

A Strategy for Long-Term Growth

Envoy Mortgage is thriving right now in the midst of market mayhem. Part of this stems from adhering to a set of core principles that made the company get out of subprime lending way back in 2005.

BY DAVID ZUGHERI

On Oct. 1, First Houston Mortgage changed its name to Envoy Mortgage as part of our company's effort to rebrand itself from a regional company to a national lending organization. Despite the worst downturn in the history of the mortgage business, this corporate expansion is possible because our company never strayed from its guiding principles. ● I would like to share those core principles with you because they have proven so fundamental to our success. I would also like to suggest ways other lenders might implement their own guiding principles to strengthen their organizations and succeed over the long term. ● Lenders that follow the model our firm relies on do not focus solely on obtaining the maximum number of loans when times are good. For lenders like us, good times are the time to build your foundation so that you can seize market share during bad times. When these core values are strictly adhered to, mortgage lending is profitable and not a risky business.

Many valuable lessons can be learned from past mistakes. The same principle applies to this industry. For each mortgage lender going out of business, there is another that has stimulated its own progress, enabling it to be successful even in today's tough market. By studying these examples, we can strengthen our own companies and improve the way the mortgage industry conducts business.

If you were to examine the DNA of successful lenders, similar traits would appear. Their genetic makeup mirrors the basic guiding principles that drive the organization, much as the Constitution drives the United States. The quality of these guiding principles and the lender's commitment to implementing them makes the company better-suited to survive and prosper, even during the worst economic times. It is modern-day Darwinism—survival of the financially fittest.

Envoy Mortgage has followed this idea from Day One, using our core principles to guide our business. These core principles include: tempering risk, leveraging innovation into the engine of success, demonstrating a commitment to staffing excellence and understanding that success is a perpetual journey.

Tempering risk

Before one can heed this advice, it is important to understand the difference between taking a calculated risk and engaging in risky business. Taking a calculated risk in the mortgage business is encouraged. Remaining in your comfort zone does little to stimulate growth for your company.

With calculated risk, you know your risk level measured against potential reward. You have a degree of control

over all the factors that can boost your chances of success. However, engaging in risky business is similar to gambling when you do not truly understand the odds against you. In a way, you are leaving your own success or failure to a third party that may not have your best interests at heart. The industry learned this the hard way as Wall Street rapidly discontinued loan programs in 2007.

In 2005, like the rest of the mortgage industry, Envoy Mortgage was forced to take a hard look at our level of risk. We were buying highly profitable third-party loans in Southern California; these high-margin loans (including stated-income adjustable-rate mortgages [ARMs]) constituted roughly 30 percent of our net income. On the surface, it was a seemingly lucrative lending arrangement for Envoy.

By the end of 2005, we decided to cease third-party originations—a decision that cost us hundreds of thousands of dollars that could have been reinvested for growth.

This decision came far in advance of anyone in the industry going bankrupt. We simply made the choice to stay away from anything that could potentially threaten our ability to operate for

the long haul. These loans had a high level of risk over the long term, and this decision most likely saved our ability to remain in a position of strength as the mortgage crisis started to unfold.

We viewed the 100 percent financing on non-owner-occupied, stated-income, stated-asset, not-verifying-anything loan as akin to playing Russian roulette, a game where the revolver contains a potential bullet in every chamber—a very risky business.

The increased profits generated from these types of loans were far outweighed by the heavy risk associated with them. In addition, we made a companywide decision in 2005 to only broker out subprime loans. Rather than put out any subprime loans on the warehouse lines, we sent each entire package out to the investors willing to make that decision to buy the loan, close the loan in their name and fund it at the title company. By acting in the capacity of a mortgage broker on subprime loans, we lost at least 100 basis points per transaction, accumulating up to \$1,000 in lost execution per \$100,000 in mortgage funds originated.

The decision to avoid aggressively risky business and the sacrifice of short-term profit enabled us to dodge any buybacks on subprime loans. That not only kept us alive, but it put us in a position of strength as the market began its collapse.

If we had banked subprime loans, we would not have been able to survive the heavy volume of buyback requests that were soon to follow. We estimated that 10 years' worth of net profits could have been erased with as few as 15 subprime buyback requests—a chance definitely not worth taking.

Leveraging innovation

In trying to apply modern Internet technology to the lending process, most lenders have found success does not come easily or quickly. We are in a business where many processes are decades old. We chose to disregard the archaic standard processes and embrace new technology. Conducting business the same way it was done in 1988 will eventually lead to the demise of any obstinate lending institution.

In order to expand, every lender must experience the short-term pain that always accompanies innovative change for the purpose of achieving long-term success.

For example, those who invested in technology years ago in the form of flexible Web-based applications are now enjoying numerous advantages such as centralized underwriting and dashboard reporting. Many of these well-positioned lenders are getting paid back for those earlier investments in technology, even with the current state of the lending environment.

To harness the benefits of innovation, Envoy Mortgage carefully set up a series of technological milestones that have significantly contributed to our success. These milestones included developing a proprietary paperless platform for originating and processing loans; creating an offshore due-diligence team; scrapping any applications that are not Web-enabled; developing a proprietary Web-based document-management system for investor delivery and storage; and implementing the delivery of imaged data loan files to investors.

While these technological innovations created challenges in the form of upfront expenses and extreme process changes, they have greatly contributed to our ability to more

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efficiently load-balance workflow, speed up our origination-to-closing capabilities and significantly reduce costs. For our average 21-business-day origination-to-closing cycle, we saw speed increases of 20 percent. The estimated hard- and soft-cost savings are \$250 to \$500 per loan file. Many of these technological changes were initially viewed with skepticism by internal staff, our peers and our vendors, but now have led to our success and financial stability.

Demonstrating a commitment to staffing excellence

Nothing is more valuable than hand-picking a championship team to work for your mortgage company. Make it a priority to

hire those who fit in with the company culture and possess like-minded ideals. In the past, mortgage companies often defined success by how many employees they had. Rather than a “hire-by-numbers” approach, mortgage lenders should place more emphasis on quality. The people who represent your company are some of the most effective tools for achieving high-quality growth.

It is important in this industry to spend more time on the recruitment process. In the past, mortgage companies were not very selective. They tended to hire a skill set and not an individual.

Lenders should also assess the exact needs of the company to avoid over-hiring because that often leads to costly layoffs when business is slow, to the detriment of company morale. Having a smaller staff of highly productive, well-compensated people is much more efficient in the long run than having a larger, less-productive and less-expensive work force.

With the understanding that productivity starts with human resources, Envoy Mortgage puts each candidate through several interviews. We have found it best that candidates meet several members of the staff they will be working with, ensuring the best fit for both parties. This approach must be working, because we have a productivity rate of 15 files delivered per day, per loan shipper.

For new branches, we have multi-day orientation meetings and ongoing training programs that incorporate both ideological and practical content. No one walks in and is hired on the spot. Taking the time to build a championship team can be painful at first, but is a necessary step in creating a positive work environment and simplifies future recruiting efforts. The company started in 1997 with only two employees. In 11 years, we have increased the number of employees by several hundred. In 2008 alone, we have experienced a 151 percent growth in the number of employees.

Equally important in hiring a great staff is retaining your rising stars by creating a secure and stable environment conducive to increased productivity and innovation. We created a classroom in our main office used for training, brainstorm-

ing, goal-setting, morale-boosting and team motivation.

For Envoy’s branches located outside the main office, we bring the meetings to them through recorded video updates and WebEx™ presentations, communicating our message more effectively than we could with long-winded e-mails or typewritten memos. Through these mechanisms, we promote our guiding principles and spread the corporate culture to our remote employees while bringing them up-to-speed on the latest developments and strategic initiatives of the company.

Envoy Mortgage also places great value on continuing education. We encourage our employees to earn designations from the Mortgage Bankers Association (MBA), and are proud of the fact that Envoy Mortgage has the highest number of Certified Mortgage Bankers (CMBs) of any Texas-based mortgage lender. We also encourage employees to enroll in CampusMBA courses offered by MBA.

Our company functions in a highly disciplined way, both in terms of performance and alignment to our core principles. This operating environment is demanding, and works naturally to screen out those not up to the challenge. In one example, a former employee at Envoy Mortgage left due to a disconnect with our goal of basing lending decisions around whether a borrower buying a house would have the ability to make the payments on the loan they were seeking.

This former employee was not unique within the lending industry, where many lenders became subservient to loan officers’ focus on loan volume for its own sake. Lenders that succumbed to this way of thinking ended up offering artificially low-down-payment loans in order to provide good customer service and to close more loans.

This former employee argued our company was too conservative to ever truly be successful. Ironically, many of the “conservative” lenders are doing well right now, despite current market conditions.

There is nothing wrong with having robust dialogue between loan officers and underwriters, and we encourage originators to plead their cases. However, when the employee’s views deviate from the company’s core principles, the company has little choice but to make the tough decision to let him or her go. This should be accepted as part of the evolutionary growth process of any potentially great lender. Not everyone is going to fit in.

It is crucial to reinforce your company’s core principles with your staff to develop a strong sense of company loyalty, reduce turnover and increase productivity. Through extensive and ongoing training and education, everyone working for a company begins thinking as a unified body and can better understand and implement the company’s envisioned future.

Understanding that success is a perpetual journey

Self-improvement necessitates long-term planning and never resting on one’s laurels. Many companies wrongfully limit their planning strategy to the gains of the “now,” which deal with the immediate needs of the company—such as budgeting and net profits generated by month-end. These factors are important, but do not guarantee lenders success over the long term. In order for lenders to survive, even during hard times, they must regularly use comprehensive self-evaluation procedures.

Continued self-improvement requires faith in the envisioned

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future, and although times are bad, the mortgage industry is not going away. If you intend to stay in this business, commit to perpetually enhancing quality and productivity. Preserving the status quo means you are going nowhere.

As William Faulkner once wrote, "Don't bother just to be better than your contemporaries or predecessors. Try to be better than yourself." If you don't continue to improve, you can only maintain your competitive edge until everyone else starts offering the same level of products and services.

At Envoy Mortgage, we established key performance indicators (KPI) for our lending procedures and constantly look for ways to improve the business in the future. We developed

a KPI report that measures various tasks such as how long it takes to order an appraisal. Incentives are provided when KPI average benchmarks are exceeded. Specific key performance indicators are ordering verifications from third parties, retrieving title work, requesting appraisals, and pre-underwriting and closing/funding functions. All of these functions can be at least partially automated. Measuring the time each of these tasks weighed against the time to automate was time well-spent at Envoy. By measuring these tasks and building technology around them, we have reduced our loan processing time by 20 percent.

Our internal evaluation system has driven us to become early adopters of new technologies and alter the way we select and train new staff both domestically and abroad. The process is similar to the way a staff member receives an annual review, except it occurs more frequently and is used to make procedural

changes to optimize efficiencies. If we find we can build or buy technology to beat the benchmark metric established from our KPI, we measure and execute. It was our KPI research that led us to become early adopters of the eMortgage in mid-2007. Based on our research, adopting a paperless environment decreases 20 percent of time and 15 percent of expenses.

Now that the mortgage industry has largely rejected the niche, higher-risk loans, lenders are in a situation where we must learn to restore proper margins to the more commoditized loan programs. Collectively, we also have the responsibility to change the current cynicism toward the mortgage industry and restore its overall image.

This responsibility falls especially heavily on those thriving lenders weathering the storm and planning for the long term. Most of these lenders are the ones built to last, armed with a core set of guiding principles—that they adhere to—helping them not only to survive but to stimulate progress and growth at the same time.

In many ways, lenders no longer have the option of engag-

ing in too much risk; however, we must remember that as the industry begins to normalize, you can bet the temptation will present itself again. Potential opportunities that offer the alluring promise of bigger profits yet loaded with risk will enter the marketplace once again in years to come.

It is ironic that some of our industry's greatest innovations have finally started to come of age just as the market is stuck in a downturn. For example, technologies enabling a paperless work environment or facilitating the origination of the eMortgage offer lenders the ability to more effectively manage workload, speed up the closing process and enjoy cost savings.

Lenders are often put off by the initial effort and startup costs associated with implementing these innovations. These tools may seem far-off and visionary for now, but soon should be commonplace. The shelf life of any new and good idea is shorter and shorter each day.

Current market conditions have actually made it easier to find great staff and innovative personnel. Investing in these intelligent, extremely qualified people, mortgage lenders can leverage these new employees' previous work experience into much higher productivity levels and start laying the groundwork to grab market share through increased efficiencies.

There is a lot of introspection going on throughout the lending industry currently, and this is quite healthy and long overdue. Most of us have been forced to take a serious look at how we do business just to survive. I believe the entire industry will emerge stronger and better equipped to profitably provide sound lending services. Armed with these core principles, the industry has the necessary tools to renovate our reputation and restore a healthy market once again.

This opportunity is what makes the United States different from many other countries. Virtually every American has the opportunity to buy a home through hard work, careful financial planning and perseverance. The mortgage industry makes it possible for people to own a house that will appreciate and someday be worth a substantial amount more than the initial purchase if they regard it as a long-term investment.

Homebuyers also enjoy tax-free gains on the sale of their primary residence. As long as we preserve the mortgage-backed security system and do not lose focus on the core purpose to make sound loans built around a borrower's ability to repay, we can confidently look toward an even brighter future than the best of times we saw in the past.

With the industry under high levels of scrutiny, it is important that we all come together to seek common solutions that will collectively restore our industry. Incorporate a long-term vision that will guide and shape the direction of your company and can stand the test of time. Through this simple approach to business, the mortgage industry can be transformed one lender at a time. This is not the end, but rather the beginning of a challenging and arduous task of restoring confidence in mortgage banking. **MB**

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