LEND ACADEMY

PODCAST TRANSCRIPTION SESSION NO. 168 / MATT HUMPHREY

Welcome to the Lend Academy podcast, Episode No. 168. This is your host, Peter Renton, Founder of Lend Academy and Co-Founder of LendIt Fintech.

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Today's show is sponsored by LendIt Fintech USA 2019, the world's leading event in financial services innovation. It's coming up on April 8th and 9th, 2019, at Moscone West In San Francisco. We've recently opened registration as well as speaker applications. You can find out more by going to lendit.com/usa

Peter Renton: Today on the show, I'm delighted to welcome Matt Humphrey, he is the CEO and Co-Founder of LendingHome. Now LendingHome are a fascinating company, they have in a very short amount of time become the largest fix & flip lender. They've done over $3 billion as of this recording and we talk about how they were able to do that, how they were able to go into this space that was really dominated by, you know, small hard money lenders and create an online process that's efficient.

We talk quite a bit about the technology they've been able to develop, we talk a lot about how they differentiate themselves from the other players in this space, we talk about the loans themselves, we talk about the investing side of the business and much more. It was a fascinating interview, I hope you enjoy the show.

Welcome to the podcast, Matt!

Matt Humphrey: Thanks for having me, Peter.

Peter: Okay, so I like to get these things started by giving the listeners a little bit of background about yourself. Maybe you can tell us what you did before you started LendingHome.

Matt: Sure, so I guess you can say I'm a multi-time tech entrepreneur. This is depending on how you count, I think company number 8 (Peter laughs) since 2004, every time in different spaces, everything from 3D virtual world to content delivery to social games, e-commerce, lending and more. You know, I'm classically trained as an engineer, I love attacking problems no matter where they may be where tech can really truly create an advantage; that was my upbringing.

I was Carnegie Mellon computer science...long story short, actually started there when I was 13 years old, I was that guy and basically finished my core computer science requirements by 18 and then I didn't have a minor so I went and got an MBA, caught the startup bug and then started building companies.

So I moved out west from Pittsburgh where I grew up and went to school in 2007, and then built a variety of things from there. So my last company was a company called HomeRun, it was an e-commerce platform that we built back in 2010 and actually we sold it for a very strong outcome only about 18 months after founding and we basically powered an e-commerce platform where we sold things to consumers and we also powered rewards and loyalty and commerce solutions for large card companies and banks like JP Morgan Chase and American Express and others. So next up after that, after selling it and working with the acquirer for a number of years, started LendingHome.

Peter: It sounds like...looking at your LinkedIn profile, LendingHome is your longest running startup, it sounds like. It's where you've spent the most time in your career, just on pure timewise.

Matt: Well for some of those early ones I've got to admit it wasn't a high bar to spend more than, you know, 12 to 18 months. (Peter laughs) I really think that I took a philosophy of just start things, learn, rapid pace, rapid prototype, get products to market and if we're going to succeed, great and if we're going to fail, let's fail fast, learn and iterate. And so, you know, through those early days of some faster start and stops, learned a lot I think, you know, a lot of life lessons as an entrepreneur.

HomeRun was a good three year and change run and LendingHome has been now between four and five years. You know, I have to say though, it is...I am more proud of what we've built here than probably all of the past 7+ combined. Just in the scale and scope of what we're taking on, the technology that we brought to market and we've built a real business which is cool and exciting.

Peter: Right, right. So let's just talk about the early days at LendingHome, what were you thinking when you thought you needed to start an online mortgage origination platform? What was the problem you were trying to solve?

Matt: Yeah, so going back to middle of 2013, I, having sold HomeRun in 2011, I actually was angel investing in a lot of technology startups and caught the bug to also want to think about investing in real estate and it didn't seem like there was a simple, scalable, online, transparent way for investors to access investments in real estate or specifically mortgage, and I was intrigued when other companies like LendingClub, Prosper and beyond had brought such a straightforward way for an individual investor to invest in personal loans that didn't exist in mortgage.

So I was actually looking at it from more of that side and actually got approached to be an LP in a few private mortgage funds covering areas of lending and credit for homes where banks did not so the fix & flip space that we now find ourselves in...single family rental, foreign nationals, those that are self-employed; lots of verticals that banks didn't cover. So I actually took a step back and said, would I rather be an LP in a few of these funds or can we actually build technology to do this even better.

And then you combine that with some of my close friends and family, even ones with great credit that were having just the hardest time even refinancing loans with their existing bank, taking months if not quarters, asking them multiple times for their documents over and over again and consistently getting surprised in the process. So it led me to be pretty introspective and say, whoa, if this asset class of mortgage is so big and both the borrowers and investors have trouble accessing it in a simple, fast, reliable way, what if we did it better with tech and that's how LendingHome was born.

Peter: Right, right. Obviously, you started just a few years ago and you've built it up into a pretty sizable scale. I saw just recently your press release that came out, you crossed $3 billion in total originations, so can you just give us some context to that, like how many homes is that, how many loans have you done, that kind of thing.

Matt: For sure. So yes, about a month ago, we reported that we had crossed about $3 billion in cumulative originations. Each billion has come considerably faster than the last; it was around 30 months for the first billion, 11 for the next and then about eight for the third and so we're very excited that the business is accelerating and growing so quickly.

You know, that breaks down if you just do some simple math, the average mortgage in the US is slightly over $200K and so it should be no surprise that that actually equates to...now, as of the day of this call we're over 15,000 individual homes that we've lent to so that's about $200,000 and a little bit per loan. We have focused our tech, our process, how we go to market to be able to lend to the average homeowner across the US.

Whereas, I think there's lots of platforms that are focused on small balance commercial or office buildings or hotels, we're focusing on those single family homes, townhomes, condos in the Phoenix, Arizonas', the Las Vegas, Nevadas'. The repeatable part of this asset class is that standard average home across the US so it's been great and I think as we focused, the majority of that volume has been focused towards the asset class of fix & flip where our borrowers are buying, oftentimes rehabilitating and reselling homes in their area.

We think this is awesome because this is how communities all across the country stay fresh with this type of financing to enable older, more rundown homes to become new, fresh, come back on market and to be available for homeowners to buy. So that's what we've done and at the same time, not only have we helped to rehabilitate the housing stock, we've actually had a lot of borrowers that have gone from hobbyists of this to actually building businesses, turning homes of the sort so it's been really rewarding to see.

Peter: Right, so let's just touch on that a bit because how much of your business is this sort of one person doing it as a hobby versus someone who has taken out five loans every year kind of thing. What is the typical borrower, like who are they?

Matt: Yeah, so that's a great question. Across the US, when we look at all of the data that we keep a pretty close eye on, we see that about half of this market for buying, rehabilitating and reselling homes and the financing thereof occurs to folks that are more of repeat borrowers and that's what we say internally. Just as a note that somebody is doing multiple loans in a given year or two year span. Sometimes they've made this their job, sometimes this has literally become their livelihood and they build strong businesses on this and our lending and our loans enable them to do so.

About half of the space is your one-off or two-off borrower that maybe this is a hobby and so what we've seen is we've actually seen our business grow on both sides. About three quarters of our business today is more of the what we would call pro or repeat audience that has done this many times and about a quarter of it is that one-off individual loan to a borrower that may be more one and done, more of the hobbyist, but we've seen strong growth across both and now across well over half of the states in the US that we're actively licensed and lending into.

Peter: Okay, so then I saw, I think it was last year you announced you were going to get into traditional mortgages. I haven't heard you mention that yet, is that sort of initiative on hold or are you in a pilot phase, where are you at with that?

Matt: Yeah over the last year we basically have been in a protractive pilot phase. You know, we decided earlier this year to really double down and focus on the bridge loans and the fix & flip, bridge is our internal term for fix & flip because we've gone from zero to number one in that market and we've really decided to double down there. So earlier this year, we paused the originations of the 30-year mortgages to focus on that bridge space.

We still have the technology platform built, we're still actually making progress in that space, just with rates going up in Q1/Q2 and how much volume in business there is on the bridge side where the average traditional mortgage company is losing money today. Even if we could do better with tech, we still have such margins, such scale potential and so many customers coming to us asking for help on the bridge side, we decided to kind of truly double down our focus there.

Peter: Okay, okay, that makes sense, So then what about...this is a primarily or has been traditionally an offline process, very paper-based and it sounds like you're often working with just individuals, tell us about how you've sort of implemented technology to make this process more efficient. What have you done to really make this a repeatable process?

Matt: Yeah, so we have a little bit of a running joke internally of fintech companies, sometimes they're more “fin fin” or more “tech tech.” I think we've struck a really nice balance of both the fin and the tech. Look, technology is at our core and we say, at the end of the day, we win on service, you know, we're here to be a customer company that wins on service, enabled and growing through technology and that is our ethos and that's our essence and that is our edge.

So we internally break down how the tech can add advantage into three camps. We say experience, platform and marketplace, and I'll start with the first, so experience. Can somebody who has never gotten a mortgage before find out about us, walk up and answer a few simple questions, see if they qualify, select the perfect product for them and then finish their application in just minutes where it could take days or weeks with a traditional paper-based lender.

There's a lot of technology that has to be built to acquire those customers, to make sure we're asking the right questions, to really run our credit engine in real time to be able to, frankly, decision customers literally as they're on our website answering questions without a human ever having to step in.

I'm pleased to report that actually about 80% of our customers are submitting loans, loan inquiries and then their full applications before they ever talk to a human on LendingHome's side and that's validation to us that...you know, where other lenders have to talk to maybe 10 or 20 customers for every one that closes, we do much better than that and we put the power and control in the customers' hands so they can run their process the way they want to. So that's part of how we're differentiating on the experience side.

When it comes to platform, the average...I don't know if you track this stat, it's truthfully a little bit crazy. The average cost to close a residential mortgage loan has gone up just about every quarter for the last 20 and is now around $9,000 a loan.

Peter: Wow!

Matt: So if we pause on that for a second. Average loan in the US is $200,000, average cost to close it $9,000. That borrower is charged about 4.5% in higher fees, rates, hidden charges by traditional lenders just to pay their expenses, to pay their bills, that's before their profit. That's actually why in Q1, the Mortgage Bankers Association released the stat that the average independent mortgage company was losing money per transaction, that's crazy.

And so we've been able to actually create, through significant amount of automation of the underwriting process, we've been able to create a process that we make thousands of dollars per transaction and have a really, really, really good business on a per unit basis, make strong margins. That then puts both money in our pockets that we can reinvest back into more tech to keep accelerating that lead, or it actually allows us to charge less fees to our borrowers and save them money.

Peter: Right:

Matt: So that platform is all about automation of the process, pulling in data automatically and not having to have 20 or 30 humans triple, quadruple, quintuple checking each other. That's our edge with tech.

And the third is marketplace. You know, we have a wide array of investors who buy our loans and so our marketplace allows us to find, within days of closing that mortgage, allows us to find the perfect place to sell that loan, whether that's large institutions and banks, whether that's a credit fund that we've launched, whether that's our peer-to-peer platform. And so that efficiency lets us not have to accrue loans for months or quarters or years, but actually sell them off within days of close and it lets us be hyper efficient with our capital. So really tech, it's from end-to-end experience, platform, marketplace and that's what we build every single day here at LendingHome.

Peter: I'm curious about mobile because...what percentage are coming to your site through the mobile device and how are you optimizing for that?

Matt: Yeah, I believe the last time we checked new customers that were coming at the top of the funnel was about 50/50...

Peter: Wow!

Matt: ...which even let's say four years ago when we started lending, those numbers have increased steadily. You might think, hey, this is a mortgage, this is the most important financial transaction that most customers are ever going to make and it's stressful and people are dug in for a hard process, but people are still...they want to inquire on the phone, they want to see if they qualify. That's where they're figuring out the first steps of the process.

Basically, we haven't launched an app as you would traditionally think of an iPhone app or an Android app. What we've done is every part of our site from learning about us, to seeing if they qualify to that entire experience with their application, when they're on their phone it's optimized for mobile so they can go through the entire experience right there and even with some of their documents.

For instance, if they're going through their application on their phone, they can take a picture of them, have them in their photo album and seamlessly upload them right through their mobile web browser right into our hands so we can verify those docs. So we don't have apps, so to speak, but we take advantage of it and it's super important, it's a high percentage today.

Peter: Right, right, makes sense. So now you've got the scale, you've got the technology, but is there…like when you look at the marketplace there's obviously many people doing fix & flips, there's many successful offline lenders that are doing fix & flips and you now have, you know, quite a few in the online space. So how do you differentiate yourself, is it really your tech and your scale or is there something else?

Matt: Yeah, so when we look at the competition, I would say there's a number of ways we look different and there's a number of ways that we have an edge. So I would say that the first is compared to most of our more offline or traditional counterparts, borrowers think of us as effectively having a national presence, right. We don't have to have local sales people in every city that we operate in, borrowers literally anywhere can walk up and apply for a loan at any given time and we do most of our customer acquisition through online channels and so this actually just vastly reduces the overhead and the physical people in each location that we need to scale our business. So that's thing one.

I would say thing two is really, really driving down those operational costs, right. You know, when a borrower is let's say on their second, third, fourth, fifth loan that application is only taking minutes, we're able to approve within days and sometimes those borrowers are able to close the same week. That's really impressive level of service, but even though they might, you know, be traditionally going to their local country club lender who makes the process really easy for them because it’s done over a handshake, they get the certainty and scale of working with a national scale player like us, but they get that same efficiency.

We even have some of our largest borrowers that used to have in-house staff just to manage disparate loan processes with lots of different lenders that were using paper and faxes etc. and when they found LendingHome they realized, wow, I don't even need that, all of my information is saved, this is super easy and especially once I’m repeating, it's a breeze and so I think the service aspect is hugely important to it.

And I would say between the operational automation that drives down our costs and our low cost of capital out in the capital markets because we've had such strong loan performance...you know, this is not 2013/2014 all over again where the country club loan is at 12 to 15% and 2 to 5 points. This is, you know, 9/10% and maybe 1.5, 2 points up front and rates and fees and terms that really work for borrowers and really perform for our investors.

So cost of capital, cost of operation, national scale presence and tech-enabled service. Multiple things in there that we think our competition is not set up to really compete with.

Peter: Right, right, okay. So I just want to ask again about the loans themselves. You mentioned you're 9/10% or whatever, but what is the range of the loans that you offer and then let's talk about LTV and the length of the loan term. Just tell us about the loans.

Matt: Yeah, so the loans are going to end up being...most of these bridge loans are one year loans so this is generally the right duration to cover the acquisition of the property, the rehabilitation and the resale. Oftentimes, the loans tend to last between seven and ten months. The borrowers can actually pay them off with no pre-payment penalty, but they're one year base loans to begin with.

We lend anywhere between as low as $75,000 and as high as $2 million, they're interest only and the ranges of those rates will be anywhere from 7.5% on the low end up to 12 or 13% on the high end and so they are compared to some of the anecdotes that I just gave you of where the market has been...they're nicely and competitively priced to borrowers.

Now you also touched upon restrictions like LTV and leverage and things of that sort. You know, we take a view, and this is informed by now having 15,000 units and lots of credit cycles to look at of full repayment of loans where we want to make sure that both…given their level of experience, does the borrower have enough skin in the game upfront and do they have enough cushion on the backend with what this home is going to be worth when they go to resell it.

The typical loan for us will look like let's say between 80 to 90% of the purchase price of the home, but then we also want to check to make sure that it's maybe 65 to 75% of the after-repair value. So if we're going to disburse some money upfront to help them buy the home and then give them some of the dollars to rehab the home itself, we want to make sure that those combined proceeds are still only let's say, at most, three quarters of the value of the home when they go to resell that.

That's going to give us comfort that the upfront loan as well as all the way through that project we have significant coverage were anything to go wrong and look, a very small percentage of the time things do, but we've had fantastic performance because I think we’ve kept our parameters really thoughtful and make our borrowers...we make loans that perform.

Peter: Right, when they do go wrong obviously, you really have this asset backing the loan like how...maybe just give us some idea, any principal loss or how has this played out. Obviously this is a one year loan, you've been doing this for four and a half years, you've had many cycles of the loan book and what have you seen when it comes to those non-performing loans?

Matt: Yeah, so high level stats to start you out there, we’ve returned about $1.6 billion in principal to investors and about $133 million of interest so we've had about $1.8 billion overall in full repayment. Again, as you mentioned, we've seen...not our first rodeo doing this and we start to get a pretty good feel for how these loans work and perform. Basically, when we feel that even a loan is at risk of potentially not repaying or the home not being resold, we actually proactively are reaching out to that borrower well before maturity.

We realized early on that we could originate amazing loans and have this great platform and help borrowers on the front end, but if we didn't actually also launch a servicing platform, we weren't going to be truly best in class and win this space and that's our goal.

So a couple of years ago, we actually brought servicing in-house which allows us to do these proactive reach outs like, you know, at month 9, 10, 11 reaching out to the borrowers. If they need, let's say an extension, but the home is listed, it's just not fully sold yet, we can make those within certain bounds and then should the borrower actually not pay and not be able to exit the loan, our data and analytics team, in concert with our risk teams are running all the analysis of the market, the home, the state it’s in, other purchase and sales that have occurred recently to give us the best analytics of what to do with it.

That investor who technically holds the risk is generally coming back to us saying, hey, what do you recommend we do with this asset and in almost every case, we're able to get full principal and interest repaid. We don't talk specifics on those credit performance numbers, but our investors have been extremely pleased with that performance to date and it's exciting to see.

Peter: Okay, so on the investor side then...my understanding is you fund these loans off your own balance sheet and then sort of sell them to the marketplace just for the ease of use for the user experience more than anything I guess, but tell us about the typical investors you have. I know you started off you were 100% institutional and you opened up to retail, it was one or two years ago now so tell us a little bit about that. What's the breakdown between the two and the kinds of investors you have.

Matt: Yeah, so three main camps of our investors we would say are marketplace platform or basically, the p2p platform; second is our institutional investors and third is we actually launched a second iteration in October 2017, was when we announced it, of a mortgage opportunity fund, it’s a credit fund that we actually launched and managed in-house dedicated to buying our loans.

So today, the platform looks about 15% peer-to-peer; about 30% towards the fund and about 55% institutional and that's a good balance of where we actually enjoy keeping that mix with all of those channels growing proportionally as we scale. And so going one by one there, the marketplace platform is essentially any accredited peer-to-peer investor can walk up, can prove they're accredited, can connect their bank account and launch assets on to our platform and then either select individual loans they would like to invest in or use our simple auto invest algorithm that dials up or down their risk reward ratio that they want to get them the return that they’d like.

So at this point, hundreds of millions of capital on that platform and we're seeing great retention that...you know, some investors as soon as they start to get those first repayments, they put in more and many at that 6, 9, 12-month mark when those first loans start to fully repay, they get it, they see the fruits of our great credit work and they re-up with a sizable reinvestment. So that platform is growing and we're very excited about it.

The fund which was again a dedicated opportunity fund for mortgage was launched in October 2017, we raised about $100 million of equity and we have a credit facility against it of up to $300 million of debt and so that fund earns our LPs in that fund strong returns north of 10% and can hold up to $400 million in assets at any given time.

And then the last is institutions and I think you hit the nail on the head there. When we started, we were pretty much asking just about anybody who will buy our loans. You know, if you go all the way back to 2014, starting off much more in fast money: hedge funds, private equity, folks that really needed a north of 10% unlevered return and as we've proven that credit and proven that scale, we've really normalized this asset class and we've been able to expand that to asset managers, specialty mortgage funds and in conversations with pensions and insurers now to even broaden that mix further. So diversified channels, diversified investor base and very exciting overall.

Peter: Right, okay, we're just about out of time, but I can hear the passion in your voice and you really are excited about what you're doing here so what is your vision, what is the future for LendingHome? Are you going to be the largest mortgage lender in the country, or what are your plans?

Matt: Yeah, so in the near term we are focused heads down growing and scaling the business. If you just look at our first product in fix & flip, we've become number one in that market from a standing start in between three and four years and we can have just on that first product, we can have a highly profitable, highly scalable business and the near term focus is to go even deeper towards that.

I think as we do that we're going to continue building out the best mortgage platform in the world and that could be a platform that supports, you know, bridge loans, loans of adjacent products or all the way to 30-year mortgages and that platform is diverse enough to really allow us to go into any market that we want to, when we want to go into it and be truly the best way to get that mortgage product.

And last, you know, it really comes down to just that, what is the right expansion of our products over time where we can scale and be one of the most significant mortgage players in the country.

So if you've got that experience, that platform, that marketplace and you really unlock the business with winning on service, there's not a lot we can't do so focused on that and you know, as we look out to other lenders that we have admiration for like the GreenSky's of the world who went public earlier this year, the Funding Circle's of the world who are going to go public, folks that can leverage tech, efficiently use capital and help customers where banks aren't or partner with banks to do that, can build multi-billion dollar businesses and that's what we're excited to do.

Peter: Alright, well good luck to you, Matt, we'll have to leave it there. I really appreciate you coming on the show today.

Matt: Thank you so much, always a pleasure.

Peter: Okay, thanks, see you.

Matt: Bye.

Peter: You know, it's interesting to me that LendingHome has decided to double down on one product, the fix & flip product. Obviously, they announced mortgage as we talked about, but they haven't really done much with it. They're doubling down on fix & flip and in some ways it goes against conventional wisdom in the fintech space today that companies need to offer multiple products.

So I think clearly, it's not a one size fits all mentality for having a diversified product, they've decided that they can really build a profitable business in this single vertical and I think part of the reason is they have these borrowers that come and do two, three, four, five, six loans a year so the customer acquisition cost, it's not like a personal loan where someone might do them once every two or three years. They are able to generate this repeat business in a much quicker fashion so maybe that's it. I think there's a lot to be said for focusing on one product if you can build a profitable business around it and it sounds like that's what they're doing.

Anyway on that note, I will sign off. I very much appreciate your listening and I'll catch you next time. Bye.

Today's show is sponsored by LendIt Fintech USA 2019, the world's leading event in financial services innovation. It's coming up on April 8th and 9th, 2019, at Moscone West In San

Francisco. We've recently opened registration as well as speaker applications. You can find out more by going to lendit.com/usa

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