Pricing To Your Target Audience

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Each day, if not more often mortgage bankers produce rate sheets in hopes of attracting loan activity. A rate sheet is a rate and discount point combination for a specific loan product. There exist a broad array of layouts used for rate sheet distribution. There exists an even greater variety of approaches used to derive the rate and discount point combinations.

Typically, the rates / price grids are tied to a certain delivery window (say 60 days forward), with adjustments to that window reflected in another section of the rate sheet or on a separately referenced information page.

The fact is, this is the ideal time to pinpoint your target ("ideal") loan customer. The fact is, often the loan terms quoted are not framed in such a way to attract this target customer. Why? Most often the process used reflects a collection of compromises and "rules of thumb" that are aimed at producing a rate sheet on a timely manner and not providing a focused marketing device.

Many processes start with an investor price for a designated delivery window. They tend to use the same investor for all rate and window combinations for a given loan instrument. If the price includes a value for the servicing component, the pricing desk has made a compromise. This compromise will result in many of the loans quoted through this system being mispriced.

Those lenders that price the servicing component separately, but continue to consider only one lender are still making a compromise. Compromise equals mispricing. Mispricing creates an opportunity for borrower arbitrage. Mispricing means you will tend to get the low profit / high loss loans. You will tend not to get loans when your compromise made your price non-competitive.

Mortgage bankers spend a lot of time developing down-stream relationships. Those who participate in compromise pricing waste the opportunities their investor development efforts create. Many feel that there are so many other things to concentrate upon that getting those final few basis points are just not worth it. However, they may be guilty of not putting pencil to paper.

There are two types of mortgage bankers that stay in business through strong and slow business cycles. The first are those who are well connected to a strong demand chain and the second are the sharp pencils. The companies most likely to fail or be consolidated are those that are following along taking what price is given them, focusing on processing loans but not maximizing total profit and minimizing volume fluctuations.

Also, you can not wait for your investor to come to you and point out the mispricing arbitrage that exists in their rate sheets. In the first place, they probably don't know where they exist. Secondly, it is not always in their best interest to reveal their Achilles' Heal.

Achieving market leadership either as a niche lender or a broad based lender still involves picking your punches, knowing your weaknesses and making strides to shore up those shortcomings.

How does this pertain to pricing? First, you must have a pricing engine that will determine the best investor instrument for each specific rate / window / loan feature set combination. Second, have a distribution system capable of communicating the optimal pricing set to your audience. Third, be able to tie secondary marketing actions to the loan locking activity that your optimal pricing set produces. Fourth, use analytic tools that will help you move toward the optimal product mix versus warehouse and hedge cost constraints. Fifth, be able to generate the pricing results on a timely basis. Sixth, be able to reliably maintain the various pricing alternatives.

Through a combination of software and dedicated staff a system that incorporates all six components of the targeted pricing framework can become a powerful engine driving a consistently profitable mortgage banking operation.