

Mortgage Industry Financial Performance: Mid-Year 2002 Results

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STRATMOR

GROUP

CONSULTING

INVESTMENT BANKING

Agenda

- Peer Group Overview
- Overall Summary
- Key Performance Drivers
- Peer Group Hot Buttons
- Open Forum - Questions

Peer Group Overview



June 30, 2002

MBA/STRATMOR Peer Group Program

- ❑ MBA/STRATMOR joint effort
- ❑ Data submissions every six months
- ❑ Divide companies into Peer Groups
- ❑ Generate comparative reports
- ❑ Meet offsite with Peers to discuss
- ❑ Timely data - high quality
- ❑ 40% coverage of National Market

Peer Group Structure

- Peer Group M - Mega-lender/Serviceers
- Peer Group A - Large Lenders/Serviceers
- Peer Group C - Small/Medium-sized lenders
- Peer Group S – Subprime Lenders

The Peer Groups

Peer Group M Mega-Lender/Serviceers

- ABN Amro Mtg.
- Bank of America
- Cendant Mortgage
- Chase Manhattan Mtg
- CitiMortgage
- CTX Mortgage
- E-Loan
- First Horizon
- GMAC Residential
- National City Mortgage
- Principal Residential Mortgage Inc.
- SunTrust Mortgage
- Washington Mutual

Peer Group A Large Lenders/Serviceers

- Alliance Mortgage
- Aurora Loan Services
- Branch Banking & Trust
- Charter One Mortgage
- Columbia National
- HomeBanc
- Huntington Mortgage
- Irwin Mortgage
- Market Street Mortgage Corp.
- New America
- RBC Mortgage
- Regions Mortgage
- Resource Bancshares Mtg. Corp.
- SIB Mortgage-dba Ivy Mortgage
- Taylor, Bean and Whitaker

Peer Group C Small/Medium-Sized Lenders

- AmSouth Bank
- Bank of Oklahoma Mortgage
- BSM Mortgage
- CMG Mortgage
- First Merit Mortgage Corporation
- Guild Mortgage
- H&R Block Mortgage Corporation
- Ivanhoe Financial Inc.
- Pinnacle Financial Corporation
- Residential Mortgage Capital
- Secured Bankers Mortgage Co.
- Sidus Mortgage Corporation
- Southtrust Mortgage Corporation
- Synovus Mortgage Corporation
- United Pacific Mortgage

Peer Group S Subprime Lenders

- Aegis Mortgage
- Altegra Credit Company
- Centex
- Champion
- Chase Manhattan Funding
- CitiFinancial Mortgage
- Cresleigh Bancorp
- First Franklin
- NetBank, Inc.
- New Century
- NovaStar
- Option One Mortgage Corporation
- Saxon
- Washington Mutual
- WMC Mortgage Corp.

Future Plans...

- ❑ Expand participant base from 67 current participants to 75 next round
- ❑ Create 2nd subprime group
- ❑ Operational Focus Groups (Retail, Direct, Broker and Operations)
- ❑ Ongoing additions to data set
 - Processor, Underwriter and Closer productivity
 - Modifications and additional retention metrics
 - Technology capital expenditures

Peer Group Results



Overall Summary

Six Months Ended June 30, 2002

The Big Picture

- ❑ Overall production margins improved from 70 bps in 2001 to 74 bps in 2002
- ❑ Revenues increased by 6 bps, partially offset by slightly higher costs
- ❑ Productivity slipped from 2001 levels
- ❑ Net warehouse interest spread became a bigger piece of the revenue pie in 2002
- ❑ Mega Lenders outperformed Large and Small lenders on many fronts, including revenues, productivity and production margins
- ❑ Servicers continued to take a beating from MSR impairment and amortization, but improved performance operationally

Peer Group Characteristics

	2002	2002	2002	2002	2001
	Small	Large	Mega	Full Sample	Full Sample
Assets (\$mil)	\$148	\$697	\$13,280	\$4,823	\$3,829
Production Volume (\$mil)	\$1,299	\$4,952	\$51,655	\$19,712	\$17,972
Avg Orig Loan Balance	\$132,558	\$141,559	\$167,860	\$164,458	\$153,854
Servicing Volume (\$mil)	\$4,367	\$14,119	\$147,399	\$69,382	\$56,046
Avg Svg Loan Balance	\$77,568	\$99,938	\$116,420	\$111,454	\$103,333
* Annualized Results based on June 30, 2002 data					

Peer Group Characteristics - Production Channel Mix

	2002 Small	2002 Large	2002 Mega	2002 Full Sample	2001 Full Sample
Retail	74%	45%	34%	36%	34%
Broker	21%	35%	36%	35%	35%
Correspondent	2%	18%	24%	23%	25%
Direct Marketing	1%	2%	6%	6%	6%
Subprime	2%	0%	0%	0%	0%
	100%	100%	100%	100%	100%

- **The Retail channel dominates among small to mid-sized lenders**
- **Not surprisingly, Large and Mega Lenders have more Broker and Correspondent channel activity**

Return on Required Equity (%)

	Small	Large	Mega	2002 Total	2001 Total
Production	110	106	95	96	79
Servicing	-44	-6	15	14	-3
Overall	45	38	48	48	32

* Results based on June 30, 2002 data, annualized

Production Margins (bps)

	Wtd Avg Pretax Margins				
	2002	2002	2002	2002*	2001
	Small	Large	Mega	Full Sample	Full Sample
Retail	71	87	78	78	79
Broker	31	43	73	70	59
Correspondent	17	41	54	53	56
Direct Marketing	85	85	161	159	146
Overall	63	63	76	74	70
	Refinance % - Based on \$				
Retail	55	42	52	51	55
Broker	50	62	62	62	66
Correspondent	23	58	57	57	57
Direct Marketing	98	92	80	81	86
* Annualized Results based on June 30, 2002 data					

Production Margin Trends: Five-Year Trends(bps)

	Wtd Average Pre-Tax Production Margins (bps)				
	2002*	2001	2000	1999	1998
Retail	78	79	(3)	15	60
Broker	70	59	12	46	48
Correspondent	53	56	6	16	26
Direct Marketing	159	146	40	73	161
Overall	74	70	6	25	51
* Annualized Results based on June 30, 2002 data					

- Note: Megalender group formed in 1999

Servicing Results

	2002	2002	2002	2002*	2001
	Small	Large	Mega	Full Sample	Full Sample
Net Operational Income (\$/loan)	272	241	436	415	374
Direct Expense (\$/loan)	97	83	75	76	71
Average Loan Balance	72,610	93,613	114,109	111,454	103,333
Loans per Employee	962	987	1,261	1,223	1,243
* Annualized Results based on June 30, 2002 data					

- Operating income gap driven by differences in average loan balances, direct expense and g-fee differences

Peer Group Results

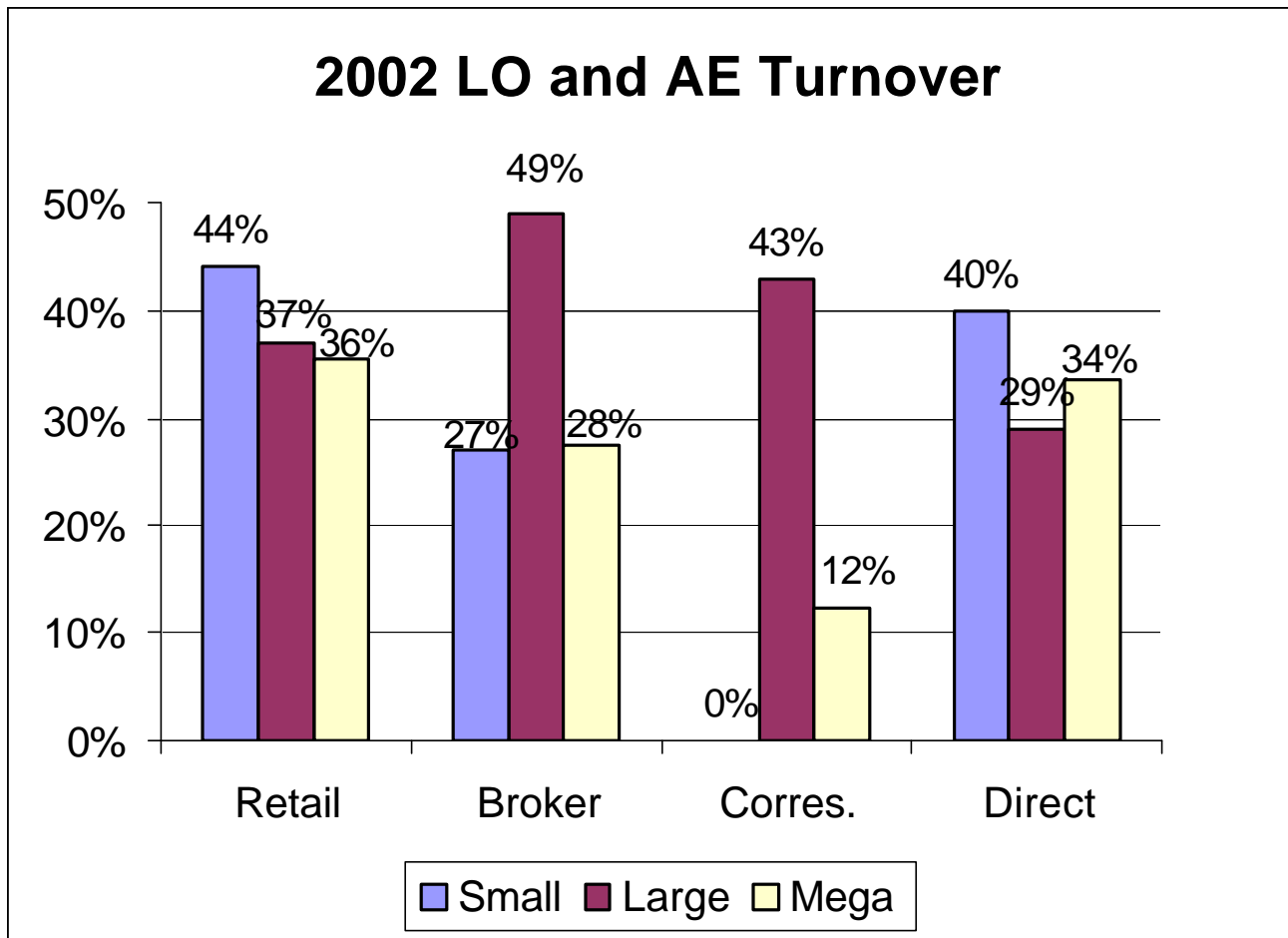


Key Performance Drivers

Productivity – Relates to Size in 2002

Productivity by Channel and Peer Group			
	Small	Large	Mega
<i>Retail Channel</i>			
Loans per Loan Officer	69	92	111
<i>Broker Channel</i>			
Loans per Account Executive	650	851	1,180
<i>Correspondent Channel</i>			
Loans per Account Executive	1,174	2,348	7,686
<i>Direct Marketing Channel</i>			
Loans per Loan Officer	114	189	359
* Annualized Results based on June 30, 2002 data			

LO and AE Turnover – Is This as Good As It Gets?



Bank Affiliated vs. Independent – What Are the Differences?

□ **Bank**

- **Cost driven**
- **High control**
- **Salesmanship lacking historically**
- **Lower revenues, but lower costs**

□ **Independent**

- **Sales and production driven**
- **Never met a loan they didn't like**
- **Entrepreneurial**
- **High service – focus on customer**
- **Higher revenues, but higher costs**

Sample Financial Results – Bank vs Independent

	Bank	Indep
# Companies in Sample	5	7
Total Retail Volume Originated (\$000s)	1,750,934	747,055
Retail Average Loan Balance (\$)	132,373	146,071
% of Retail Loans Brokered (based on \$)	1	12
Dollars per loan:		
Total Income	3,277	4,948
Expenses:		
Total Production Expenses	1,773	3,338
Total Allocated Prod Support Expenses	347	280
Total Corporate Allocation	242	375
Total Expenses	2,363	3,994
Net Retail Production Income	915	954
Basis points per loan:		
Total Income	249	364
Expenses:		
Total Production Expenses	133	247
Total Allocated Prod Support Expenses	26	20
Total Corporate Allocation	19	26
Total Expenses	178	293
Net Retail Production Income	71	71

Interest Spread Matters in 2002

	Retail	Broker	Corresp	Direct
Interest Spread (\$ per loan)	695	856	530	740
PreTax Production Margin (\$ per loan)	1,298	1,246	801	2,387
Spread as % of Margin	54%	69%	66%	31%
* Annualized Results based on June 30, 2002 data				

Servicing Financial Items (\$/loan)

	2002	2002	2002
	Small	Large	Mega
Svcg.Operational Inc \$/ln	272	241	436
Amortization	(179)	(204)	(378)
Impairment	(176)	(145)	(120)
Hedging Gains/Losses	(34)	67	153
Bulk Sale of Svcg	0	17	2
Total Financial Items	(389)	(265)	(343)
NET FINANCIAL INCOME	(117)	(24)	93
* Annualized Results based on June 30, 2002 data			

Market Share Forecast

- Based on our survey of peer group participants, all companies are forecasting an increase in market share for 2003...
- While we are not sure, we sense that this may not be possible

Peer Group Hot Buttons



Business Issues and
Reporting/Measurement
Response

Is the Mortgage Business a Good Business?

□ **Business Issue -**

- Life has been good recently, but does the mortgage banking business provide a reasonable return throughout all interest rate cycles commensurate with the risks?

□ **Measurement and Reporting -**

- EVA measurement
- What is the appropriate cost of capital? Hurdle rate?
- Opportunity cost – evaluate other investment choices
- If attached to a bank, what is the customer relationship value and is it attributed to the mortgage division?
- Don't neglect franchise value considerations

Contingency Planning – Life After the Refinance Boom?

□ **Business Issue -**

- How can we plan for the inevitable end of the refinance boom?

□ **Measurement and Reporting -**

- Specific action plans with timetables
- Shock Testing - Sensitivity of production, revenues and expenses to changes in interest rates
- Have we “variable-ized” all possible costs?

Have Servicing Values Dropped Permanently?

□ **Business Issue -**

- Has there been an industry-wide, permanent structural change to the value of servicing rights?
- If so, what are the implications to your business?

□ **Measurement and Reporting -**

- If compensation is based on production dollars, what happens to margins?
- Better off retaining servicing rights?
- What will happen if certain mega lenders improve retention capability? Will this be priced in to SRP?

Should you Incentivize the Same for a Modification/Refi/Purchase?

□ **Business Issue -**

- If a refinance or modification costs less to source and process, should the L.O. receive the same commission?

□ **Measurement and Reporting -**

- Loan officer morale and retention considerations
- Is it better to bypass the L.O. and refer refis to a centralized call center/processing center?
- You may lose some refinance business; is that so bad? Potentially less volatility, improved franchise value.

Streamline Refinance and Purchase Production

□ **Business Issue -**

- If it costs so much less, why don't we originate loans on a streamlined basis more often?

□ **Measurement and Reporting -**

- Have you segmented your production to determine which loans may be streamline eligible?
- Have you identified processes that could be either made more efficient or eliminated?

How Much More Does it Cost to Produce a Government Loan?

□ **Business Issue -**

- Is government lending a profitable product line?

□ **Measurement and Reporting –**

- Do you know the cost to produce a government loan versus a conventional loan?
- STRATMOR Group regression analysis
 - Retail direct cost to originate government loans (before commissions) average \$1,200 more than conventional loans
- Why this might be true:
 - Agencies accepting loans that would have previously been originated as government; What's left are loans that may not fly through AU; more difficult to do (adverse selection)
- If true, what are the implications?
 - Lenders would need more than 90 to 100 bps of additional revenues (servicing value, pricing gains, fees) to make up difference

Local Processing vs Centralized – And the Winner Is...

□ **Business Issue -**

- In the end, is it better to use local processing or to centralize processing?

□ **Measurement and Reporting –**

- What does your internal data/experience tell you?
- Peer Group data – inconclusive to date
- We will capture data on fulfillment centers next round to begin building the data set needed to conclusively answer this question

Loan Officer Quality

□ **Business Issue -**

- How can we improve the quality of our loan file packages “upstream”?

□ **Measurement and Reporting –**

- Do you measure loan package quality?
- Do you report loan package quality?
- Do you provide feedback to loan officers?
- Do you provide incentives (carrot or stick) for loan officers to improve file quality?
- Broker report cards used?
- Key – what is the cost/benefit of capturing and monitoring file quality?

Other Issues

- ❑ To what extent should you outsource the origination function?
- ❑ Can you measure profitability at the loan level?
- ❑ How much equity should be allocated to the mortgage business?
- ❑ RESPA Reform - Implications
- ❑ Do you measure customer satisfaction?
- ❑ Loan officer recruitment - hire “green” or “seasoned”?
- ❑ Are the returns in subprime commensurate with the risks?
- ❑ How can you increase purchase money business? Any luck with CBA's?
- ❑ Technology – Are we measuring the ROI associated with the deployment of new technology? If so, how?

Open Forum



Final questions or discussion
items?