Is The Bloom Off for E-Lenders?

Today, Eloan filed to go public – an exciting event for the two that ran a small mortgage broker operation for many years. Soon, they'll realize a life's dream in what will no doubt be another hot Internet IPO. As I write this, I wonder what their market value will be in weeks to come, $50m, $150m, $500m, $1b? We've seen some hot Internet IPO's receiving multi-billion dollar status. So just what is the future for what I call E-Lenders? Will they dominate the market?

Ironically, this same day I gave a speech at MBA's Technology Conference – certainly THE mortgage technology event of the year. I posed a question to the standing room crowd of 300+ attendees – the best and the brightest of the mortgage technology scene. Just what portion of the industry's total originations will come to be directed by these electronic "portals" of the mortgage industry. Would it be less than 20%, around 40% or 60% plus. Just a few handfuls thought the answer would be less than 20%. A little over half the audience thought that 40% was the answer and the remaining felt a whopping 60% or more of total originations would start with an E-Lender.

If the audience is correct, you can expect E-Loan to achieve multi-billion dollar status. Given their great web site address, they will certainly do well almost no matter what you think the future of E-Lenders will be. Many mortgage brokers consider the E-Lenders as a major threat to their future. Perhaps there are some things to be concerned about but most should find comfort with a host of real problems the E-Lenders are facing.

To begin the list, we've already seen some horror stories among borrowers that tried their luck using an E-Lender. Stories of poor service, lost files and missed closings. It's hardly surprising when your loan volume skyrockets far faster than your production capacity can handle. Still, those who influence borrowers are not recommending these sites for anything beyond education and rate checking.

Along similar lines, what Realtor would advise their client to use a service in some other state that they have no relationship with and little faith that their client (and their commissions) will be protected all the way to the closing table (no matter what goes wrong in the process). Realtors are very careful about what mortgage companies they recommend and it often takes years to really gain their confidence. They like a local mortgage company familiar with local businesses and local methods of doing business.

The success of E-Lenders has been primarily based upon doing refi's. I've heard that some of them had upwards of 80% of their volume being refinance loans. As this market goes away, E-Lenders will have to drive their huge production shops with purchase money transactions. Can they attract purchase money borrowers? The newest advertising campaign from E-Loan directly attacks local mortgage companies as they try to displace traditional mortgage companies. It's unlikely that E-Lenders will be successful in convincing borrowers they are better off closing their loan with a company that is hundreds or thousands of miles away. Evidence of this is that 83% of E-Loans volume comes from the state in which they are located.

By and large, consumers are unsure the Net can offer a better deal. In fact, a recent survey showed that 87% of consumers were "unsure the net is better". Other similar web sites that offer discounts on substantial purchases such as cars, are finding the best they can do is to refer the prospective buyer to a local dealer. The car buyer simply uses the Internet to research what car they want with what options. They still go to the local dealer for the purchase.

Most successful mortgage operations know that developing a relationship with the borrower is crucial to keeping their business. Just as important is earning repeat business. On both accounts, E-Lenders have not been successful. Consumer research shows that users of the Web have little customer loyalty.

Escalating traffic generation costs will force E-Lenders to increase their costs to the consumer. A year ago, an E-Lender could pay for a radio spot or rent a billboard and obtain a substantial amount of business. The cost per loan application was amazingly low. Now, with hundreds of E-Lenders competing for this business, the cost per loan application has increase tremendously and thus, the price advantage E-Lenders had is disappearing. Reports of $300 per closed loan simply for the lead has been reported.

Some E-Lenders like E-Loan are relying on centralized processing centers in the mistaken belief that such centers would be more efficient. The reality is that there are no economies of scale for loan processing. This has been proven many times by large lenders like Countrywide who continue to rely on local offices to process loans. It is also why loan origination through mortgage brokers are the most efficient methods available in our industry.

The expense side for E-Lenders is tremendous as they spend hundreds of thousands on technology and even re-writing back office systems. These are expenses other companies don't have. Some of these E-Lenders have even gone to the extent of believing that they can create a better way to process a loan. The fact is, only Fannie Mae and Freddie Mac can streamline the processing of a loan. Everyone else must process the loans in almost an identical fashion. Just because a loan application comes over the Internet, doesn't mean that the back office environment would be any different.

The bottom line to all these issues is that E-Lenders are loosing a lot of money in their efforts to obtain loans from the Net. At the very least, expenses are now at equilibrium with traditional mortgage originators. Looking at the SEC filings for E-Loan we can see that operational expenses alone are greater than their origination income. On sales of $6.8m in 1998, E-Loan had operational expenses of $7.6m. Add to these expenses the $5.6m for marketing and $4.9m for other expenses and their loss for 1998 totaled $11.1m. Their expenses were almost three times their income. It's unlikely that these expenses can drop which should eventually force E-Loan to increase consumer pricing. They claim to reduce the cost of origination fees by 50% to the consumer but it's costing more than the 50% savings to do so.

Perhaps now you have a better understanding of the difficulties that lie ahead for E-Lenders and why the typical broker may not need to be so concerned about these highly funded companies. However, this is not to say that a presence on the Interenet isn't crucial for even the smallest broker. The fact is, consumers will flock to the Internet to research mortgages and to find that local mortgage company that offers the best combination of pricing and service. Those companies without a good online presence will be overlooked in the years to come.