BANKING & FINANCE

Who's 'Winning' Residential Mortgage Loans? A View from the Atlanta Fed

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The battle for mortgage business is a constant one for community banks that traditionally compete for customers with larger financial institutions. Community banks within the Atlanta Fed's region have expressed concern that their mortgage production market share is being eroded by the financial technology (fintech) firms that offer alternative lending services.

Staff at the New York Fed published an extensive study, *The Role of Technology in Mortgage Lending*, that analyzed fintech lenders' U.S. mortgage production market share using Home Mortgage Disclosure Act (HMDA) data.

Although the fintech landscape is broad, the New York Fed study defined fintech mortgage lenders as those that offer a completely online application process. Seven such fintech firms were identified in 2016, and by 2017 that number grew to 18, largely attributed to customers' preferences for speed and efficiency. Using the HMDA data, the New York Fed found that fintech lending has grown by 30 percent annually from $34 billion of total originations in 2010 (2 percent of the total mortgage market) to $161 billion in 2016 (8 percent of the total mortgage market).

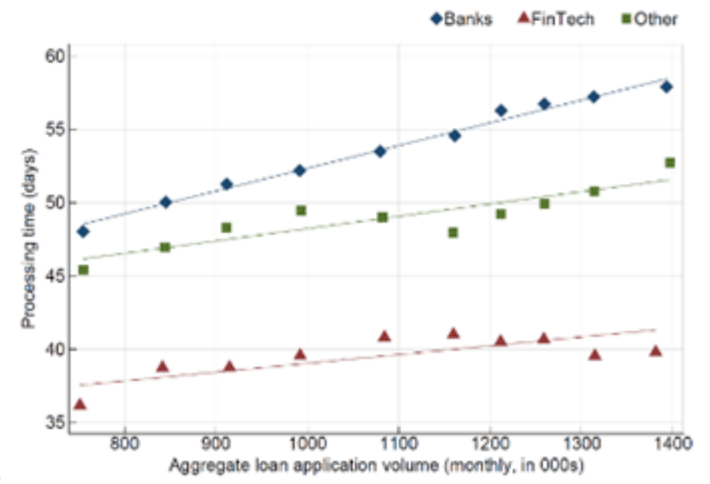
The study also shows that fintech lenders can reduce processing time by 20 percent through their digital lending platforms even when controlling for detailed loan, borrower, and geographic observables (see the chart). Cost savings usually occur with refinance mortgages rather than purchase mortgages due to the level of documentation required for a purchase mortgage. Digital mortgages have turned much of the mortgage business into a commodity—customers focus on speed and convenience and will choose the lender that best meets their needs, whether that's a traditional or alternative lender.

The study also concludes that the market share of fintech lenders varies significantly by geography and across segments of the mortgage market. Generally, fintech borrowing is higher in more educated populations, which may be a contributing factor to greater lending in urban areas.

Analysis methodology

This analysis considered mortgage loans originated between 2010 and 2016 for states in the Atlanta Fed's district: Georgia, Florida, Alabama, Mississippi, Tennessee, and Louisiana. Only loans that were secured

by a first lien, for a one- to four-family home, and intended for a home purchase or refinancing were included. (This analysis excludes purchased loans, or loans bought or acquired by an entity that did not make the credit decision for granting the original loan request).



Source: The Role of Technology in Mortgage Lending

Chart 1. Fintech lenders have decreased loan processing time by 1 to 2 weeks.

For a more concentrated look, this article draws comparisons of market share by lender type within select cities as well. This article also presupposes that the following cities might have outsized fintech activity, given connectivity and population demographics: Atlanta, Birmingham, Jacksonville, Miami, Nashville, and New Orleans. Each of these cities has a Federal Reserve Bank of Atlanta branch office. (Also, cities with a larger tech presence are more likely to use fintech lenders.)

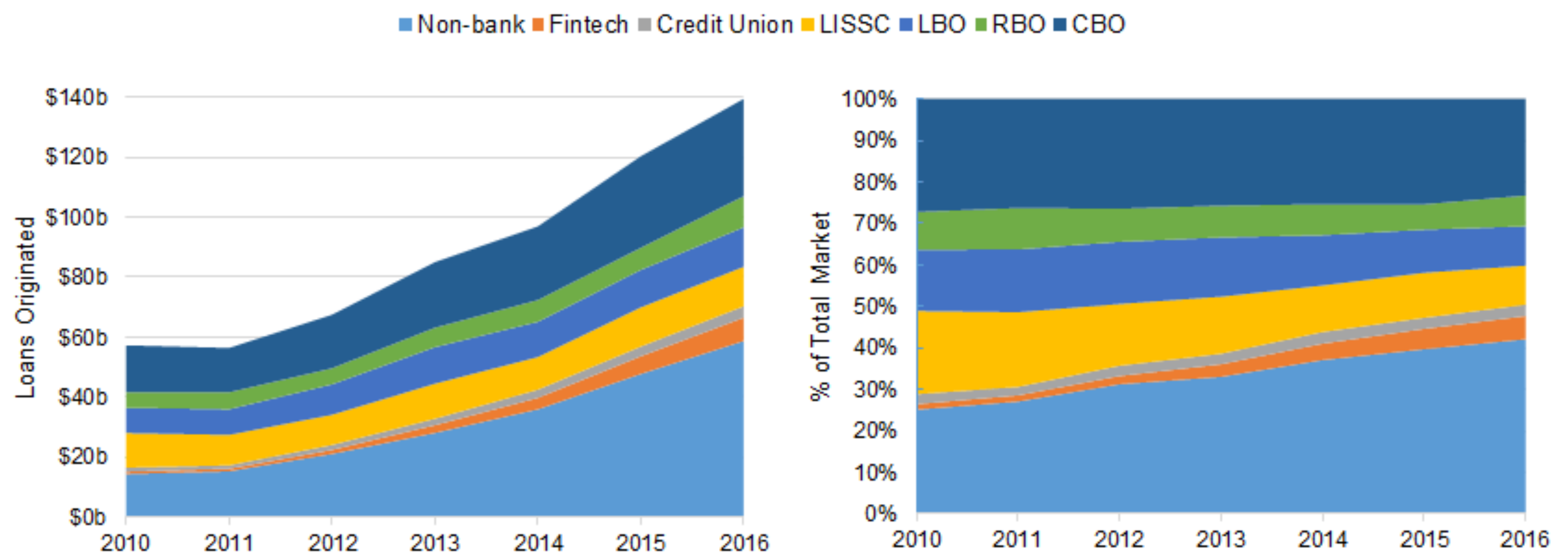
Atlanta, Miami, and Nashville are considered technology hubs, with both Atlanta and Nashville making Cushman & Wakefield's Top 25 Tech Cities list. Atlanta ranks third in the United States for fintech companies and start-ups. (All three cities are competing to host Amazon's second headquarters.) In contrast, Birmingham still relies heavily on more traditional employment sectors such as manufacturing and distribution.

Overall regional trends

When examining the southeastern mortgage market, it is important to differentiate between home purchases and refinance activity.

Between 2010 and 2016, purchase mortgage originations more than doubled as mortgage growth accelerated, beginning in 2012, across the entire Sixth District. Surprisingly, nonbanks (typically independent mortgage finance companies) had the largest market share at 43 percent, followed by community banks with 22 percent, and larger banks (those with assets of $50 billion and higher) with 9 percent each (see the chart). Fintechs held just 5 percent of the market. Lending in the District by traditional financial institutions (including community banks, credit unions, and banks with assets between $10 billion and $50 billion) as a percent of total market share trended downward from 2010 to 2016. Although community banks' market share declined 5 percent, larger institutions experienced an even more significant drop: from 20 percent in 2010 to 9 percent in 2016.

Purchase Mortgage Orginations in the Sixth District



Source: HMDA; FI-SRCH

Chart 2. Purchase mortgage originations in the Sixth District more than doubled from 2010 to 2016 (left chart). An appreciable shift in market share has occurred among non-banks, fintechs, and larger banks (right chart).

Overall in the region, the top three nonbank purchase mortgage lenders in 2016 were Caliber Home Loans Inc. (based in Texas), Fairway Independent Mortgage Corporation (based in Wisconsin), and FBC Mortgage LLC (based in Florida). Nonbanks use a different model than traditional banks, relying heavily on the secondary mortgage market, where loans are securitized and sold to third-party investors or government-sponsored entities. Roughly 25 percent of mortgages originated by traditional lenders and reported through the HMDA are held on the balance sheet, while nonbanks retain only 5 percent of originated mortgages. Part of nonbanks' growth might be a result of the real estate crisis, when funding for third-party finance companies became scarce, resulting in a loss of market share by 2010. As funding avenues normalized, these nonbank mortgage companies were able to win back market share.

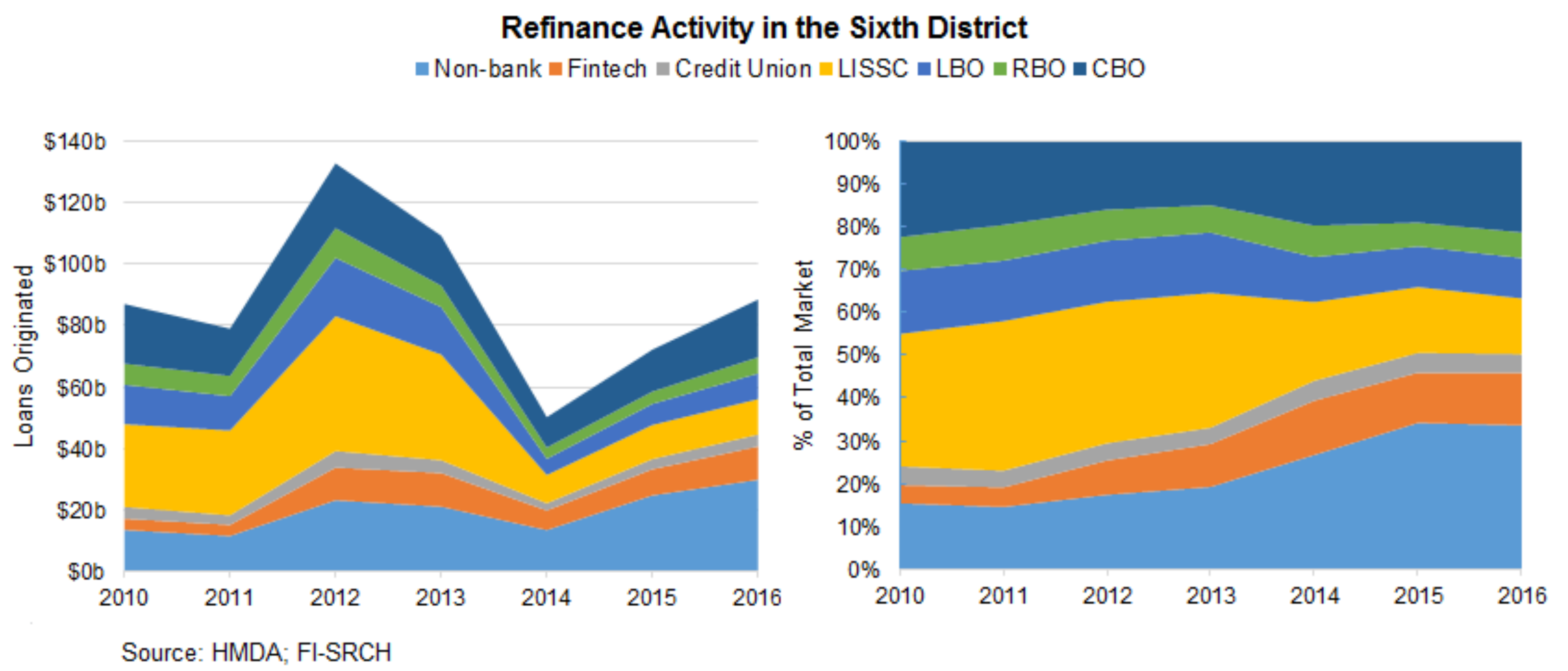


Chart 3: Refinance activity in the Sixth District in 2016 has returned to 2010 levels (left) with an appreciable shift in market share among nonbanks, fintechs, and superregional banks (right).

Refinancing has been a key part of the mortgage market as rates have remained historically low during the last 10 years. Refinance activity in 2016 just surpassed the level seen in 2010 when the District struggled to recover from the sharp decline in property values following the real estate crisis (see the charts). The nonbank share of the refinance market has more than doubled, jumping from 15 percent in 2010 to 33 percent in 2016. Fintechs have also seen a significant increase in market share during this period, from 4 percent to 12 percent. Meanwhile, community banks have seen a decline from 22 percent to 16 percent. Banks with assets greater than $250 billion have experienced a significant drop, from 30 percent to 13 percent.

Six key cities

In examining purchase mortgage originations, the distribution of market share in Atlanta, Birmingham, and Jacksonville mirrors the overall Sixth District trend, with nonbanks having the largest market share, followed by community banks, larger banks, and fintechs (in single digits). New Orleans and Nashville were split between nonbanks and community banks, where each held 30 to 35 percent market share in 2016. In the same year, nonbanks in Miami held 50 percent of the market, community banks held 16 percent, and fintech firms held only 2 percent—an unexpected finding. Because Miami is considered a tech hub, it seemed reasonable to expect that fintech firms would have a larger share of the market.

In examining refinance activity, the distribution of market share in Atlanta, Nashville, and New Orleans mirrored the overall District trend, with nonbanks having the largest market share as of 2016, followed by community banks, larger banks, and fintechs. In Miami, however, banks with $250 billion or more in assets have maintained a larger market share than community banks since 2010, though these institutions have seen a decrease from 45 percent to 21 percent during this period. Fintechs held 10 percent, more than tripling market share in the metropolitan area. In Jacksonville, community banks—with just 9 percent market share—lagged behind nonbanks, larger banks, fintechs, and even credit unions in refinance activity.

Urban versus rural areas

The U.S. Census Bureau defines urban areas as "Urbanized Areas of 50,000 or more people and Urban Clusters of at least 2,500 and less than 50,000 people." "Rural" is defined as all areas not included within an urban area. There is a notable difference in mortgage lending market share between urban and rural areas. Nonbanks have established a clear mortgage market leadership in urban areas.

Chart 4. Mortgage market distribution in the Sixth District (including purchase mortgage originations and refinance activity). Urban areas (left) vs rural areas (right).

In rural areas, though, community banks still have the largest market share of purchase mortgage origination and refinance activity. Nonbanks and fintechs, however, are gaining market share in these areas at the expense of both community banks and larger banks.

Many have cited a lack of high-speed internet access or stagnating education levels in rural areas as contributing factors to faltering financial inclusion. Existing evidence suggests, however, that as more fintech firms enter the mortgage market, rural areas may have the potential to adapt and benefit from new technological platforms.

Eyes on fintech's future in mortgages

HMDA data for the Sixth District show that independent mortgage companies (that is, nonbanks) have the greatest share in the residential mortgage market. Nonbanks have increased market share by providing favorable rates and a large variety of loans to a larger variety of customers. Further, they follow the conventional business model of providing numerous physical branch locations and typically require the customer to visit a branch at some point in the process. Many nonbank loans are financed or sold to the secondary market and guaranteed by government-sponsored entities. Nonbanks lenders' share of loans insured by the Federal Housing Administration grew to 75 percent in 2015.

Fintechs focus on technological innovation, which may give them a competitive advantage and lead to an increase in market share. Consumers, especially in smaller markets without many financing options, have gravitated to these lenders, seeing value in the speedy and convenient fintech alternative to the once-arduous process of mortgage financing. In the last quarter of 2017, Quicken's Rocket Mortgage became the nation's largest mortgage lender (by volume), surpassing Wells Fargo, and sustained that position through the first quarter of 2018. As the completely digital loan process becomes mainstream and the lines separating banks, nonbanks, and fintechs blur, the lending landscape will continue to evolve.

Note: For purposes of this article, the following lenders were classified as fintechs: Amerisave Mortgage, Cashcall Inc., Guaranteed Rate Inc., Homebridge Financial Services, Homeward Residential, Movement Mortgage, and Quicken Loans.

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