fast-forward

Demographics, online technology, consolidation, mortgage product innovation and even government policy are conspiring to change the mortgage business in dramatic ways. This glimpse at the half-formed future environment will help dictate the battle plans of would-be survivors. It demands rethinking much of what lenders do today.

BY JAMES D. JONES

HOW WILL YOU MAKE MONEY IF YOU'RE NOT A TOP-10 LENDER WHEN 90 PERCENT OF ALL MORTGAGES ARE ORIGINATED AND SERVICED BY THE TOP NATIONAL LENDERS? /// How will you compete when more than 40 percent of mortgage applications are completed over the Internet in less than 15 minutes? /// Are you prepared to meet the mortgage demands of millions of foreign-born immigrants, aging baby boomers (born 1946–1965) and Generation Xers (born 1966–1980)? /// Will your future mortgage product be more of the same—15- and 30-year fixed-rate mortgages (FRMs) and adjustable-rate mortgage (ARM) products—or will this industry undergo a wave of dramatic product innovation typified by the upstart 2-year-old Edinburgh, Scotland–based online bank called Intelligent Finance (IF)? /// What will be different about mortgage banking in the future, and how will you make the correct business decisions today to succeed in that future environment? /// Executives' energies typically focus on today's business needs, and understandably so since volumes can explode or plummet overnight. Top executives, however, often find they are required to make large financial bets—technology investments, new products, mergers and acquisitions—in order to better position their organizations to compete.

Reprinted with permission from the Mortgage Bankers Association (MBA)

Decisions to diversify revenues, obtain more customers or buy advanced technologies can make great business sense. These decisions, however, are always made with some degree of uncertainty about the future. This article identifies some of the drivers shaping mortgage banking's future to assist executives making big decisions in 2004.

There are several primary drivers shaping the future of mortgage banking: Consolidation, the Internet, the self-service Web experience, major demographic trends, populist politics and regulations, the rise of alternative delivery channels and product innovation are some of them. Let's discuss each to understand how the future may unfold.

Mortgage brokers will remain a vital part of the process in the future.

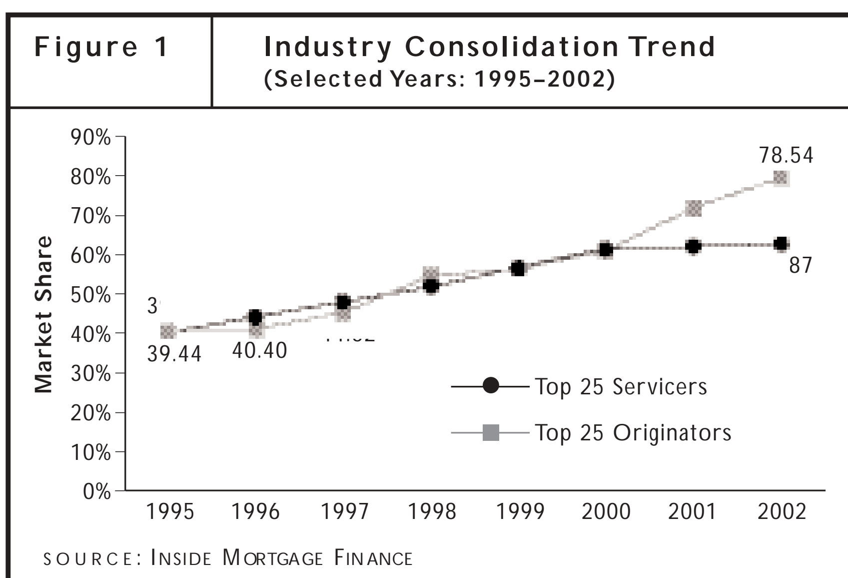
Industry consolidation sharpens company choices

The mortgage industry continues to consolidate at a dramatic rate. In 1995, according to *Inside Mortgage Finance (IMF),* the top 25 lenders originated 39.44 percent and serviced 39.87 percent of all loans originated in the United States. By 2002, *IMF* reported dramatic consolidation. Top lender shares increased to 78.54 percent of loans originated and 61.87 percent of loans serviced (see Figure 1).

What is fueling this consolidation? It is the belief by megalenders that scale matters. The thinking is that the long-term winners in the mortgage industry will be giant lenders with the size to maintain massive distribution channels, intelligent proprietary technology, highly favorable government-sponsored enterprise– (GSE-) and vendor-negotiated deals, outstanding staff, national brands, innovative products and complex risk and regulatory management systems.

A recent example of industry consolidation has been Washington Mutual Inc., Seattle. WaMu, using its "buy-and-build" expansion strategy, acquired Fleet Mortgage Corporation, PNC Mortgage, Dime Bancorp Inc. and HomeSide Lending Inc. to build huge additional scale, serve more customers nationally and leverage its technologies and efficiencies.

In the future, I believe lender consolidation will continue—possibly mirroring the mortgage markets in Europe and Canada—where five or six giant lenders will battle for market share in a Battle of the Titans. Locally, we will continue to see community banks merge, reducing the overall number of banks making mortgage loans in the United States. This does not mean that thousands of local banks, credit unions or mortgage brokers will cease doing business. Megalenders will continue to depend on local lenders and brokers to execute the critical "customer-facing" sales role as brokers and correspondents.



This consolidation trend will lead more local lenders to choose specialization—to evolve to the mortgage broker model. Mortgage brokers excel as nimble sales organizations. Many community banks will continue the current trend of acting as brokers and correspondents, offering megalenders' products to their bank customers to provide service and generate fee income while eliminating the complex regulatory and accounting requirements and financial risks. Community banks will continue to offer market-specific niche portfolio products, holding the loans in portfolio or collaborating with partners like the Federal Home Loan Banks' Mortgage Partnership Finance (MPF) program.

Mortgage brokers will remain essential to the industry

Mortgage brokers will remain a vital part of the process in the future. Garth Graham, senior vice president of e-commerce and customer relationship management for ABN AMRO Mortgage Group Inc. (AAMG), Ann Arbor, Michigan, sees mortgage brokers as essential to a megalender's overall strategy. Brokers provide needed volume without lenders having to build out a brick-and-mortar retail distribution channel.

Graham also sees brokers as technology-savvy. According to Graham, in July 2003 brokers used AAMG's Internet technology to lock 80 percent of the loans and create documents for 90 percent of the broker loans delivered to AAMG. In the future, megalenders will continue to deploy smarter technology to brokers, allowing these originators to select products, quote prices and fees, draw documents and provide approvals at the point of sale. The Internet will prove to be the most enabling broker technology in the history of the industry, in my view.

It's possible, however, that the overall number of brokers may decline in the future. States will continue to pass stricter broker licensing laws, which may cause some brokers to exit the business.

As megaservicers continue to refine customer-retention machines, retention rates should rise and brokers will be prevented from refinancing some former customers. In my view, however, brokers will not diminish as a primary origination force because of their entrepreneurial skills and also because millions of Americans will still prefer the face-to-face experience often with brokers as advisers.

Jeffrey L. Briggs, executive vice president of Wendover Financial Services, an EDS company, Greensboro, North Carolina, recently shared with me the trend he's seen in Internet self-service for mortgage borrowers. Following a Mortgage Bankers Association (MBA) School of Mortgage Banking presentation in Boston in July 2003, Briggs spent a few minutes speculating on ways future borrowers may become "kings of their data." They would do this by performing routine tasks such as authorizing payments, changing insurance carriers and updating tax information online—tasks currently performed by servicing personnel.

Vendors, certainly, are not excluded from the consolidation trend. Consider Fidelity National Financial Inc. (FNF), Jacksonville, Florida. Directly, and through Santa Barbara, California–based Fidelity National Information Services (FNIS), FNF recently augmented its technology offerings by acquiring ALLTEL Information Services' financial services division, Jacksonville, and Eastern Software Corporation, Sharon, Pennsylvania. FNF also continues its steady consolidation of the title insurance business, claiming the No. 1 ranking after years of title company acquisitions.

During the last 10 years, the Internet has become indispensable to mortgage lenders and consumers.

Fiserv Inc., Brookfield, Wisconsin, and The First American Corporation, Santa Ana, California, two other companies with deep histories of acquisitions, are positioned with FNF to take advantage of lender consolidation and consumer-friendly regulatory reforms, including the proposed Real Estate Settlement Procedures Act (RESPA) reform.

The future indeed promises to be a Battle of the Titans—several megalenders fiercely fighting for market share using price, proprietary technologies, products, channels and innovation to win the battle. In such an environment, mortgage origination expenses could decrease by $500 to $750 through negotiated bundled services, the use of lower-cost products like automated valuation models (AVMs) and title insurance alternatives, technology and lower-cost self-service Web channels. I believe the battle will be won on the basis of lower costs to the consumer. It's likely lenders will pass on any realized savings to the consumer in order to gain market share.

Price competition among lenders will only increase in this mature industry, especially given the rate-shopping skills of savvy "refinance-hardened" consumers. I foresee a Battle of the Titans also among the top full-service vendors, including Fiserv, FNF and First American, as these organizations compete for bundled-service contracts with megalenders, continue to acquire companies, integrate technologies to support product delivery and come out on the winning side of lender acquisitions.

Full-service vendors already doing business with a megalender who is a successful bidder on an acquisition may experience a dramatic volume surge after the acquisition, while vendors previously doing business with the acquired lender may lose some or all of the business post-deal closing. Post-acquisition consolidation activities typically include a vendor-review followed by an overall reduction in the number of vendors.

Self-service Web technology reduces lenders' costs

The Internet has revolutionized all our lives. Made available to the industry in 1993, the Internet rapidly found a prominent place in mortgage banking.

During the last 10 years, the Internet has become indispensable to mortgage lenders and consumers. Today, 64 percent of households have computers connected to the Internet, according to Cambridge, Massachusetts–based Forrester Research's Consumer Technologies Benchmark Studies (see Figure 2). Forrester indicates that the Internet user in 2003 represents the average American consumer—averaging 46.6 years old, 51 percent female and 59 percent with no college degree. The Internet has become an indispensable tool of the American consumer.

The Internet is profoundly affecting mortgage banking. Several lenders have created sophisticated business-to-consumer (B2C) lending sites, including AAMG's mortgage.com. AAMG has recently experienced incredibly high self-service Internet traffic for its business-to-business (B2B) and B2C sites.

According to AAMG's Graham, a staggering $1.5 billion of AAMG retail and $10 billion of wholesale originations in July 2003 were Internet loans. AAMG also has seen Internet self-service demand from its servicing customers. Graham reports that 350,000 of ABN AMRO's servicing customers use the company's Internet site an average of 10 times per year.

Figure 2 — Consumer Readiness for Internet Self-Service Experience

	1998	1999	2000	2001	2002	2003
U.S Households Connected to the Internet	25%	33%	43%	57%	61%	64%
Average Years online	1.6	2.2	2.5	3.1	3.5	4.5
Have Broadband Access at Home	1%	2%	6%	10%	17%	23%
Buy Online	22%	27%	50%	49%	51%	51%

SOURCE: FORRESTER RESEARCH INC.

Web technologies are also being widely offered by technology vendors. Cedarburg, Wisconsin–based Mortgagebot LLC and Edina, Minnesota–based Dexma Inc. have created private-label B2C Web sites for hundreds of lenders. Loan origination system (LOS) technology vendors are focused on Web-based technologies, including Wayne, Pennsylvania– based GHR Systems Inc.'s entelligent™ products, Atlanta-based Harland Financial Solutions Inc.'s INTERLINQ® E3 and Norcross, Georgia–based, London Bridge Group's Diamond. Long-term, industry initiatives such as the Mortgage Industry Standards Maintenance Organization (MISMO) and e-mortgage will rely heavily on the Internet as an enabling technology.

What is the Internet's future potential? One clear trend is the self-service Web experience. On the B2C front, consumers are increasingly using state-of-the-art Internet centers in the comfort of their homes—personal computers, broadband access, scanners, digital photography and other technologies. Today, 51 percent of households buy online and 23 percent have broadband access, according to Forrester Research.

As B2C lending portals are refined and simplified, the consumer will fulfill many of the application steps online. This is the view of Michael H. Jackman, general manager, Harland Financial Solutions Inc. In the process of deploying E3, a browser-based, native Web LOS, Jackman foresees a future where customers can self-serve their applications online, immediately scanning and delivering required documentation such as W-2s, pay stubs and bank statements as part of the application process.

Jeff Kato, president, Strategic Decision Support Inc., San Rafael, California, speculates that more refinances will be originated by megalenders' consumer-direct channels as the process becomes more transparent, technology is improved, processes are streamlined and consumers become more comfortable applying for refinances online. Kato believes this will be a zero-sum game where brokers' refinance market share declines as lenders' consumer direct business rises.

What are the primary lender benefits of the new Web-based technology generation? These new Web-based systems are browser-based, platform-independent and do not require information technology (IT) staffs to distribute software to thousands of personal computers. Web technology simply requires PCs, browser software and Internet connections. The movement away from legacy DOS and Windows®-based systems will open up tremendous opportunities for the industry.

The envisioned future is one where paperless e-doc prep, e-closings, e-recordings and e-notes are standard.

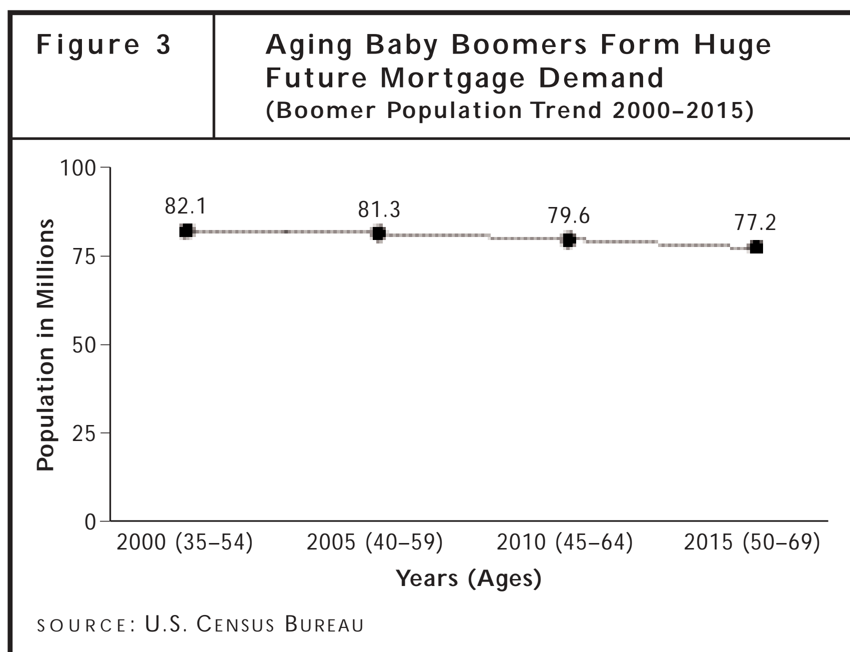
Lenders and vendors should be able to move more quickly to integrate their supply-chain systems to support the procurement of requested mortgage services. Participants in the mortgage process—consumers, originators and vendors—will be able to directly complete many of the steps in the mortgage origination process online, eliminating delays.

Much has been made of the e-mortgage. The envisioned future is one where paperless e-doc prep, e-closings, e-recordings and e-notes are standard. According to Gabe Minton, vice president of industry technology at MBA, it is not a question of whether the e-mortgage will become a reality, but *when*. MBA is currently doing a cost study to quantify the expected savings from e-mortgages. "Once the dictionary is defined, the cost benefit can be determined," says Minton. He feels that in the postclosing portion alone—the "pain area for the lender"—there will be huge savings.

Today, key groups are developing the building blocks. MISMO, SMART docs (securable, manageable, archivable, retrievable, transferable documents), an MBA-endorsed e-note registry, e-recording initiatives and new state and federal legislation point to broad-based support for the e-mortgage. Minton anticipates it will be approximately 10 years before the pieces are in place for e-mortgages to become mainstream, at more than 50 percent of the market.

Certainly, the amount of groundwork required to make e-mortgages commonplace is massive. The adoption curve of e-mortgages will be slow in the early years as pieces of the process are built, but much more widespread in the years 2009 through 2013 as the technologies, standards, integration, procedures and legality are proven. Megalenders, the GSEs and national vendors will drive the e-mortgage trend, since they will enjoy the greatest benefits.

Figure 3 Aging Baby Boomers Form Huge Future Mortgage Demand (Boomer Population Trend 2000–2015)



SOURCE: U.S. CENSUS BUREAU

Three demographic waves dictate future mortgage loan demand

During the next 10 years, three important demographic groups will drive mortgage demand: baby boomers, foreign-born immigrants and Generation X. An estimated 82.1 million baby boomers, 56 million Generation Xers and 29.1 million foreign-born immigrants, according to the U.S. Census

Bureau, currently comprise a mortgage-buying group of a staggering 167.2 million consumers. Here is how each group will affect future mortgage demand.

Figure 3 demonstrates how baby boomers will age as a group between 2000 and 2015. Baby boomers believe their retirement years will be unique and far different than any earlier generation; and this, I believe, is the key to their future mortgage demand.

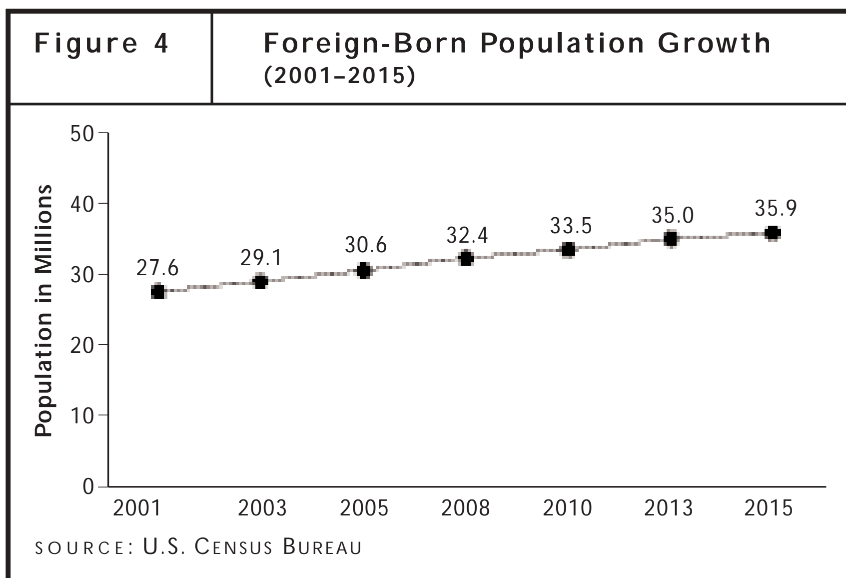
In 1998, Washington, D.C.–based AARP and Harrison, New York–based Roper Starch Worldwide Inc. conducted a major research project entitled *Baby Boomers Envision Their Retirement: An AARP Segmentation Analysis.* Segmenting baby boomers into five attitudinal and behavioral groups, AARP and Roper Starch found the groups' view of retirement was atypical compared with any previous generation. Among their findings: About 80 percent believe they will work full- or part-time during retirement; 80 percent do not plan on moving to another geographic region; 65 percent do not expect that they will have to scale back on their lifestyle; and most believe they will have good health.

Baby boomers, living longer, will not want to rein in their spending but will focus on optimizing the use of their largest financial asset: their home.

Compared with their parents' retirements, most baby boomers say they will need more money (84 percent), are more self-indulgent (75 percent), will live longer (67 percent) and will be healthier (56 percent). The study identified five distinct baby boomer groups that vary in retirement attitudes from pessimism to optimism. The groups—the Strugglers, the Anxious, the Enthusiasts, the Self-Reliant and Today's Traditionalists—break down the myth that baby boomers represent a monolithic group marching toward retirement.

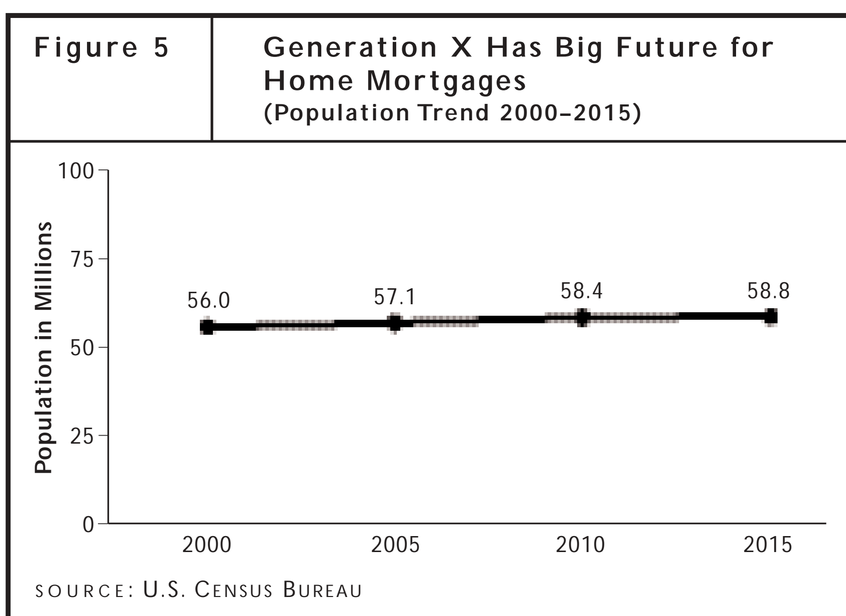
I predict baby boomer retirees will maintain mortgage debt on their homes longer and at higher amounts to support desired lifestyles, to maintain their independence and because they will remain in the labor force. Baby boomers, living longer, will not want to rein in their spending but will focus on optimizing the use of their largest financial asset: their home. Mortgage lenders may have more opportunities to finance primary and secondary homes, offer home-equity loans and offer innovative products that allow baby boomers to actively manage their home assets.

Figure 4 Foreign-Born Population Growth (2001–2015)



SOURCE: U.S. CENSUS BUREAU

Figure 5 Generation X Has Big Future for Home Mortgages (Population Trend 2000–2015)



SOURCE: U.S. CENSUS BUREAU

Foreign-born immigrants' American dream fuels future mortgage demand

Foreign-born immigrants are demonstrating their intense desire to participate in the American dream of homeownership. As of 2003, this group represented 29.1 million U.S. residents, according to the U.S. Census Bureau (see Figure 4). Fueled by an average estimated 1.2 million annual net migration into the United States, the number of foreign-born immigrants is projected to swell to 35.9 million in 2015, according to the Census Bureau. Foreign-born immigrants will comprise an ever-increasing percentage of the total population, rising from 10.3 percent in 2003 to 11.5 percent in 2015, according to the Census Bureau.

Rachel Bogardus Drew, a research assistant with the Cambridge, Massachusetts–based Harvard University's Joint Center for Housing Studies, makes a strong case for foreign-born immigrant mortgage demand in her August 2002 research report entitled, *New Americans, New Homeowners: The Role and Relevance of Foreign-Born First-Time Homebuyers in the U.S. Housing Market,* published by the Joint Center for Housing Studies.

According to Drew, foreign-born immigrants already comprise a large homeowner block—more than $1.2 trillion in home value and 8 percent of all homeowners (see sidebar). She points out facts relevant to lenders looking to increase their share of lending to first-time immigrant homebuyers this decade: The median time after immigration for foreign-born first-time homeowners to purchase a home is 12 years and the median age is 35 years. Based on these statistics, Drew forecasts that fully 10 million immigrants who arrived during the 1990s will enter the optimal time for first-time homeownership during this decade.

The American Housing Survey (AHS) of 2001 (www.census.gov/hhes/www/ahs.html), conducted by the Census Bureau for the Department of Housing and Urban Development (HUD), substantiates this large foreign-born immigration demand. The 2001 AHS survey reported that 10.6 percent of all households were comprised of foreign-born immigrants and more than 5.5 million foreign-born householders were renters. This renter pool represents future mortgage demand.

Lenders and vendors looking to focus on the first-time immigrant homebuyer will need to continue to develop products, technologies, language and cultural competencies and targeted marketing and sales strategies designed for the major immigrant groups, including the Hispanic and Asian communities. Drew points out that about three-quarters of recent immigrant first-time homebuyers are Hispanic or Asian.

Generation Xers enter the prime time for home-buying

Generation X represents a third big mortgage-buying group for this decade. Currently ranging from 23 to 37 years old, this buying block represents more than 56 million individuals, according to the Census Bureau, many in their prime home-buying years (see Figure 5).

Harvard's Joint Center for Housing Studies indicates that Generation Xers are experiencing homeownership at even younger ages than their baby boomer parents. Most would agree that Generation Xers view an Internet-connected personal computer as a required home appliance, essential to daily life. The Internet allows time-pressured Generation Xers to shop when, where and how they like.

A nationwide phone survey conducted in 2000 by the Chicago-based Round Table Group Inc. (RTG), a consulting firm comprised of academic scholars and industry experts, found the majority of Generation Xers preferred the Internet for information-gathering over newspapers, television or the library. Generation Xers are often described as open, cynical, wary of advertising hype and self-reliant. Mortgage lenders looking to do substantial business with Generation Xers will benefit by differentiating their approach to this market.

A customized Generation X Internet site, supported with dedicated Generation X call-center staff, could be a great start to meet the needs and desires of this market. If car manufacturers create targeted Generation X cars, advertising, price points and Internet sites, why can't mortgage lenders customize Generation X strategies? Mortgage lenders that focus on an integrated strategy for Generation Xers could increase their Generation X market share substantially.

How many lenders currently target Generation Xers for mortgage loans? A recent Google™ search yielded just one hit—Albany, New York–based SEFCU, a $1-billion credit union. SEFCU (www.sefcu.com) dedicates Web pages exclusively to its Generation X shoppers, including first-time homebuyers.

Lenders paying special attention to first-time homebuyer products for Generation Xers, especially in high-cost housing areas of the United States, could solve the dilemma of many young adults who want to own homes but don't know how to make the leap from renting or living with parents to homeownership in high-cost areas.

Populist politics and regulations

A recent wave of legislation—the Gramm-Leach-Bliley Act, the Sarbanes-Oxley Act of 2002 and various predatory lending laws—all point to one fact in my mind: There is a populist trend in government. The future industry implications are higher costs, more regulations and increased liability.

The proposed RESPA reform aims to provide consumers with a way to more easily compare loan packages among lenders with guaranteed interest rates and costs. The pro-consumer bent of that initiative conforms with my view that legislation and rule-making are following a more populist track.

There is every indication that this populist trend in legislation and regulation will continue. In my view, this trend initially favors megalenders, rather than midsized or local lenders, because megalenders can spread increased compliance costs over greater scale. Midsized and local lenders are likely to continue the trend of risk transfer by converting to mortgage brokers and correspondents. Some mortgage brokers may exit the business, merge with other mortgage brokers or become mortgage lenders and sell directly to the agencies, in the face of a more onerous regulatory environment.

RESPA reform, if adopted in substantially its current form with the Guaranteed Mortgage Package Agreement (GMPA),

THE FACES OF NEW IMMIGRANT HOMEOWNERS

LENDERS NEED TO UNDERSTAND THE FACTS ABOUT WHERE MUCH OF the new borrowing demand will come from as they reach out to serve a significant market segment. Here are some key numbers:

- Foreign-born homeowners own more than $1.2 trillion in housing value.
- First-time foreign-born homeowners' median home value is $150,000.
- As of 2001, there were more than 5.7 million foreign-born homeowners in the United States.
- Hispanic and Asian foreign-born first-time homebuyers comprise 74 percent of immigrant first-time homebuyers segment since 1997.
- The median time and age to homeownership for recent immigrant first-time homebuyers is 12 years and 35 years, respectively.
- Seventy-six percent of recent foreign-born first-time home buyers are married.
- Ten million foreign-born immigrants who arrived in the United States during the 1990s will enter the optimum period for homeownership this decade.

SOURCE: ©Rachel Bogardus Drew, *New Americans, New Homeowners: The Role and Relevance of Foreign-Born First-Time Homeowners in the U.S. Housing Market*, Joint Center for Housing Studies, Harvard University, August 2002

I think may also initially favor megalenders and large lenders. The largest lenders will have the most negotiating power with national bundled-service providers and the deepest technology and compliance teams for integration, workflows and product enhancements to support the GMPA. Yet all lenders will negotiate the best possible discounts on bundled services and likely pass on the negotiated savings to their consumers.

It's conceivable in my mind that if GMPAs are implemented by an increasing number of players in the next few years, small lenders may find the GSEs assisting in providing technology to deliver guaranteed mortgage package solutions to them. Should something like this happen, it might be viewed as leveling the playing field similar to the way the GSEs did in the mid-1990s with automated underwriting systems. Also, smaller lenders, as brokers and correspondents, will gain access to megalenders' GMPAs for the loans they sell to aggregators.

Lenders will negotiate the best possible discounts on bundled services and likely pass on the negotiated savings to their consumers.

Alternative delivery channels become more common

E-LOAN Inc., Dublin, California, and E*TRADE Mortgage Corporation, Huntington Beach, California, are well-known industry pioneers in alternative Internet and call-center retail delivery channels. Recently, some newer entrants into the U.S. mortgage market have offered a selection of lower-cost alternative delivery channels. Such players include Wilmington, Delaware–based ING Direct, a subsidiary of the Netherlands–based ING Groep, N.V., and Charles Schwab Bank NA, Reno, Nevada, a subsidiary of The Charles Schwab Corporation, San Francisco.

ING Direct and Charles Schwab Bank NA both chose low-cost alternative distribution channels for all bank products, including mortgages. Each has invested in Internet and call-center channels so that mortgage shoppers can apply for mortgages online or by phone. Neither organization has traditional brick-and-mortar retail locations.

In January 2003, Principal Residential Mortgage Inc., Des Moines, Iowa, also announced a decision to reduce the cost of its retail production channel by selling its traditional brick-and-mortar retail branches and investing more in the lower-cost Principal Residential Mortgage Direct Inc., its Internet, telephone and direct-mail lending distribution channel. What does this trend favoring alternate production channels mean for the industry as a whole?

Over the next five years, lenders will increase their investments in B2C and B2B Internet channels, as these channels prove their effectiveness as lower-cost channels and as lenders deliver better online lending experiences for consumers and brokers. At the same time, traditional retail, broker and wholesale channels will continue to operate without interruption.

Gradually, baby boomer, Generation X and Generation Y (born 1981–1994) consumers will conduct more and more of their mortgage business online, supported by tools like instant messaging (IM) and Internet telephony. Still, large numbers of mortgage consumers will opt for customer assistance in person and over the phone, rather than online.

Lenders will continue to integrate their call centers into their Internet channels, and will build more sophisticated online self-service features into the consumer's origination and servicing experience. Some lenders will invest proportionately more dollars into alternative channels—including the Internet, call centers and direct mail—in order to reduce the cost of originating and servicing mortgages. The percentage of online originations will increase as lenders and technology vendors improve the ease of product selection, application and refinancing.

Product innovation remains a wild card

The United States has a reputation for leading the world with its secondary and capital markets. It also has the reputation for lagging far behind many countries in product innovation.

The standard U.S. product mix includes 15- and 30-year fixed rate mortgages and the conventional array of ARMs. Little true product innovation has occurred over the last 10 years, due in part to the dominant role of Wall Street in defining investor requirements and due to the long-standing consumer preference for fixed rates.

Recently, several lenders have introduced innovative products to the mortgage marketplace. In 2002, Wells Fargo Home Mortgage Inc., Des Moines, Iowa, introduced its Home Asset Management℠ Account (HAMA). The HAMA combines, in a single offer, a first mortgage and a home-equity line of credit (HELOC). With this product, during the HAMA's life the consumer is automatically able to tap into his or her increased home equity created by principal payments and higher property values. Last summer a bank president told me he was pleasantly surprised to see the increase in borrowing capacity automatically produced in his HAMA account in less than one year.

E*TRADE Mortgage Corporation, with its Mortgage on the Move portable mortgage and Calabasas, California–based Countrywide Home Loans Inc.'s PaymentPower skip-a-payment mortgage pilot program are other examples of recent product innovation.

Mark Marple, vice president–mortgage banking strategies for Mortgage Guaranty Insurance Corporation (MGIC), Milwaukee, particularly likes a more striking example of product innovation found in the United Kingdom. Intelligent Finance (www.if.com), part of the 20 million–customer Halifax plc, West Yorkshire, England, is a 2-year-old upstart in the U.K. mortgage market. IF is an example of the new type of bank—an Internet and phone-centric bank.

Started in 2000, IF claimed a 10.4 percent share of U.K. net mortgage lending in its first 18 months. (The United Kingdom calculates "net mortgage lending" as the total of new

mortgage loans for a period minus all principal repayments and refinancings.) The IF model turns the traditional mortgage approach on its head. The lender's mortgages offer variable rates, with daily interest, up to two payment holidays annually, customer-defined terms, optional overpayments and withdrawals, and flexible repayment options. Interest can be optionally charged on the net mortgage balance, after offsetting the balance with current and savings account balances. IF's concept is to allow consumers to get the most out of their money by calculating daily offsets before charging interest, providing payment holidays and allowing for instant transfers.

IF founder Jim Spowart has recently moved to parent HBOS plc, Edinburgh, Scotland, in order to bring IF to the United States and Europe. HBOS has been talking to potential partners in the United States in order to crack the U.S. market. Marple speculates that the offset mortgage could gradually replace demand for the 30-year mortgage over the next 10 to 15 years.

IF plans on breaking even by year-end 2003. Clearly, the company—with its offset mortgage, replete with features and flexibility—would be the most innovative mortgage product yet to come to the United States mortgage market. Several significant hurdles, however, would need to be overcome in order for the product to be successful here. The business model would need to be profitable; IF has yet to turn a profit.

American consumers will need to embrace IF's variable-rate mortgage or IF would need to offer a fixed-rate option; historically, the American consumer has overwhelmingly chosen the fixed-rate mortgage.

American consumers will need to be persuaded to make IF their primary bank to benefit from account offsets; IF will need to spend lots of money educating U.S. prospects on their value proposition. The secondary and capital markets will have to endorse the offset mortgage if the IF mortgage product is securitized.

If successful, the Intelligent Finance offset mortgage could be one of the most exciting developments in U.S. product innovation during this decade.

Gradually, baby boomer, Generation X and Generation Y (born 1981–1994) consumers will conduct more and more of their mortgage business online.

Final thoughts

Six forces—consolidation, the Internet and self-service Web technologies, large demographic waves, populist politics and regulations, low-cost alternative delivery channels and product innovation—aim to transform mortgage banking more over the next decade than in any time during the last 30 years. These drivers will produce changes that require companies to choose between scale and specialization, to make ongoing investments in Web-based technologies and to choose well in their partnerships.

The next decade should provide mortgage lenders with tremendous opportunities as baby boomers, foreign-born immigrants, Generation Xers and leading-edge Generation Yers pursue homeownership. Lenders will have abundant opportunity to target their products, delivery channels, sales and marketing to these large demographic blocks.

Price competition will not abate; in fact, it will become increasingly fierce with consolidation and competition. The winners will succeed because they, as lenders or vendors, use personnel, technology, alternative channels and products, and workflows to drive down mortgage origination and servicing costs.

Product innovation will be a wild card. The U.S. mortgage market will either continue with isolated cases of product innovation or experience a product renaissance with offerings like Intelligent Finance's offset mortgage.

Ten years from now, outstanding mortgage debt will be greater than today and homeownership ranks will be the most diverse in history. In a decade the Internet will be an indispensable part of the industry, in ways we cannot even imagine. And we as an industry will have learned many lessons along the way. **MB**

James D. Jones is founder and president of First Wellesley Consulting Group Inc. (www.firstwellesley.com), Wellesley Hills, Massachusetts. First Wellesley Consulting is a national management consulting firm specializing in the real estate finance industry. The firm's practice covers corporate strategy, technology evaluation, business process re-engineering, new product development and, in partnership with PriSim Business War Games, Libertyville, Illinois (www.prisim.com), employee education using the Deep Pockets™ and Cycloan™ business simulation programs.