The Changing Face of Mortgage Lending

The Finance & Accounting Forum For Financial Institutions

Tuesday, June 21, 2011 *2:15 – 3:15 PM*

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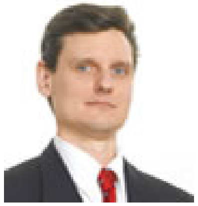

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Right to Survive

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- Barings Bank – 1762 - 1995
- Arthur Anderson 1913 – 2002
- Lehman Brothers 1847 – 2008
- General Motors 1908 – 2009
- AW Faber 1761 – 1976
- Swiss watch manufacturers

Long Term Capital Management; Taylor, Bean & Whittaker; Enron; FHLMC; FNMA

1/3 Fortune 500 are gone > 20 years

Average lifespan of largest = 40 years

Agenda

- Originations
- Secondary
- Servicing

Originations - Present

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Residential Production in 2011 - 2003: The Product Mix

Dollars in Billions

Year	Total Prod	Prime Prod	B&C Vol	Alt-A Vol	IO Vol	Payment Opt. ARMs	FHA/VA
2011(e)	$1,600	$800	$1	$1	$60	$0	$430
2010(e)	$1,400	$900	$0	$1	$50	$0	$440
2009	$1,919	$1,371	$1	$5	$60	$1	$454
2008	$1,614	$1,091	$6	$16	$105	$25	$200
2007	$2,650	$1,323	$182	$270	$439	$226	$80
2006	$3,267	$1,338	$665	$612	$700	$348	$75
2005	$3,294	$1,373	$807	$400	$676	$231	$112
2004	$2,790	$1,341	$608	$192	$282	na	$140
2003	$3,904	$2,473	$390	na	na	na	$208

Source: Mortgagestats.com / National Mortgage News
Categories are not exclusive and may not foot across

Origination - Homeownership

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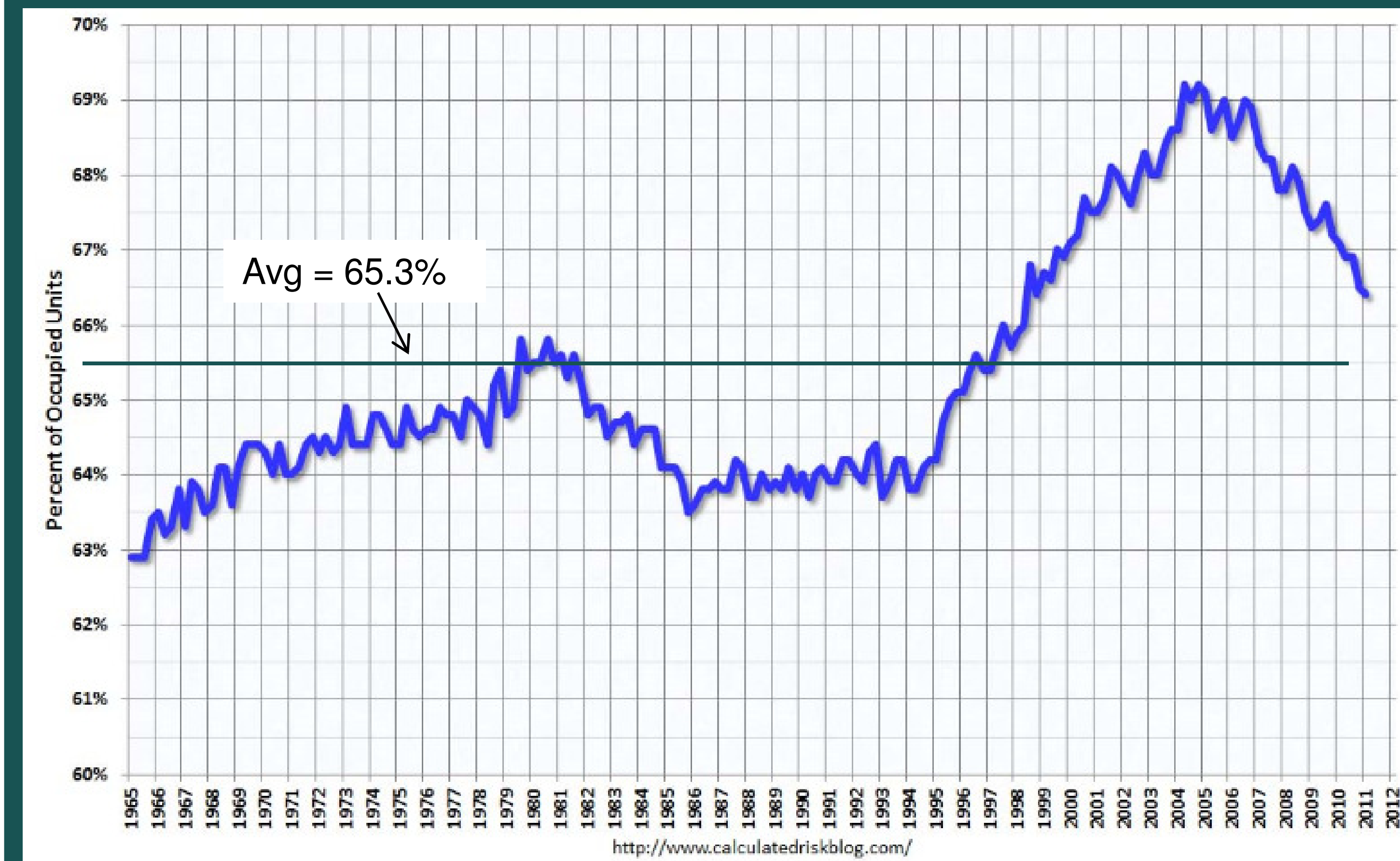

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Origination – Unemployment Rate

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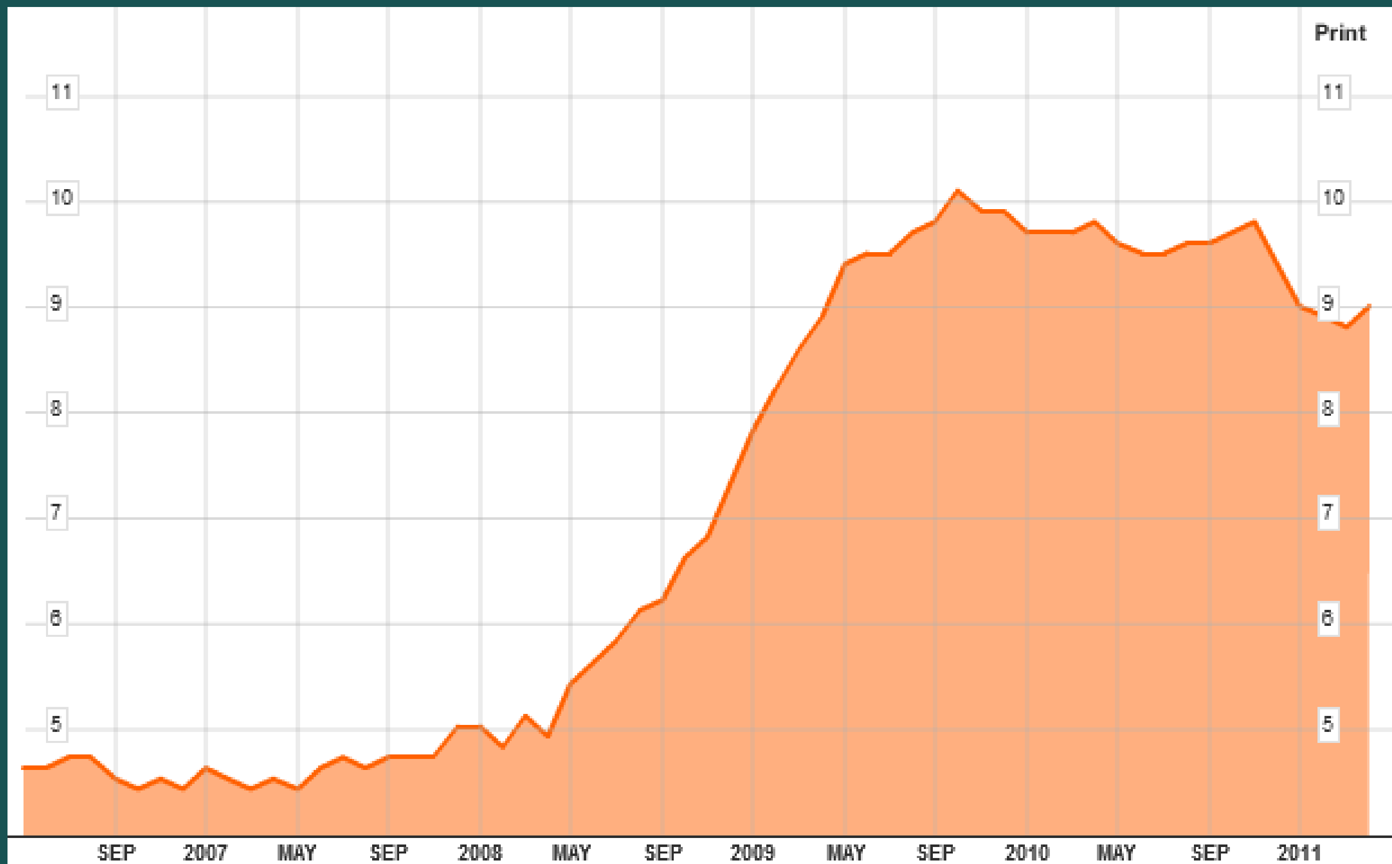

Source Bloomberg

Origination - QRMs

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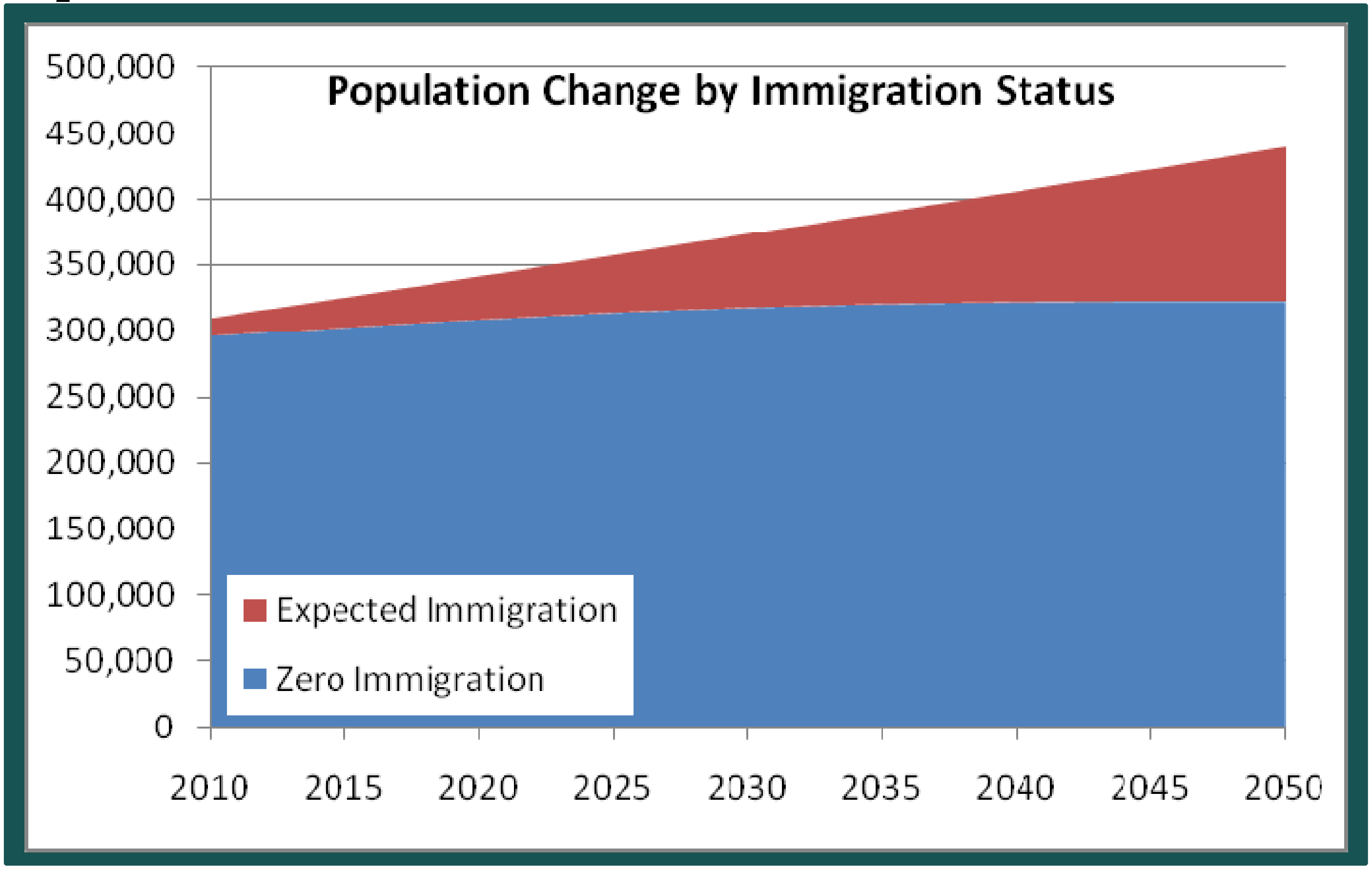
Return of Other Investors?

Originations – Population Growth



Source: US Census Bureau

Originations – Demographics

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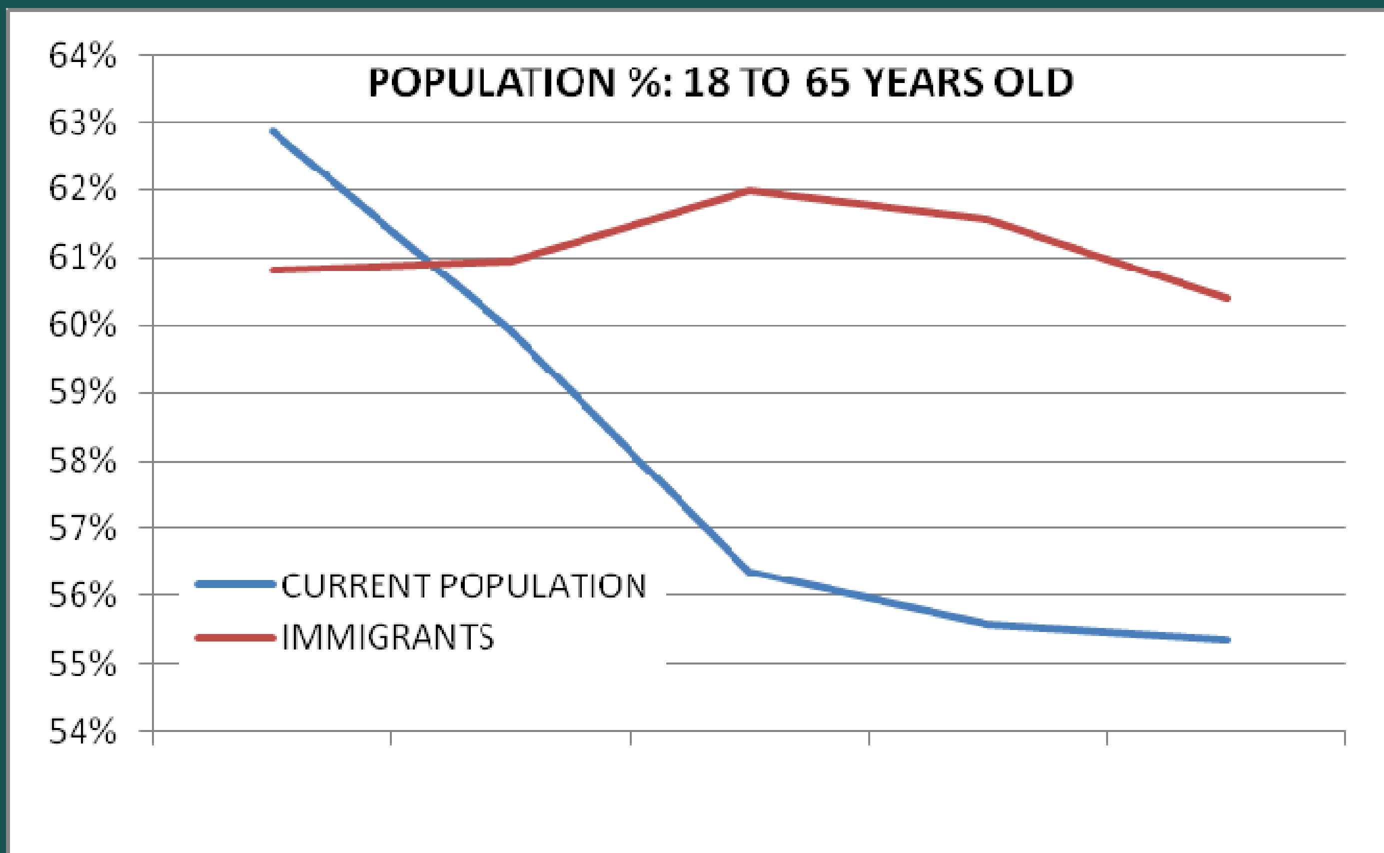

Source: US Census Bureau

Originations –
Pull through Volatility is Down

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Broker/Borrower behavior models of past do not properly predict magnitude of pull-through volatility

- Narrow range of products
- Demise of the broker
- Stricter underwriting guidelines
- Decreasing portability of appraisals
- High correlation between loan with post-lock data modifications and pull-through

Source: SECONDARY INTERACTIVE

Originations – Trends/Observations

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Banks are lending but few are borrowing

- Increased underwriting standards
- Housing demand down
- Exotic mortgages less popular

Originations – Trends/Observations

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Balance sheet compositions are changing

	3/31/2011	3/31/2010	12/31/2010	12/31/2009	12/31/2008
Percent of Average Assets					
Loans Held For Sale	0.08	0.06	0.09	0.08	0.05
Loans Not Held For Sale	61.82	64.45	63.72	65.98	66.80
Less: LN&LS Allowance	1.09	1.07	1.07	0.98	0.86
Net Loans & Leases	61.01	63.61	62.97	65.26	66.16
Interest-Bearing Bank Balances	5.11	4.04	4.49	2.88	1.17
Federal Funds Sold & Resales	1.63	1.82	1.70	2.08	2.98
Trading Account Assets	0.04	0.05	0.05	0.07	0.08
Held-to-Maturity Securities	1.17	1.25	1.21	1.34	1.42
Available-for-Sale Securities	17.16	15.52	16.01	15.24	15.15
Total Earning Assets	91.50	91.35	91.39	91.63	91.83

Source: FFIEC Peer Group Average – All banks

Originations – Trends/Observations

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Balance sheet compositions are changing

	3/31/2011	3/31/2010	12/31/2010	12/31/2009	12/31/2008
Percent of Average Assets					
Liabilities					
Demand Deposits	10.86	9.98	10.25	9.83	9.98
All NOW & ATS Accounts	9.01	8.45	8.61	7.98	7.57
Money Market Deposit Accounts	12.45	11.63	11.82	10.93	10.50
Other Savings Deposits	9.66	8.79	9.15	8.36	7.91
Time Deps At or Below Insurance Limit	32.13	28.19	31.16	23.16	23.90
Time Deps Above Insurance Limit	4.04	10.49	6.81	16.19	15.22
Fully Insured Brokered Deposits	1.42	1.77	1.65	2.07	2.10
Deposits in Foreign Offices	0.13	0.12	0.13	0.12	0.13
Total Deposits	84.58	83.62	83.77	82.49	81.20

Source: FFIEC Peer Group Average – All banks

2010 JD Powers Mortgage Origination Customer Satisfaction Survey

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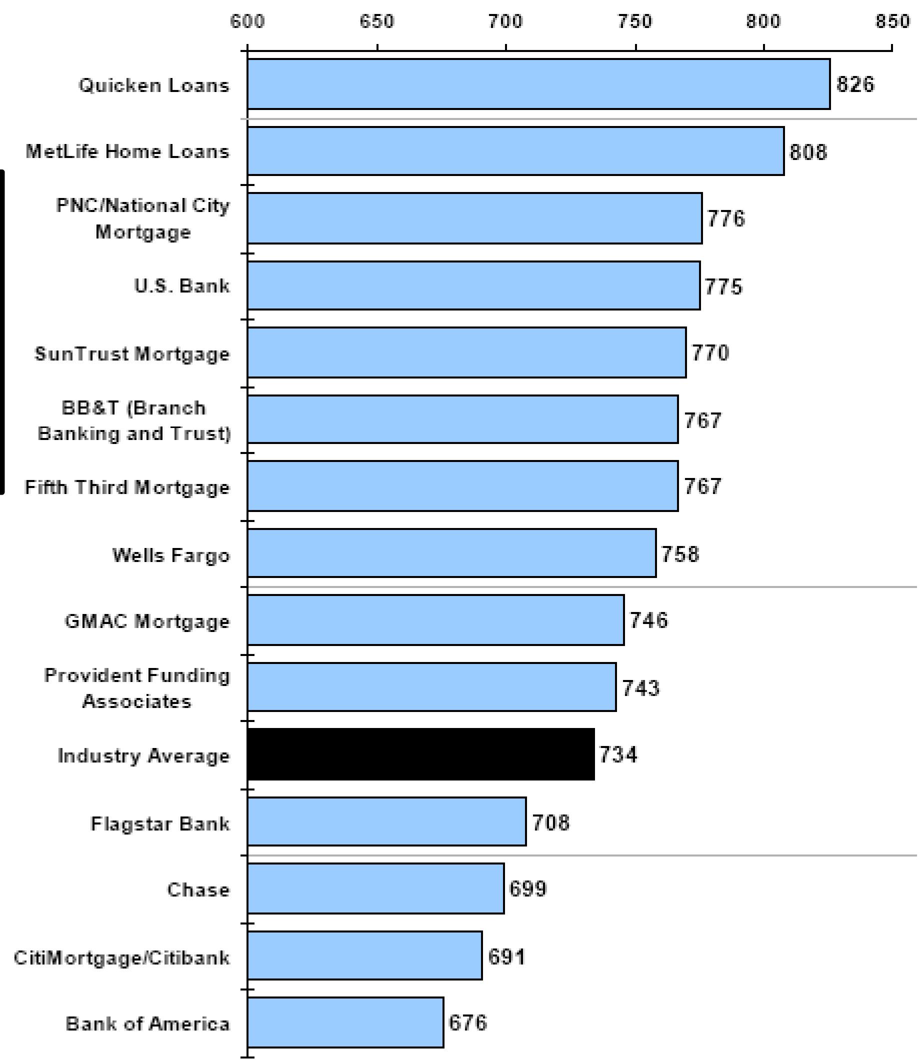
- Providing proactive updates on the status of the loan
- Providing a welcome acknowledgment after an application is submitted
- Avoiding asking for the same information more than once
- Closing on the promised date
- Clearly explaining loan options and ensuring that the customer understands
- Clearly explaining the entire process from application to approval



Source: J.D. Powers

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Secondary – New Originations

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GSE Name	1Q 2010 Purchases/Guarantees	1Q 2010 Market Share
Fannie Mae	$191	50%
Freddie Mac	$97	25%
Ginnie Mae	$90	23%
TOTALS	$378	98%

Source: Mortgagestats.com / National Mortgage News

Secondary – Seasoned Portfolios Whole Loans vs Securities

- Improved liquidity
- Higher risk-based capital ratios
- Higher return on risk-based equity
- Redeploy freed-up capital
- Greater servicing value
- Lock in credit risk
- Facilitates Asset/Liability Management

Servicing - Worth?

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Servicing Values - SRPs

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11/12/2010	Conv 30	Conv 15	Govt 30	5/1 ARM
Bank of America	1.617	1.451	2.909	1.436
Chase	1.796	1.693	1.670	1.040
Citibank	1.600	1.410	2.330	NA
SunTrust	0.984	0.695	1.528	0.326
Wells Fargo	2.130	1.770	2.550	0.330

SRPs based on:
State: NY
Min Fico: 720
1st Lien Amount: 300,000
LTV: 80
Full Doc

	Wells Fargo		
	Low UPB		High UPB
AZ - Arizona	1.300	5	1.750
CA - California	1.150	7	1.600
FL - Florida	1.700	1	2.150
MA - Massachusetts	1.200	6	1.650
MD - Maryland	1.500	3	1.950
NV - Nevada	1.400	4	1.850
NY - New York	1.600	2	2.050
AZ - Arizona	0.900	5	1.450
CA - California	0.800	7	1.350
FL - Florida	1.250	1	1.800
MA - Massachusetts	0.800	6	1.350
MD - Maryland	1.100	3	1.650
NV - Nevada	1.000	4	1.550
NY - New York	1.150	2	1.700

- **Little to no change over time**
- **Variation by state**
- **No variation by credit …..**

Source: www.L1Loans.com

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17 Largest Lenders Rate Sheet Pricing

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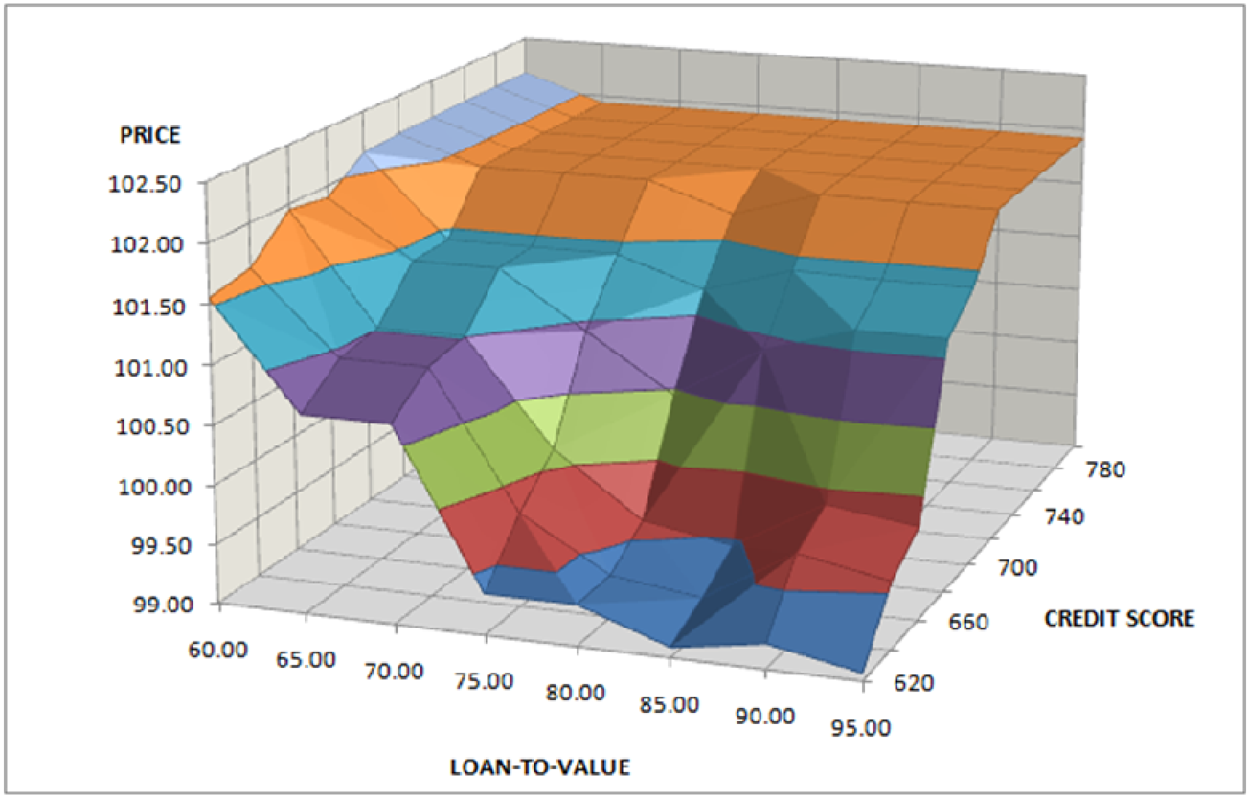
But … no variation in SRPs



Source: www.L1Loans.com

Servicing Values – FNMA IO Multiples

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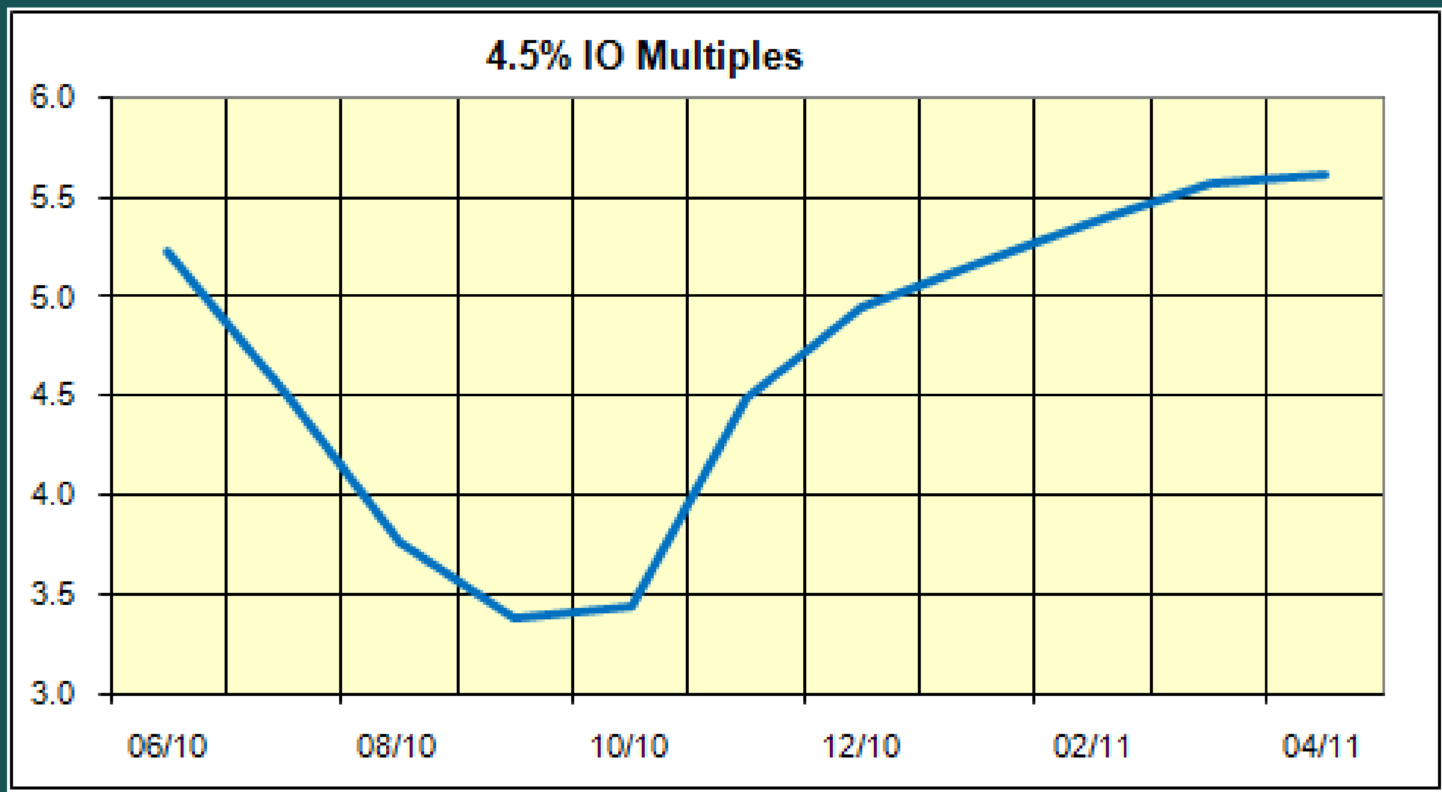

Source: Level 1 Loans

Servicing Values from 10Qs

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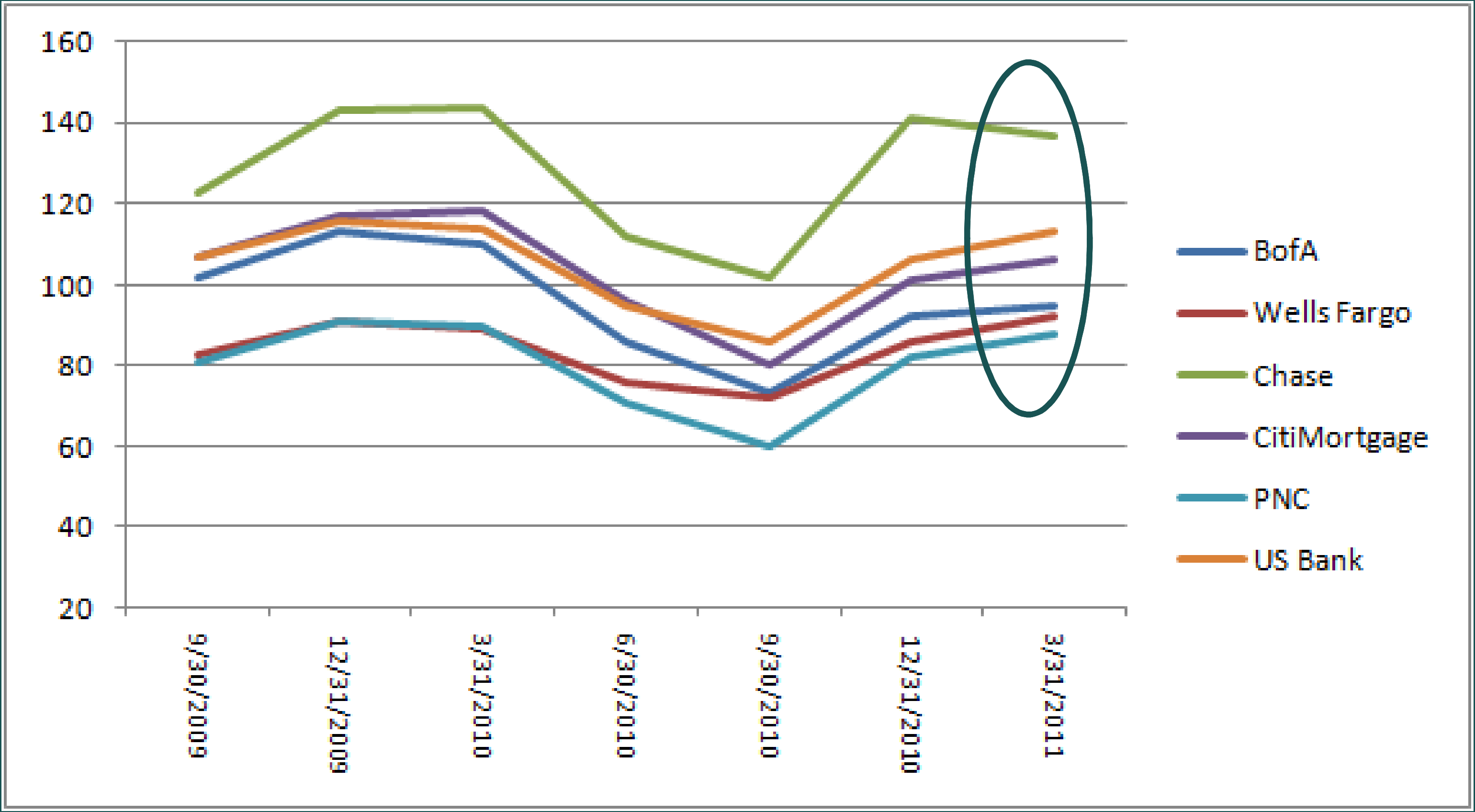

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Servicing Risk - Interest Rates are Volatile

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MSR Interest Rate Risk – Prepays

Embedded options to prepay Mortgage Loans (without penalty) create uncertain cash flows

- Unlike mortgages, MSRs gain value when rates rise
- Prepayments are hard to predict
- Examiners often scrutinize prepay assumptions used in valuation models

MSR Interest Rate Risk – Prepays

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Estimating MSR Prepays

- Generate predictions based on historical data
- Forecast speed changes in different rate simulations
- Understand underlying loan characteristics

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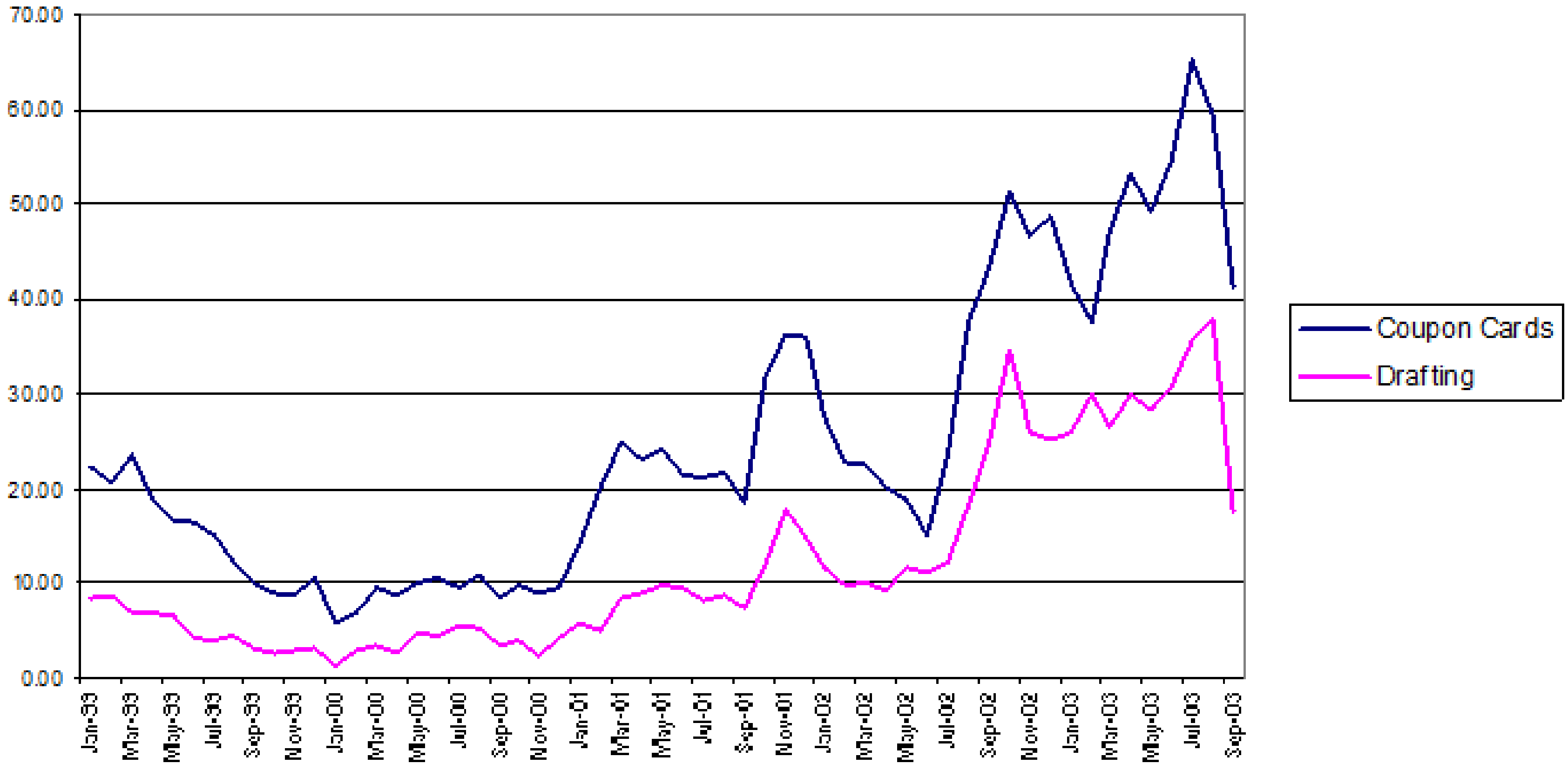
MSR Interest Rate Risk – Prepays

Application of Prepay Estimates & Effects of Recent Financial Turbulence

- Understand the market
- Test and document the assumptions
- Update assumptions as conditions change
- Acknowledge changing borrower and lender behaviors

MSR Interest Rate Risk – Prepays



MSR Interest Rate Risk – Prepays

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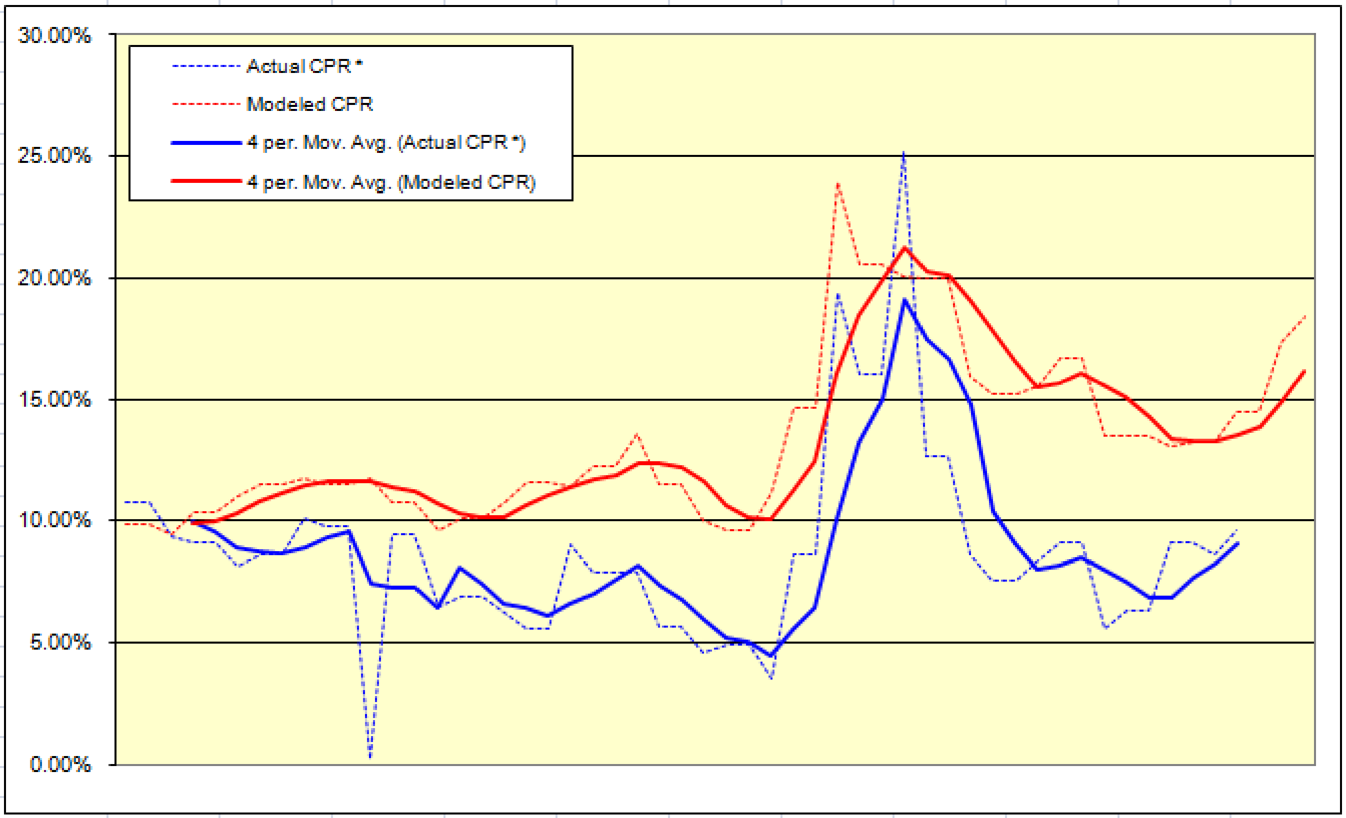

** Actual plotted with a three month lag to modeled*

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MSR Interest Rate Risk - IRR

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Portfolio Average Coupon	4.50%	[redacted]	[redacted]	4.50%	[redacted]	[redacted]	4.50%	8.00%
30 year FRM Current Coupon	4.50%	[redacted]	[redacted]	4.50%	[redacted]	[redacted]	4.50%	8.00%
MSR spread	4.50%	[redacted]		4.50%	[redacted]		4.50%	4.50%
Option spread	**0.00%**	[redacted]		**0.00%**	[redacted]		**0.00%**	**9.00%**
Pre-tax Discount Rate	9.00%	[redacted]		9.00%	[redacted]		9.00%	21.50%
Prepay Speed - PSA	175	[redacted]		175	[redacted]		175	266
Price Multiple	**5.00**	**4.50**		**5.00**	**3.44**		**5.00**	**3.47**

Servicing - Credit Risk

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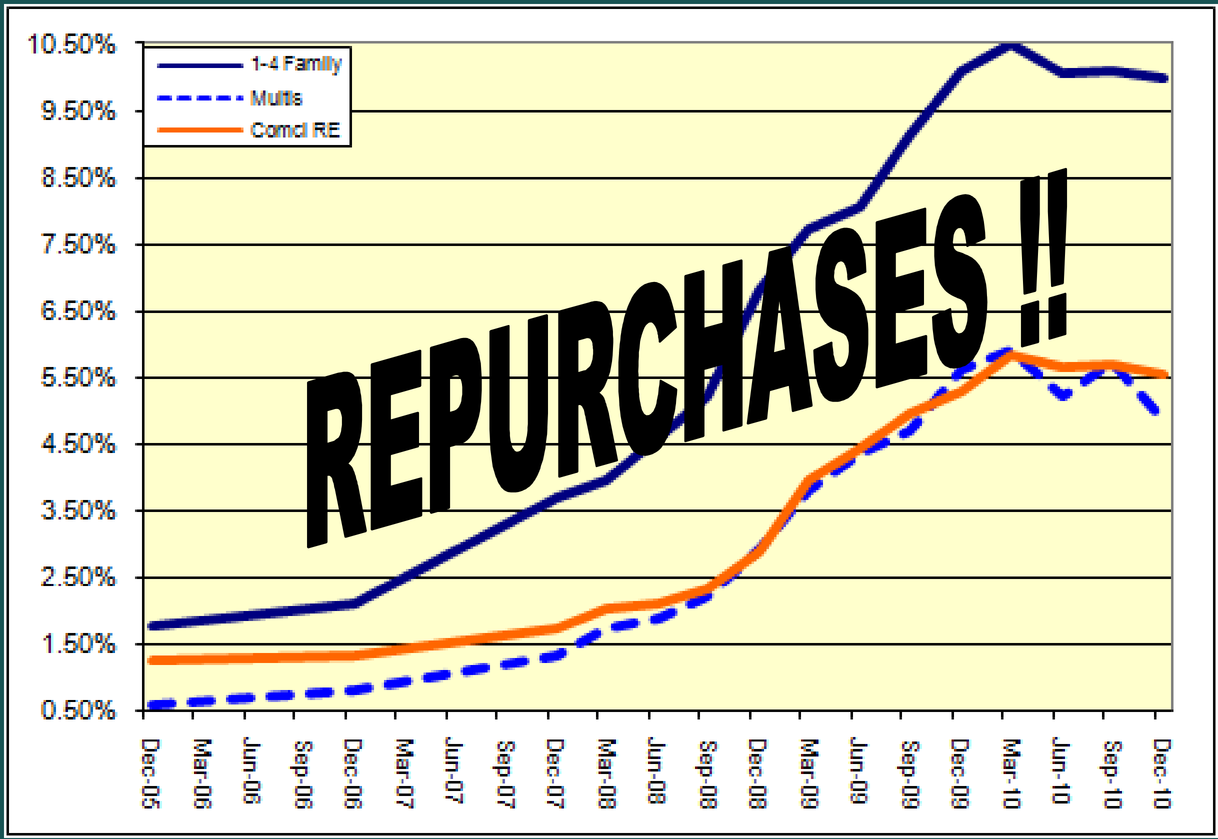

Source: Level 1 Loans

Servicing – Repurchase Risk

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	POPULATION LOAN COUNT			
Repurchase Reason	**Agree**	**Disagree**	**Inconclusive**	**Grand Total**
Compliance	68	0	0	68
Credit Score Guidelines	0	13	0	13
DTI Issues	17	25	33	75
Employment Misrepresentation	24	239	98	361
First Payment Default	165	674	199	1,038
Identity Theft	3	6	16	25
Income Misrepresentation	13	284	137	435
Legal Doc Deficiency	12	24	12	48
Loan Terms are Incorrect	33	7	0	40
Miscellaneous Fraud	0	43	12	55
Missing Documentation	8	0	0	8
Non-Arms Length Transaction	0	8	25	34
Occupancy Misrepresentation	13	163	56	232
Straw Buyer	0	37	3	40
Title Issues	0	3	6	9
Underwriting Deficiencies	9	115	71	195
Undisclosed Debt	44	433	103	580
Value Not Supported	0	164	19	183
Grand Total	**409**	**2,238**	**792**	**3,439**

- First Payment Default: Request was sent to defendant after loan was foreclosed and REO sold.
- Undisclosed Debt: Debts were disclosed, just not on the final 1003. Additional mortgage payments were included in the ratios; the file contained copies of the rental agreements and other documents for each property; and all debts were disclosed on the credit report.
- Undisclosed Debt: Plaintiff discovered two additional mortgages. These mortgages were taken out one month *after* the referenced loan origination date.
- Income Misrep: Speculation that borrower's business might not have supported *stated* income.
- Occupancy Misrep: Speculation that borrower did not intend to move to subject property since four months after the transaction, borrower was still registered as a voter at his old address.
- Guideline Violation: No violation of guidelines in effect *at time of origination*.

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MSR – PD% Risk

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Base Frequency of Foreclosure - 30 Year Fixed-Rate Mortgage

	FICO Score											
LTV%	591 - 610	611 - 630	631 - 650	651 - 670	671 - 690	691 - 710	711 - 730	731 - 750	751 - 770	771 - 790	791 - 810	811 - 900
<= 62.5	2.75	1.97	1.41	1.01	0.72	0.51	0.37	0.26	0.19	0.13	0.09	0.07
62.6 - 67.5	3.17	2.28	1.63	1.17	0.83	0.59	0.42	0.30	0.22	0.15	0.11	0.08
.67.6 - 72.5	3.65	2.63	1.88	1.35	0.96	0.69	0.49	0.35	0.25	0.18	0.13	0.09
72.6 - 77.5	4.20	3.03	2.17	1.56	1.11	0.79	0.57	0.40	0.29	0.21	0.15	0.10
77.6 - 82.5	4.83	3.49	2.51	1.80	1.29	0.92	0.66	0.47	0.33	0.24	0.17	0.12
82.6 - 87.5	5.55	4.02	2.89	2.08	1.49	1.06	0.76	0.54	0.39	0.27	0.20	0.14
87.6 - 92.5	6.37	4.62	3.33	2.40	1.72	1.23	0.88	0.63	0.45	0.32	0.23	0.16
92.6 - 97.5	7.30	5.31	3.84	2.76	1.98	1.42	1.01	0.72	0.52	0.37	0.26	0.19
>= 97.6	8.36	6.10	4.42	3.19	2.29	1.64	1.17	0.84	0.60	0.43	0.30	0.22

Characteristic	Factor
• Market Value Decline Upon Default	
Best	35%
Worst	40%
• Time to Liquidate Property	
Best	2 yr
Worst	3 yr
• Documentation	
Full	1.00
Reduced	1.28
Low doc	1.43
No doc	1.58
• Loan Purpose	
Cash-out	1.75
Purchase	1.00
Rate & Term	0.90
• Occupancy	
Investor	1.24
Second Home	1.12

Other Characteristics

- Months to Roll
- Property Type
- Payment Option
- Interest Only
- Interest Caps
- Term
- Loan Balance
- Months Delinquent.
- Debt to Income Ratio.

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MSR – LGD% Risk

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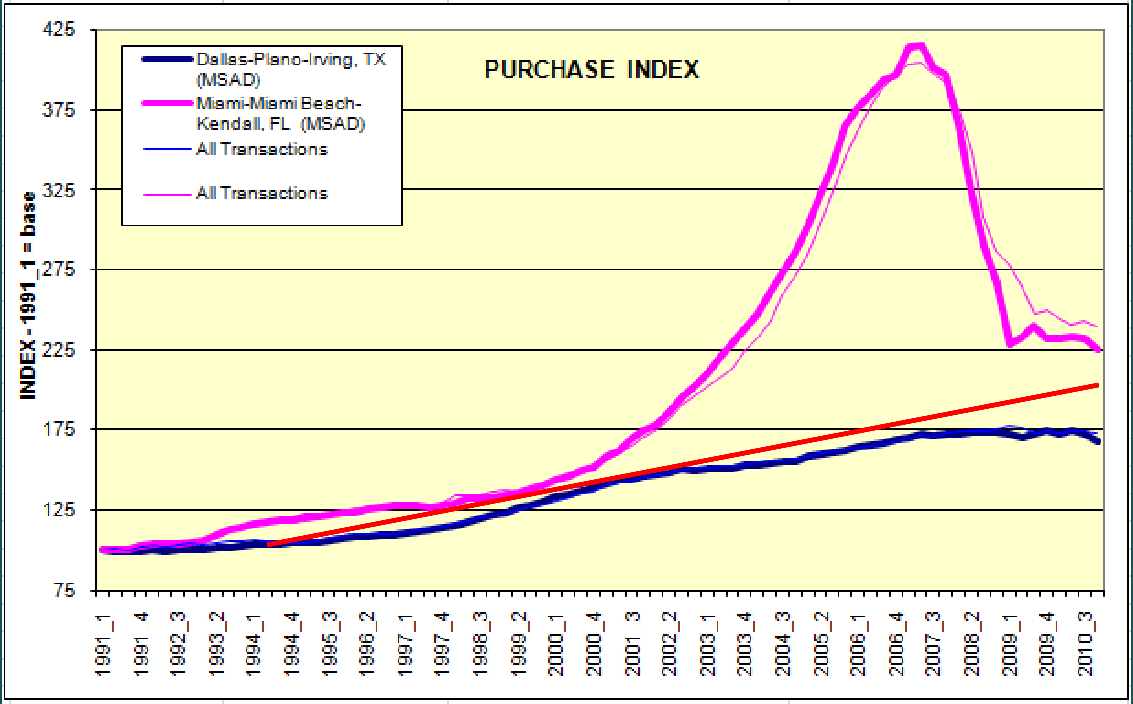
Age in Months	42	Dallas-Plano-Irving, TX (MSAD)	Miami-Miami Beach-Kendall, FL (MSAD)
% Change - Purchased Only*		-2.6%	-45.7%
% Change - Purchase & Refis*		0.7%	-40.7%



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MSR – Basel

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- MSAs <= 10% of tier 1 capital
- 1,137 of 7,941 banks Have MSAs
- 67 exceeded 10% (ignores other intangibles)
- These 67 has excess MSAs of $25B ($3.0T)
- Phased implementation

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MSR –
Good News; Convexity

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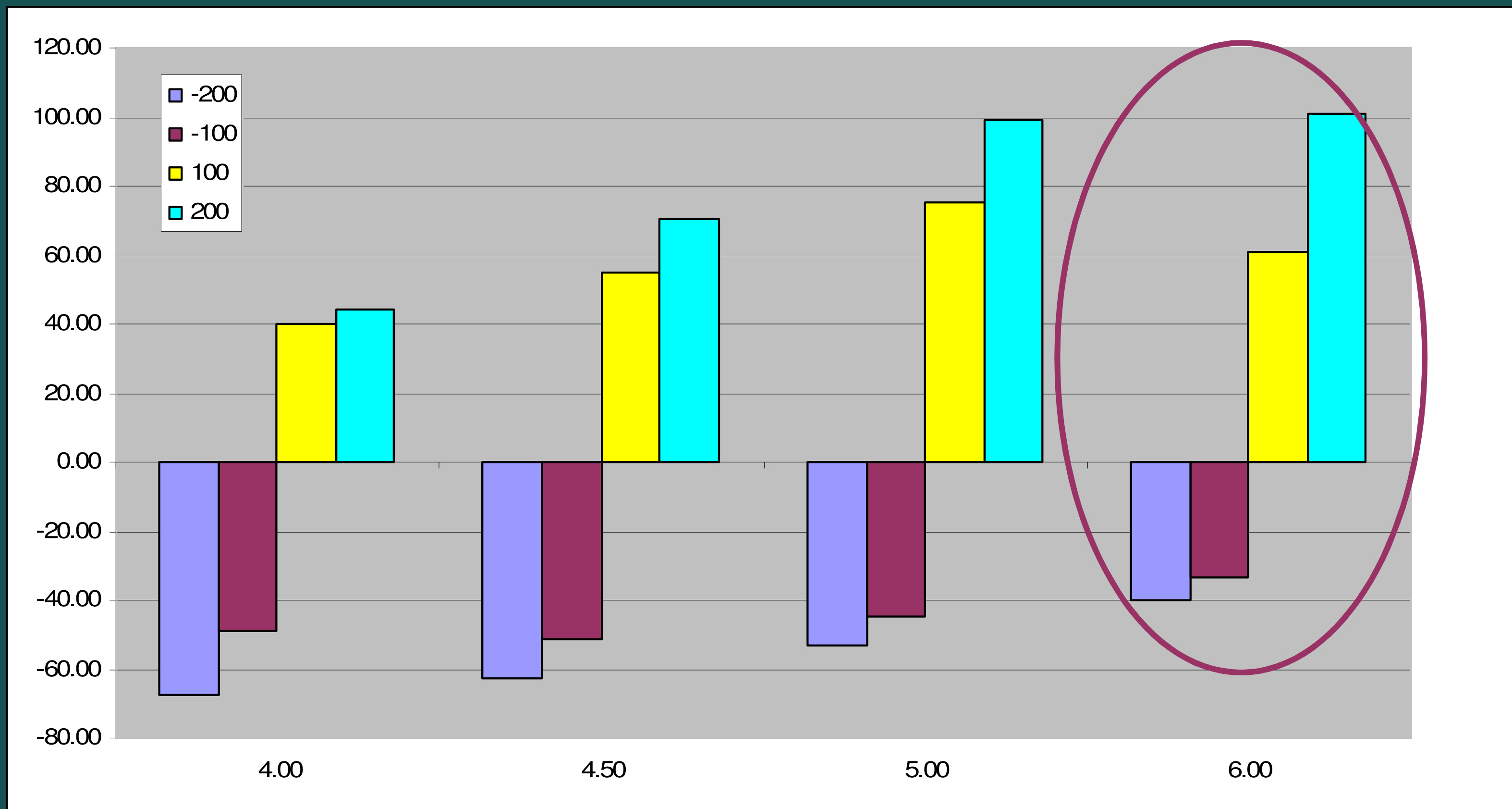

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2010 JD Powers Mortgage Servicing Customer Satisfaction Survey

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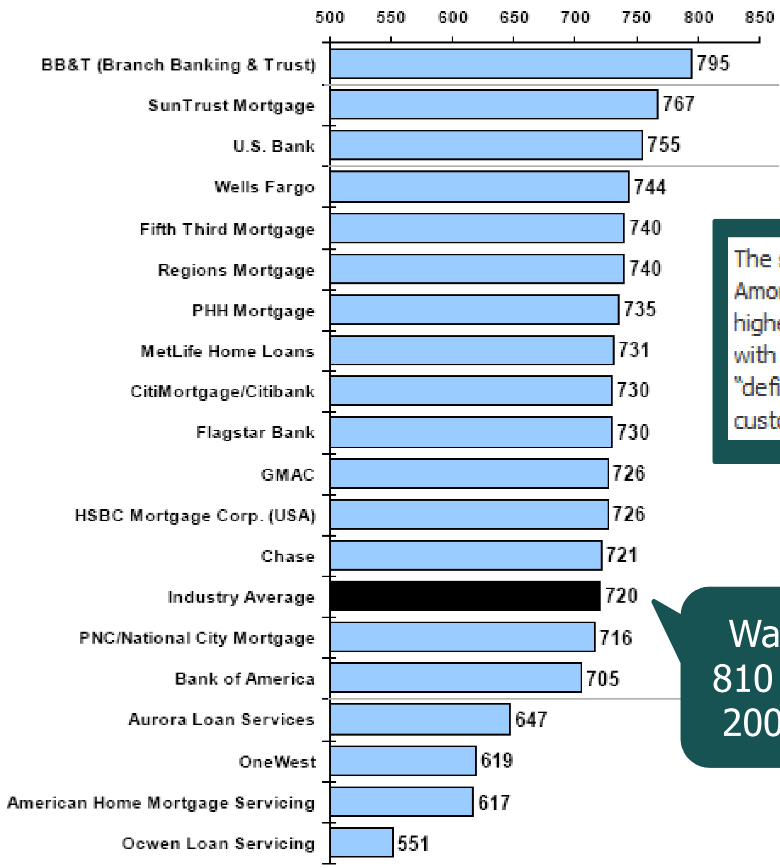

Was 810 in 2006

The study also finds that higher customer satisfaction may lead to higher levels of loyalty and retention. Among customers in the prime credit segment, 34 percent of those who are highly satisfied (scores of 800 or higher) say they "definitely will" recommend their servicer—compared with just 6 percent among customers with lower satisfaction scores. Similarly, 27 percent of highly satisfied prime credit customers say they "definitely will" select their servicer for a new home mortgage, while only 6 percent of less-satisfied customers say the same.

Source: J.D. Powers

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Managing in Turbulent Times: Peter Drucker

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"The greatest and most dangerous turbulence today results from the collision between the delusions of the decision makers, ... and the realities."

"... a time of turbulence is also one of great opportunity for those who can understand, accept and exploit the new realities."

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LEVEL 1 LOANS

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Overview

Valuation Services & Software
compliant with FAS 157 / ASC 820
Market --- Economic --- Liquidation --- **Prepay** & **ALLL**

Securitizations, **Due Diligence** & **Repurchase Request Defense**

Our practice focuses on:

- Residential Mortgages
- Reverse Mortgages
- Multifamily Loans
- Servicing Rights

		Level 1	Level 2	Level 3	Grand Total
Performing	Loan Count	2,413	5,688	346	8,447
	Current Balance	486,212,046	1,284,500,478	119,968,703	1,890,681,226
	Avg Coupon	4.38	6.23	5.32	5.70
	Avg FICO	734	677	727	695
	Average Age	92	70	67	76
	Original LTV	49.8	51.0	57.8	51.1
	Value_ %	**100.77**	**102.88**	**99.73**	**102.14**
	Loss %	**0.00**	**-1.31**	**-1.25**	**-0.97**
	Price %	**100.77**	**101.57**	**98.48**	**101.17**
	Price $	**489,964,837**	**1,304,611,469**	**118,145,716**	**1,912,722,022**
Non-Performing	Loan Count		1,002	38	1,040
	Current Balance		266,639,116	28,495,425	295,134,541
	Avg Coupon		9.21	8.70	9.16
	Avg FICO		620	694	627
	Average Age		37	32	36
	Original LTV		66.9	73.1	67.5
	Value_ %		**108.33**	**107.28**	**108.23**
	Loss %		**-36.58**	**-36.72**	**-36.59**
	Price %		**71.75**	**70.57**	**71.64**
	Price $		**191,312,468**	**20,108,007**	**211,420,475**
Total Loan Count		2,413	6,690	384	9,487
Total Current Balance		486,212,046	1,551,139,594	148,464,128	2,185,815,768
Total Avg Coupon		4.38	6.74	5.97	6.17
Total Avg FICO		734	667	721	686
Total Average Age		92	64	61	70
Total Original LTV		49.8	53.7	60.7	53.3
Total Value_ %		**100.77**	**103.82**	**101.18**	**102.96**
Total Loss %		**0.00**	**-7.38**	**-8.06**	**-5.78**
Total Price %		**100.77**	**96.44**	**93.12**	**97.18**
Total Price $		**489,964,837**	**1,495,923,937**	**138,253,723**	**2,124,142,497**

Losses on Level 1 loans are already reflected in the Value %

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VBC Velligan-Blaxall Consultants, LLC

GIVING BANKS CONFIDENCE SM

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Overview

Risk Management Services and Consulting

Asset/Liability Management --- Financial Risk Measurement --- Model Review

Securitizations, Due Diligence & Repurchase Request Defense

Seasoned Mortgage Loan portfolios

<u>Our practice focuses on:</u>

- Interest Rate and Market Risk Reporting and Consulting
- A/L Model Validation and Back Testing
- A/L Model Implementations
- Non-maturity Deposit and Prepay Speed Studies

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