



THE MORTGAGE JOINT VENTURE

Options and Best Practices
to Establish an In-House Lender



(800) 215-7138
www.metrocitiesjv.com
myspace.com/metrocitiesmtg

The Mortgage Joint Venture

Options and Best Practices to Establish an In-House Lender



An in-house mortgage lender is a logical extension of services for many “affinity businesses,” including:

- Realty companies
- Home builders/developers
- Banks and credit unions
- Financial and investment firms

Note that the listed affinity businesses have a natural connection to mortgage lending through core offerings in home buying or finance. Affinity businesses’ goals for starting an in-house lender include:

- Providing greater value to customers
- Increased revenue
- Synergies between affinity company and in-house lender
- Improved service through proximity and shared systems/technology

INDUSTRY TRENDS DRIVING ONE-STOP SHOP STRATEGY

In 2007, Terry Morris, President/CEO of GMAC Real Estate’s company-owned division, cited downward trends in agent commissions and productivity (closed units per agent) as an impetus for realty companies to establish “one-stop shops.” The main reasons: increased service offerings, elevating the value of the company and its agents to consumers, and more revenue for the company in the face of declining income from the primary real estate sales model. While realty companies are the predominant affinity business establishing in-house lending, all affinity businesses can partake in the benefits of improved service and profits. Mr. Morris’ conclusions echo the major affinity business goals listed above.

STATISTICS REVEAL CONSUMER PREFERENCE FOR ONE-STOP SHOP

Enthusiasm for an in-house lender is not limited to affinity companies and their mortgage partners. Surveys have revealed a consumer preference for “the one-stop shop,” a real estate office that houses ancillary services necessary to the transaction. A noted study by the Real Estate Services Providers Council (RESPRO), Murray Consulting, and Harris Interactive found that 82% of buyers would consider using “a simplified, one-stop shopping process” for their real estate transactions. The survey also showed that in-house mortgage was the service that would receive the highest level of consideration among ancillary businesses proposed.

“82% of buyers would consider using ‘a simplified, one-stop shopping process’ for their real estate transactions”

The same survey produced another telling statistic: 77% of all buyers used the mortgage professional recommended by their real estate agent. In conclusion, the majority of consumers is receptive to an in-house lender and will follow an agent's recommended choice of lender. This analyzed set of consumer behaviors is a prime rationale for establishing an in-house lender.

FOUR APPROACHES TO IN-HOUSE LENDING

There are four primary means to creating an in-house lender through an affiliated business arrangement program, or ABA:

⇒ **DESK RENTAL** ⇒ **SHARED MARKETING AGREEMENT** ⇒ **COMPANY OWNED** ⇒ **JOINT VENTURE**

Each ABA approach has inherent advantages and disadvantages which must be weighed when considering the best balance between costs, risks, return and service results.

⇒ **DESK RENTAL** ⇒ **SHARED MARKETING AGREEMENT** ⇒ **COMPANY OWNED** ⇒ **JOINT VENTURE**

Desk rental is the simplest approach to in-house lending. It frequently originates through a personal relationship between the partnering business owner and a loan officer. The loan officer pays a monthly fee for a desk and a marketing presence within the partnering business, such as signage and print materials. In many ways, this is the safest, fastest and least expensive means to establishing an in-house mortgage capability.

Pros:

- No overhead
- No liability
- Easy to set-up
- Easy to terminate
- Fixed income
- No association

Cons:

- Low fixed income
- Desk rent cannot be based on Realtor production
- Cannot be based on loans closed
- No control
- No ownership
- No value toward business

“in many ways, this is the safest, fastest and least expensive means to establishing an in-house mortgage capability”

The tangible benefit the primary business owner receives is the monthly desk rental fee. There is the less-tangible potential of synergies between the in-house loan officer and members of the partnering business—opportunities for cross-referral; customers receiving a deeper level of service with the one-stop shop experience. An absence of accountability makes this second possible outcome less definite. Without an ownership position to enforce performance standards on a desk-rental lender, the primary business can only trust that the in-house lender will do a credible job. The desk rental relationship can be easily and quickly terminated; however, this makes it an “all or nothing” proposition. The primary business owner exerts no control over the loan officer. He cannot improve performance through supervisory measures such as coaching or recruitment.

Even desk rental's biggest plus—the regular monthly fee—contains negatives. This fee is flat, and cannot be tied to agent performance for loans referred or loan officer performance for transactions closed. The business partner cannot reap more revenue even if the loan officer's business increases.

A shared marketing agreement is another fee-based relationship between a partner company and a lender, more sophisticated than desk rental with specific marketing duties assigned to the partner company as part of the agreement. Some of the biggest mortgage companies use shared marketing agreements, often as a cost-effective and low-risk means for partner companies to offer in-house lending. Mortgage companies and their partners frequently use shared marketing agreements as a trial before committing to a joint venture.

Pros:

- Fixed monthly income
- Little involvement
- No overhead
- No liability
- Easy to set-up
- No association
- Can “try out” the company

Cons:

- Determining the amount – cannot be based on actual loans closed
- Fee could be low if loan officer(s) captures significant business
- No business value
- No ownership

“mortgage companies and their partners frequently use shared marketing agreements as a trial before committing to a joint venture”

In a shared marketing agreement, the partner company agrees to market the lender in specified ways, including signage, Web presence, e-mails, on-hold phone messaging, and agent presentations. The lender may compensate a business partner for performing specific marketing services based on the fair market value of the services performed and not on loans referred or loans funded.

Shared marketing agreements foster more interaction and cooperation between the partner company and the lender. The partner company must “work” for its monthly fee through stipulated marketing actions and training programs for agents to promote the in-house mortgage company. Typically, a mortgage company manager will monitor the partner company’s upholding of the shared marketing agreement and provide best practices for implementation of marketing and training programs.

Although a shared marketing agreement is more sophisticated than desk rental, it presents the same negative—static income to the partner company that may not reflect the potential success of the in-house lender. The marketing fee can only be renegotiated once a year. The partnering company must decide if a flat fee is a fair trade for the financial obligations and risks—and potential rewards—of a joint venture.

⇒ DESK RENTAL

⇒ SHARED MARKETING AGREEMENT

⇒ **COMPANY OWNED**

⇒ JOINT VENTURE

At the other end of the spectrum, a company may decide to create its own mortgage venture without any involvement from an existing lender, assuming all responsibilities and risks.

Pros:	Cons:
<ul style="list-style-type: none"> • 100% ownership • Full control • Ability to fully integrate into company • Increases value multiple of company 	<ul style="list-style-type: none"> • Liability • Maintaining network and capital reserve accounts • Necessity of knowing all mortgage laws • Company departments/staff may be challenged by differing needs of mortgage industry • Identifying leadership to grow business and stave off competition • Must staff up for the mortgage firm (processors, etc.)

“the tradeoffs with this scenario are obvious: total control versus total responsibility”

The tradeoffs with this scenario are obvious: total control versus total responsibility. A mortgage company is a complex venture requiring expertise and capital. An independent venture could not benefit from an established mortgage company’s economies of scale in staffing, technology and reserves. To offer a sufficient range of loan programs, an independent company would likely rely on brokered products, which have smaller profit margins than banker-based products funded internally. A disproportionate reliance on low-profit loans, an oft-seen pattern for smaller, independent mortgage companies, could risk the venture’s profitability and even solvency.

⇒ DESK RENTAL

⇒ SHARED MARKETING AGREEMENT

⇒ COMPANY OWNED

⇒ **JOINT VENTURE**

A joint venture is formed as a strategic alliance between a mortgage company and a partnering member. The business structure can be a limited liability company or a standalone joint venture, with ownership typically split 51/49% or 50/50%.

Pros:	Cons:
<ul style="list-style-type: none"> • Bigger profit potential as loans close • Business value for mortgage ownership increased • Reduced liability (compared to establishing an independent mortgage firm) • Ability to integrate into affinity business • Control in the business 	<ul style="list-style-type: none"> • Capital contribution needed • No loans = no money • Longer set-up time • Exit clauses that can complicate dissolution

“the joint venture represents the optimal blend of benefits for both the affinity business and the mortgage partner”

Other factors to consider in starting a mortgage joint venture include:

Broker vs. banker.

If the mortgage entity is a mortgage banker—creating loan products “in-house,” it is important to know if it is a single platform or multi-lender platform. Does the mortgage entity allow brokering out if they can’t create a product internally with competitive pricing and terms? It is then important to know their pricing guidelines on brokered loans to determine profitability. The processing of brokered loan files is another important consideration, as this is an area where the JV can “lose control” of the deal if the file is handled by another company altogether. A mortgage entity that can process such files itself could be a stronger partner due to its ability to maintain service quality and uphold transaction deadlines.

Branding.

The marketing identity for the in-house lender is a major consideration. Many JVs have a unique company brand, derived from the affinity company’s name and branding. This marketing approach helps build recognition and reassurance in the minds of the affinity company’s customers—the main source of traffic for the in-house lender.

Some mortgage partners are flexible with JV branding, working with affinity companies to develop a unique image for the in-house lender. Other mortgage partners have much stricter guidelines, limiting branding choices for the in-house lender and imposing identity standards regarding logo size/placement, color schemes and typography on flyers, signage and promotion items such as shirts and mugs. These branding considerations also impact the affinity company’s ability to co-market itself alongside the in-house lender. An affinity company must make sure it is comfortable with its mortgage partner’s branding philosophy.

Fixed overhead costs.

Many mortgage companies charge a fixed fee sometimes deemed a technology or management fee. The affinity company incurs these types of overhead charges regardless of actual loan volume. In contrast, the allocation method assigns mortgage company fees as variable costs, charged only when a loan funds. Fixed overhead costs make it harder for the affinity company to reach profitability, particularly during the start-up period.

Retail team conflict.

Many mortgage partners have retail operations—offices operating under their own brand—in the same markets as their ABAs with affinity companies. The potential for conflict is obvious and can affect many levels of performance and operation. When selecting a mortgage partner, an affinity company must ask:

- Does the mortgage partner have local retail teams?
- If so, is the retail team manager also the ABA manager? If this is the case, what is that person’s commitment level to the ABA when profits must be shared, unlike the retail operation?
- Do different marketing, human resources, and payroll departments serve the retail operations and the ABA?
- What are the rules about the local retail team calling on the ABA?

Gauging Joint Venture Success

While overall volume and profit margins dictate the bottom line, one metric stands out as the true gauge of a JV's success: capture rate, the percentage of the affinity business' mortgage-seeking customers who transact with the in-house lender. For a realty company, the "universe" comprises all buy sides. For a builder/developer, it means every home sale.

Two capture rate benchmarks indicate a JV's "health:"

- **15% and below.** This range reveals a struggling JV. When performance falls to this level, it is members of the affinity business who are historically responsible by not developing a relationship with the in-house lender and steering customers to it.
- **15-40%.** This range reveals a good—but not great—JV. Going beyond merely acceptable performance rests with loan officers "getting out from behind the desk" to join members of the affinity business in prospecting and sales activities.

Launching a JV

Upon deciding that a JV is the most advantageous approach to establishing an in-house lender, several steps are required to launch the venture:

Assign liaisons. Each JV partner must assign a manager to oversee operations and performance. The affinity business should select a sales manager or core services manager who typically supervises ancillary services such as mortgage, title and escrow. The mortgage partner should designate an experienced account manager, not an onsite loan officer, to direct its JV participation. The two managers must have sufficient authority within their parent organizations to enforce best practices and execute changes when needed.

Set realistic expectations. Benchmarks for sales and operations performance must be aggressive but obtainable. All parties must reach early consensus on:

- **Profitability**
- **Loan officer coverage**
- **Capture rate growth**
- **Availability and frequency of management follow-up**
- **Annual contributions to combined events**
- **Frequency of face-to-face meetings**
- **On-call availability and access**
- **Type and frequency of reports**
 - Capture Rate
 - Determine calculation: buy side, both sides, subtract cash, commercial, land
 - By region, office, agent, loan officer
- **Profit and loss statement with distribution**
 - Determine level of detail required in statements

Create procedures and tracking systems. Accountability and efficient administration must be built into the JV process. The following are parts of a JV procedural framework, to be in place before the doors open:

- **Mortgage participation tracking**
- **Annual event calendar**
- **Loan officer budgets and goals**

Begin recruiting. A JV is only as good as its loan officers. Recruiting must begin as soon as the affinity business and the mortgage partner have assigned direct management to the venture and agreed on how to measure and report performance. Members of the affinity business, such as real estate agents, should be canvassed for their choices in loan officers derived from their current lender relationships and assessment of the area's overall talent pool.

Set up the office.

A well-equipped and functional office is vital. Dismissing the seemingly obvious or mundane aspects of the JV's physical preparation will haunt the venture and damage reputation and morale. Make a checklist and address the following:

- Office location
- General equipment
- Access to technology: connected line or wireless in workspaces and conference room
- Phone
- Fax
- Computer
- Printer (B&W or color)
- Software

Establish marketing. Marketing is more than clever taglines and appealing images. A JV's marketing is as much about managing physical inventory as it is about creativity. Early priorities include:

- Office signage
 - Doors
 - Lobbies
 - Conference rooms
 - Loan officer offices
- Materials stands
 - Brochure holders
 - Tabletop displays
- Web site integration
 - Consistency in content and look between real estate and mortgage homepages
 - Appropriate links between agent and loan officer sites/pages
- Ongoing procedures
 - Commissioning/ordering marketing pieces
 - Fulfillment of finished pieces
 - Tracking of above

Conclusion

Among possible ABA relationships, the joint venture represents the optimal blend of benefits for both the affinity business and the mortgage partner. A JV imposes risks, responsibilities and investments on both parties, obligations that are diminished or non-existent in other ABA formats. However, the joint venture grants the best chance for success and profitability due to its unique business environment which marshals resources, motivates participating professionals and companies, stimulates sales, and divides costs and profits equitably.



(800) 215-7138
www.metrocitiesjv.com
myspace.com/metrocitiesmtg



1007-49A