cost reduction	Invest in technology	i.e., Inspections, Operating Statements, Insurance	i.e., Borrower Requests, Operating Statements
	Annual evaluation process	Out-source select functions Focus on training		Off-shore select functions

## Barriers to Re-Engineering &/or Out-Sourcing (GENERAL)

- **Don't know current costs of activities**
- **Potential loss of quality control**
- **Potential reduction of borrower/client contact**
- **Cost of set-up and transition**
- **Morale issues**
- **Inertia**

**Barriers to Re-Engineering &/or Out-Sourcing (SPECIFIC)**

Company	A Portfolio Lender	B GSE Mortgage Banker	C Regional Mortgage Banker	D Large National Servicer
	Don't know current costs	Don't know current costs	Don't know current costs	Don't know current costs
	Same model used for 20+ years	Haven't considered yet	Want borrower contact	Quality control concerns
		Highly hands-on processes		Already market leader
		Want 100% accuracy		

## How to Begin Business Process Re-Engineering

- ▶ **Re-examine your business strategically**
  - **What business do you want to be in?**
  - **What is the basis of competition in that business?**
    - Cost?
    - Quality?
    - Speed?
    - Flexibility?
  
- ▶ **Analyze your costs by activity**
- ▶ **Set targets**
- ▶ **Define initiatives required to achieve those target**
- ▶ **Prioritize initiatives**

## KEY PERFORMANCE MEASURES

*Some commercial mortgage servicing KPMs include:*

- ▶ % of required operating statements received from borrowers by period-end
- ▶ % of required operating statements analyzed and reported to trustee/investors by period-end
- ▶ Employee turnover
- ▶ Continuing education hours per employee
- ▶ Borrower satisfaction (various measures)
- ▶ # of days to respond to borrower requests (assumption, pay-off, etc.)
- ▶ Timeliness in remitting funds to master by primary
- ▶ Total loans serviced per employee
- ▶ Total annual cost per loan

## Some Servicer Achievements

- ▶ **Establish web-based site for borrowers** = *reduces customer relations staff, enhances customer relations job content, increases customer satisfaction*
- ▶ **Out-source ongoing site inspection to new loan origination staff** = *leverages servicing staff, reduces seasonal workload crunches, enhances servicing staff role, gets new origination staff into the field*
- ▶ **Migrate from portfolio-based to function-based organization** = *focuses specialists on specialized functions, reduces staffing costs by assigning repetitive tasks to lower-cost personnel*
- ▶ **Migrate from function-based to portfolio-based organization** = *increase level of customer service and quality borrower interaction*
- ▶ **Out-source analysis and reporting of borrower operating statements to off-shore third-party provider** = *reduces costs, avoids peaks and valleys in staff requirements*
- ▶ **Out-Source Technology** = *access to state-of-the-art technology, reduces set-up and implementation time and cost*

**In their own words.....**

“So we increase efficiency by \$100 or \$200 per loan but we alienate a good customer? It’s not worth it!”

“We’re ultimately going to implement new technology --- but first we need to improve our processes. After all, you don’t want to pave a cow path!”

“Training and retaining good people --- that’s a big issue. We try to avoid having our people do punch press work.”

“We lose some good servicing people to the origination and underwriting teams --- that’s going to change with the next downturn!”