

WAREHOUSE WORRIES

BY ROBERT STOWE ENGLAND

Smaller mortgage bankers report they continue to struggle to find sufficient warehouse lines even as some say the worst of the credit drought seems over.

Supply may be approaching demand; nevertheless, warehouse capacity is down substantially from its peak.



arehouse lending—the essential lifeblood of mortgage originations—began to shrink in the summer of 2007 as the mortgage market began to enter a meltdown. ■ The decline in warehouse lending started small in 2007. At first, lines were cut back or canceled for subprime and alternative-A

lenders. ■ Then the pullback of lines began to be more ominous. In March 2008, for example, Citigroup’s CitiMortgage Inc., based in O’Fallon, Missouri, reeling from billions in write-downs on subprime mortgages, announced it was shutting down its warehouse lending division—First Collateral Services, Concord, California, a major independent player. ■ The pace of departures took off after Lehman Brothers’ collapse in September 2008 led to a widespread credit market freeze. Lehman Brothers was, in fact, a major warehouse lender. One by one, the Wall Street firms and some big banks that were providing warehouse lines began to get out, including Deutsche Bank, UBS AG and ABN AMRO Bank NV. ■ The mass exodus of warehouse lenders led to the collapse of many well-run, well-capitalized independent mortgage bankers, which simply could not conduct business without warehouse lines. Mortgage companies “were dropping like flies,” recalls John Johnson, president and chief executive officer of MortgageAmerica Inc., an independent mortgage banker based in Birmingham, Alabama. ■ During 2009, the three largest remaining warehouse lenders either exited the business or sharply curtailed their lending, leading to the low point for warehouse credit roughly one year ago.

In March 2009, former No. 2 warehouse lender National City Corporation, Cleveland Ohio, which had been acquired by PNC Financial Services Group Inc., Pittsburgh, announced in it was leaving the business entirely. National City had agreed or committed to \$2.2 billion in warehouse lines to non-bank mortgage firms at the beginning of 2009.

Former No. 3 warehouse lender Guaranty Bank, Dallas, which had \$1.84 billion in commitments to mortgage bankers at the time, told its customers in March 2009 that it would exit the business when current warehouse lines expired. (Guaranty Financial Group, the parent of Guaranty Bank, filed for Chapter 11 bankruptcy protection in August 2009.)

In August 2009, the largest remaining warehouse lender, Colonial BancGroup Inc., Birmingham, Alabama, was shut down by the Federal Deposit Insurance Corporation (FDIC) and its assets acquired by BB&T Corporation, Winston-Salem, North Carolina. BB&T is discontinuing all warehouse lending outside its retail footprint, according to BB&T Chief Executive Officer Kelly King, who in October 2009 named Jeff Ellison president of the warehouse lending division.

From 120 lenders in September 2008, the number of warehouse-line providers fell a stunning 83 percent to just 20 lenders by March 2009, according to Stanley Street, president of Street Resource Group, an Atlanta-based firm that provides consulting and computer software to small and mid-tier warehouse lenders.

Total commitments by warehouse lenders to mortgage bankers plummeted from a high of \$2.25 trillion in 2006 to \$340 billion in 2009, according to The Reynolds Group, Summit, New Jersey.

“There was definitely a crisis,” recalls Tamara King, director of loan production for the Mortgage Bankers Association (MBA). “I think the good news is that warehouse lending is not as bad as it was last spring. Over the last few months there have been new parties interested in the warehouse lending space. So, that has improved the situation for our members.”

In fact, throughout 2009, MBA worked to secure government assistance to facilitate warehouse lines of credit for independent, non-depository mortgage bankers. MBA sent five letters to the administration on proposed solutions, held 13 meetings with government or agency officials, and received support from Congress in H.R. 3146 (a sense of Congress resolution encouraging the administration to provide relief for the warehouse crisis).

Warehouse crisis sends shock through system

The sharp decline in warehouse lenders and warehouse finance has been a shock to the mortgage banking system that pushed many independent mortgage bankers out business and sent others scrambling to find money to fund loans in the pipeline. That put a crimp on the ability of the mortgage industry to meet potential demand for home loans.

It also reshaped the contours of the industry, determining who could originate and who could not, forcing mortgage bankers to rethink their business strategies. It also restricted the scope of mortgage products that could obtain warehouse financing to basically government-related loan products tied to Fannie Mae, Freddie Mac and the Federal Housing Administration (FHA).

The decline in warehouse lending also led to an even

further concentration of the industry into the hands of still fewer players. According to *Inside Mortgage Finance*, the top 10 originators accounted for \$1.04 trillion or 74 percent of a total \$1.405 trillion mortgage originations for the first nine months of 2009.

The top five—Wells Fargo Home Mortgage, Des Moines, Iowa; Bank of America Home Loans, Calabasas, California; Chase Home Finance, Iselin, New Jersey; CitiMortgage; and GMAC Mortgage, Horsham, Pennsylvania—accounted for \$869 billion or 62 percent of total originations in the first nine months of last year.

A life-or-death matter

The loss of a warehouse line is no small matter for mortgage bankers, many of which keep several lines, including backup lines, so they can be sure they can temporarily warehouse their loans.

“Warehouse lenders—they decide whether you live or die,” explains Brian Koss, managing director at Mortgage Network Inc., an independent mortgage banker based in

From 120 lenders in September 2008, the number of warehouse-line providers fell a stunning 83 percent to just 20 lenders by March 2009.

Danvers, Massachusetts.

The collapse of warehouse lending has also been accompanied by a collapse in the number of end investors. The investor market, for its part, has contracted dramatically during the last two years. In 2005, there was a base of more than 600 institutional investors purchasing warehouse-financed loans. By the next year, that number had dropped to about 200. By September 2007, according to Street Resource Group’s research, some 40 percent of all production volume was flowing through 10 investors, with 60 percent through just six of the largest investors.

At year-end 2009, 50 percent of deliveries for investors other than government-direct (Fannie Mae, Freddie Mac and Ginnie Mae) went to the top three: Bank of America, Chase and Wells Fargo. If you add in two more investors, the top 75 percent for investors other than government-direct were to Bank of America, Chase, Wells Fargo, Citi and GMAC/Ally Bank.

Since the crash of warehouse lending, players that have remained in the business of warehouse lending have increased their lines to surviving, well-capitalized mortgage bankers, while more lenders have joined or rejoined the ranks of warehouse lenders.

Some warehouse lenders contend there is now no longer a shortage of warehouse funds, because they are able to

extend their lines to meet the needs of mortgage bankers.

However, other mortgage bankers would beg to differ with the notion that there is adequate supply. “If you talk to mortgagors,” Street says, “they say they are not able to fund refinance loans right now.” He adds, “Mortgage bankers are having to delay closings because of the unavailability of funds.”

Still a shortage?

So is there, in fact, still a shortage of warehouse lines? Opinions vary. For example, while Street concluded there was definitely “a true deficit of supply” as recently as early November, he now believes that the supply and demand have roughly equalized, as a result of a decline in demand based on steadily lower estimates of origination volume for 2010.

Street calculates warehouse demand at 40 percent of \$1.5 trillion projected origination volume for the year, or \$600 billion. Meanwhile, he estimates that current commitments for warehouse lines by providers are worth \$325 billion to \$350 billion. However, given the increased frequency with which lenders have been able to turn their lines, this commitment can meet a demand for \$600 billion in mortgage originations.

Even though supply and demand may be moving into balance, the players may continue to change, according to Street. “I believe that the regional and community commercial banks will still gain in market share of the overall warehouse supply chain, but that commitments are being ‘laterally displaced’ from existing warehouse lenders to new entrants into the warehouse lending space,” he says. This will “reduce supplier-side risk in general, and [more specifically] from the fallout from BB&T and NatCity in particular, rather than being driven from creating new overall capacity,” Street adds.

Street calculates that there has been an increase in the number of warehouse lenders from a low of 20 a year ago to about 30 to 35 warehouse lenders today—exclusive of community banks that have entered the warehouse lending business, he adds.

Yet, others still expect there to be a shortage of warehouse lines. By his own “conservative estimate,” Jim Reynolds, founder and managing partner of The Reynolds Group, estimates that, even under a conservative scenario, the undersupply of warehouse lines is likely to be \$235 billion, based on the expectation that mortgage originations requiring warehouse lines could rise significantly above 40 percent of overall originations. Reynolds’ firm conducts due-diligence work on mortgage banker clients for warehouse lender companies.

Based on a survey of warehouse lenders by The Reynolds Group, under the most conservative of three scenarios, demand for warehouse lines in 2010 will be \$570 billion while current warehouse lending capacity is only \$340 billion.

The shortfall will be greatest for small-cap mortgage bankers, because they are likely to see the greatest gains in mortgage origination volume. “The bottom line is that their needs are not being met—which is not good for the country, because they serve a very important purpose,” says Reynolds. By growing their origination capability, the small-cap mortgage bankers reduce the degree of concentration of

the industry in the hands of a few players, he argues.

Other observers of the warehouse lending market agree that there is still a shortage of warehouse lines. “As many of my discussions with warehouse lending executives indicate, while volume of applications has been sustained and recruiting capital to increase capacity is easier, they are turning down four [out of] five applications—so the issue isn’t liquidity as much as the tightened credit standards and requirements for a line,” says Mary Kladde, chief executive officer of Titan Lending Corporation, Denver, one of the companies that provides back-office support for mortgage bankers and, since March 2009, has provided a mortgage warehouse lending services platform for community banks.

“We are really seeing compression in the market. The small-cap market has almost no remedy,” Kladde says, and it is “unlikely that they are going to see it again anytime soon.”

“As I put it to my customers, you have to be flawless or have some massive compensating factors to entice a warehouse lender. We have had clients turned down for a bankruptcy that happened 25 years ago,” she says. “If you have less than \$500,000 net worth, there just isn’t anyone interested in stepping out ‘on faith’ with you. If you have any foibles, skeletons, missteps—good luck. [Mergers and acquisitions] may be your only course of action,” she adds.

A number of events could change the expectation for warehouse funding supply. For one thing, the Term Asset-Backed Loan Securities Facility (TALF) from the Federal Reserve is scheduled to end its massive intervention in the mortgage market, after completing its \$1.2 trillion in purchases of mortgage-backed securities (MBS).

The entry of the Fed through the TALF market has kept mortgage interest rates lower than they would be without such support. In fact, the announcement of the launching of the program prompted an immediate decline in mortgage rates and set off a refi wave that helped generate \$1 trillion in originations in the first half of 2009.

When this component of the TALF program ends, interest rates are expected to rise, all else being equal. However, given that 2010 is an election year, Reynolds expects federal officials to do what they can to keep interest rates low or limit the degree to which they rise post-TALF. Reynolds admits his view may run counter to those of bank economists, but says his forecast is not based on market and economic factors, but is instead “based on a political equation.”

More wild cards could come from continued consolidation in the banking sector and actions by the Federal Housing Administration to remove some lenders from its approved-lender list. Removal of those lenders could have adverse impacts on the warehouse lenders that have been providing them funds, according to Reynolds.

In December 2009, FHA revoked the authority of Melville, New York-based Lend America (also known as Ideal Mortgage Bankers) to make loans insured by the FHA. In response, Lend America closed its loan-making operation and laid off most of its 600 workers. Warehouse lenders exposed to Lend America face potential losses on those lines.

Lend America was the first lender in the country to receive approval from the Department of Housing and Urban Development (HUD) to underwrite, close and insure

HOPE for Homeowners loan transactions without prior HUD review. In May 2009, the lender launched a \$500,000-a-month print and broadcast advertising campaign to promote HOPE for Homeowners.

Banking consolidation takes a toll

Earlier in 2009, bank takeovers had a decidedly negative impact on the availability of warehouse lines.

A decision to terminate the warehouse lines came from National City Corporation's new owner, PNC Financial Services Group. PNC announced a deal to acquire National City in October 2008 for \$5.58 billion shortly after the regional bank received approval for \$7.7 billion in cash from the federal government under the newly enacted \$700 billion Troubled Asset Relief Program (TARP).

A bit of good news came in May 2009 when JPMorgan Chase said it had decided not to exit the warehouse lending business completely. When the bank acquired Seattle-based Washington Mutual (WaMu) in 2008, it acquired WaMu's warehouse business, which had 10 customers when JPMorgan Chase announced it was getting out of the business. A company spokesman told *National Mortgage News* last year that JPMorgan Chase would continue providing warehouse lines "to a subset of these 10 customers."

The next big blow to warehouse lending came when Colonial BancGroup failed in August and most of its assets were acquired by BB&T. Not only was Colonial the largest bank failure in 2009, with about \$25 billion in assets, it was one of the largest warehouse lenders. At the time of its demise, it had an estimated 70 mortgage companies as clients, according to Stanley Street.

Earlier, in April 2009, Colonial BancGroup, suffering high loan default rates, signed away 75 percent control of the company to Ocala, Florida-based Taylor Bean & Whitaker, a mortgage banker, in return for a \$300 million injection. However, the deal was called off in late July. The

injection, it was hoped, would make it possible for Colonial to apply for TARP funds to boost its capital.

Unfortunately for Colonial, instead of a federal rescue there was a federal raid. On Aug. 4, Colonial's mortgage warehouse lending division, based in Orlando, Florida, was raided by federal agents associated with the Special Inspector General for TARP. That same day, Taylor, Bean & Whitaker was also raided by the feds. Colonial said at the time it was facing a Department of Justice criminal investigation into "alleged accounting irregularities" in its mortgage warehouse lending division.

On the day of the raid of both companies, the FHA also suspended Taylor, Bean & Whitaker from originating and underwriting new FHA-insured mortgages. Ginnie Mae also defaulted and terminated Taylor, Bean & Whitaker as an issuer of its mortgage-backed securities.

Unlike PNC when it acquired National City, BB&T is not entirely leaving the warehouse lending business. It will continue to provide warehouse lines for lenders who are within BB&T's retail banking footprint.

The decline in originations that occurred in the second half of 2009 may also be complicating the task of boosting the number of warehouse lenders, according to Paul Miller, an analyst at FBR Capital Markets, Arlington, Virginia.

Because housing demand is going to be weak, Miller argues, "We're going to get less production—and this is feeding the lack of warehouse lines."

Another reason warehouse lenders are holding back is that many of them are part of large banks that have their own mortgage origination arm, and "they don't want to feed brokers to compete against them" for the potential customers for mortgages that are provided in the current weak housing market. **MB**

Robert Stowe England is a freelance writer based in Arlington, Virginia. He can be reached at rengland@us.net.

This feature article is an **excerpt** from the February 2010 issue of *Mortgage Banking*. This posted PDF version is not for copying, distribution or reprint.

For subscription information, please call (202) 557-2844 or visit our subscription center at: www.mortgagebankingmagazine.com.