

Federal Home Loan Bank of Topeka

Mortgage Lending in the Near Term: The Good, The Bad, and The Ugly

April 25, 2014

Agenda

Today's Topics

1. Regulatory environment – CFPB and BASEL III
2. Expected drop loan origination volume due to recent increase in rates and regulatory changes
3. Community Financial Institutions' Advantages

Mortgage Market

Consumer Financial Protection Bureau

Ability to Repay (ATR) and Qualified Mortgage (QM) Rule
Effective January 10, 2014

General ATR Standard

One must make a reasonable, good-faith determination before, or when consummating a covered mortgage loan, that the consumer has a reasonable ability to repay the loan

Inclusions and Exclusions

Inclusions

ATR/QM rule applies to almost all closed-ended consumer credit transactions secured by a dwelling including any real property attached to the dwelling.

- Loans secured by residential structures that contain one to four units
- Includes condominiums and co-ops
- NOT limited to first liens or to loans on primary residences



Inclusions and Exclusions

Exclusions

- Open-ended credit plans (HELOCs)
- Time-share plans
- Reverse mortgages
- Temporary or bridge loans with terms of 12 months or less (with possible renewal)
- A construction phase of 12 months or less (with possible renewal) of a construction-to-permanent loan
- Consumer credit transactions secured by vacant land



ATR Underwriting Factors

1. Current or reasonably expected income or assets (other than the value of the property that secures the loan) that the consumer will rely on to repay the loan
2. Current employment status (if you rely on employment income when assessing the consumer's ability to repay)
3. Monthly mortgage payment for this loan. Calculate this using the introductory or fully-indexed rate, whichever is higher, and monthly, fully-amortizing payments that are substantially equal
4. Monthly payment on any simultaneous loans secured by the same property

ATR Underwriting Factors

5. Monthly payments for property taxes and insurance that you require the consumer to buy, and certain other costs related to the property such as homeowners association fees or ground rent
6. Debts, alimony, and child-support obligations
7. Monthly debt-to-income ratio or residual income, that is calculated using the total of all of the mortgage and non-mortgage obligations listed above, as a ratio of gross monthly income
8. Credit history

Firms That Can Help

Compliance Providers

- Bankers Advisory Services – recently purchased by CliftonLarsonAllen
- Mortgage Compliance Advisors

Who is Exempt from ATR

- Community Development Financial Institutions
- 501(c)(3) nonprofits – less than 200 loans of any type per year
- State Housing Agencies

Qualified Mortgage

Types of QM

- General
- Temporary: sales to Fannie Mae and Freddie Mac until the earlier of January 10, 2021 or exit from conservatorship (includes sales to FHLBs)
- Small Creditor
- Small Creditor Balloon Payment

Qualified Mortgage

General QM Loan Features

- No more than 30 years
- No negative amortization or interest only
- Points and fees limited to 3%
- Payment underwriting: based on maximum rate in first five years
- “Old-fashioned” underwriting
- Back-end ratio 43% or less
- No minimum down payment



Temporary QM

Loans under Temporary QM status must meet the same requirements as General QM loans regarding prohibitions on risky features, a max loan term of 30 years, and points-and-fees restrictions. They also must meet at least one of the following requirements:

- Eligible for purchase by Fannie Mae or Freddie Mac while operating under federal conservatorship or receivership
- Eligible for FHA insurance
- Eligible to be insured by the Rural Housing Service
- Eligible to be guaranteed by the USDA
- Eligible to be guaranteed by the VA



Temporary QM

Eligibility for purchase or guarantee by a GSE or insurance or guarantee by an agency can be established by:

- Valid recommendation from a GSE Automated Underwriting System (AUS) or an AUS that relies on an agency underwriting tool
 - Back-end can exceed 43%
- GSE or agency guidelines contained in official manuals
- Written agreements between a GSE or agency and the creditor (or direct sponsor or aggregator of the creditor)
- Individual loan waivers from a GSE or agency



Small Creditors

Small Creditor Criteria

- Assets below \$2 billion (to be adjusted annually for inflation) at the end of the last calendar year
- Organization and its affiliates together originated no more than 500 first-lien, closed-end residential mortgages that are subject to the ATR requirements in the preceding calendar year

Small Creditor QM Loans

Small Creditor QM Loan Requirements

- Underwrite based on a fully-amortizing schedule using maximum rate permitted during the first five years after the date of the first periodic payment
- Loan must not be subject to a forward commitment
- Must consider and verify the consumer's income or assets, and debts, alimony, and child support
- Must consider the consumer's debt-to-income ratio or residual income (although no specific threshold set)

Small Creditor QM Loans

Small Creditor QMs lose QM status if sold or otherwise transferred less than three years after consummation. However, a Small Creditor QM keeps its QM status if it meets one of the following criteria:

- It is sold more than three years after consummation
- It is sold to another creditor that meets the criteria regarding number of originations and asset size, at any time
- It is sold pursuant to a supervisory action or agreement, at any time
- It is transferred as part of a merger or acquisition of or by the creditor, at any time.

Balloon Payment QM Loans

There is a two-year transition period during which all small creditors can make Balloon Payment QMs, regardless of where the small creditor operates.

After the two-year period expires, only small creditors that operate predominantly in rural or underserved areas will be able to make Balloon Payment QMs

Balloon Payment QM Loans

Balloon Payment QM Loan Requirements

- Loan must have a fixed interest rate and periodic payments (other than the balloon payment) that would fully amortize the loan over 30 years or less
- Loan must have a term of five years or longer
- Must not be subject to a forward commitment
- Must consider the consumer's debt-to-income ratio or residual income (although no specific threshold set)



Balloon Payment QM Loans

Balloon Payment QM Loan Requirements

- Must determine the consumer will be able to make the scheduled payments other than the balloon payment. Unlike the calculation of balloon loan monthly payments for determining ATR, the Balloon Payment QM calculation excludes the balloon payment even if the loan is a higher-priced loan
- Must consider and verify the consumer's income or assets, and debts, alimony, and child support



ATR Requirements with Qualified Mortgages

	ATR Standard	General QM Definition	Agency/GSE QM (Temporary)	Balloon-Payment QM	Small Creditor QM	Small Creditor Balloon Payment QM (Temporary)
Loan feature limitations	No limitations	No negative amortization, interest-only, or balloon	No negative amortization, interest-only, or balloon payments	No negative amortization or interest-only	No negative amortization, interest-only, or balloon	No negative amortization or interest-only
Loan term limit	No limitations	30 years	30 years	No more than 30 years, no less than 5 years	30 years	No more than 30 years, no less than 5 years
Points & Fees limit	No limitations	3%	3%	3%	3%	3%
Payment Underwriting	Greater or fully indexed or introductory rate	Max rate in first 5 years	As applicable, per GSE or agency requirements	Amortization schedule no more than 30 years	Max rate in first 5 years	Amortization schedule no more than 30 years
Mortgage-related obligations	Consider and verify	Included in underwriting monthly payment and DTI	As applicable, per GSE or agency requirements	Included in underwriting monthly payment and DTI	Included in underwriting monthly payment and DTI	Included in underwriting monthly payment and DTI
Income or assets	Consider and verify	Consider and verify	As applicable, per GSE or agency requirements	Consider and verify	Consider and verify	Consider and verify
Employment status	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements	No specific requirement	No specific requirement	No specific requirement
Simultaneous loans	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements	Included in underwriting DTI	Included in underwriting DTI	Included in underwriting DTI
Debt, alimony, child support	Consider and verify	Included in underwriting monthly payment and DTI	As applicable, per GSE or agency requirements	Consider and verify	Consider and verify	Consider and verify
DTI or Residual Income	Consider and verify	DTI ≤ 43 %	As applicable, per GSE or agency requirements	Consider and verify	Consider and verify	Consider and verify
Credit History	Consider and verify	Included in underwriting DTI	As applicable, per GSE or agency requirements	No specific requirement	No specific requirement	No specific requirement

Safe Harbor and Rebuttable Presumption

Safe Harbor and Rebuttable Presumption for First Lien Residential Mortgages

- If APR less than Average Prime Offer Rate (APOR)
plus 1.5%
→ safe harbor
- If APR greater than APOR plus 1.5%
→ rebuttable presumption

Safe Harbor and Rebuttable Presumption

Safe Harbor and Rebuttable Presumption for Subordinate Lien Residential Mortgages

- If APR less than APOR plus 3.5%
 → safe harbor
- If APR greater than APOR plus 3.5%
 → rebuttable presumption

Points and Fees

Points and Fees

- Limited to 3% if loan is greater than \$100,000
- Defined under the Home Ownership and Equity Protection Act (HOEPA)
- Percentage limits go up for smaller loan sizes



Points and Fees

Points and Fees Caps for Smaller Loans

- 3% of the total loan amount for a loan \geq \$100,000
- \$3,000 for a loan \geq \$60,000, but $<$ \$100,000
- 5% of the total loan amount for a loan \geq \$20,000, but $<$ \$60,000
- \$1,000 for a loan \geq \$12,500, but $<$ \$20,000
- 8% of the total loan amount for a loan $<$ \$12,500

Points and Fees

Points and Fee Definitions

- Finance Charge - for the limit, you do not have to include:
 - Interest Differential
 - MIPs
 - Federal or State MIPs
- Points and Fees include direct or indirect compensation paid to a loan originator – does not include employee compensation



Points and Fees

Points and Fee Definitions

- Real estate fees generally excluded unless there is compensation or the fee is paid to an affiliate
- Credit Life and other premiums rolled into loan amount are included
- Maximum prepayment fee included

Rules

- QRM – Qualified Residential Mortgage:
 - Rule re-proposed on Aug 28, 2013
 - Relates to securitization and “skin in the game”
- RESPA -TILA rules effective August 1, 2015
 - 1,100 pages
- Loan Originator Qualification and Compensation
 - Effective January 10, 2014

Loan Originator Qualification and Compensation

- Fairly broad definition of loan originator – Credit Unions
- Compensation:
 - Prohibits loan officers' compensation from being based on the terms of a transaction
 - Prohibits loan officers in a transaction from being compensated by both a consumer and another person
 - Allows certain contributions to certain retirement plans and bonus pools based on mortgage-related profits

Loan Originator Qualification and Compensation

- Qualifications:
 - Loan originators must be licensed
 - Requires non-loan originator employees who are not required to be licensed be trained and pass a criminal background check
- Requires loan originator identification on loan documents
- Requires written procedures
- Restricts the use of mandatory arbitration clauses

Effect on Mortgage Brokers

Number of Mortgage Brokers

2006	25,000
Jan 2013	5,000

Mortgage Brokers Percentage of Market

2004-2006	30%
2008	20%
2012-2013	10%

Source: NAMB – The Association of Mortgage Professionals



2014 Mortgage Originations Forecast

- Tapering of quantitative easing - - increase in mortgage rates
- Drop in refinance activity and potentially decrease in sales velocity
 - Example \$200,000 loan at 3.5% payment is \$898.09
 - \$400,000 loan at 7% interest is \$2,661.21 nearly 3 times the original payment

2014 Forecast

MBA Mortgage Finance Forecast

	2013				2014				2015				2013	2014	2015
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
<i>Housing Measures</i>															
Housing Starts (SAAR, Thous)	957	869	882	1,016	930	1,000	1,060	1,100	1,130	1,160	1,220	1,265	931	1,023	1,194
Single-Family	630	598	596	665	600	660	720	750	780	810	860	900	622	683	838
Two or More	328	270	287	351	330	340	340	350	350	350	360	365	309	340	356
<i>Home Sales (SAAR, Thous)</i>															
Total Existing Homes	4,943	5,057	5,358	4,937	4,840	4,994	5,324	5,382	5,410	5,485	5,617	5,723	5,074	5,135	5,559
NewHomes	449	443	388	441	497	500	507	517	529	526	534	549	430	505	535
FHFA US House Price Index (YOY % Change)	2.3	4.3	4.7	4.8	4.4	4.4	4.4	4.2	4	3.7	3.4	3	4.8	4.2	3
Median Price of Total Existing Homes (Thous \$)	176.0	203.0	206.9	197.0	192.2	200.2	204.9	196.7	198.7	204.8	204.2	202.3	195.7	198.5	202.5
Median Price of Nw Homes (Thous \$)	258.0	267.6	262.4	266.3	268.1	277.4	281.0	272.2	275.3	278.4	280.6	278.7	263.6	274.7	278.3
<i>Interest Rates</i>															
30-Year Fixed Rate Mortgage (%)	3.5	3.7	4.4	4.3	4.4	4.6	4.9	5.0	5.1	5.2	5.3	5.3	4.0	4.7	5.2
10-Year Treasury Yield (%)	2.0	2.0	2.7	2.7	2.8	2.9	3.1	3.2	3.3	3.4	3.5	3.5	2.4	3.0	3.4
<i>Mortgage Originations</i>															
Total 1- to 4- Family (Bil \$)	524	537	401	293	226	272	298	284	297	314	318	290	1,755	1,080	1,219
Purchase	136	183	195	138	115	163	195	187	193	210	216	189	652	661	808
Refinance	388	354	206	155	111	109	103	97	104	104	102	102	1,103	419	411
Refinance Share (%)	74	66	51	53	49	40	35	34	35	33	32	35	63	39	34

Source: Mortgage Bankers Association

All data except interest rates are seasonally adjusted

Mortgage Servicing

CFPB National Servicing Standards

- Effective January 10, 2014
- Exempts small servicers – under 5,000 loans

Mortgage Servicing

Basel III Limitations

- Regulatory arbitrage for credit unions for now – NCUA considering new risk-based capital rules – would risk weight servicing at 250%
- Opportunity for hedge funds – very active market in early 2014 – regulators are carefully reviewing transactions

Basel III Definitions

Comparison Table

		Current	New			
		Adequately Capitalized	Under Capitalized	Adequately Capitalized	Well Capitalized	Adequate w/buffer
Common Equity Tier 1	RWA	NA	3.0%	4.5%	5.0%	7.0%
Tier One	RWA	4.0%	4.0%	6.0%	8.0%	8.5%
Total Capital	RWA	8.0%	6.0%	8.0%	10.0%	10.5%
Leverage (Tier 1)	Avg Total	4% or 3%	3.0%	4.0%	5.0%	6.5%

Regulatory Adjustments to Common Equity Tier 1 – Section 22b

10% and 15% Rules:

- MSRs subject to limitations
 - Eligible amount risk weighted at 250%
 - MSRs recorded at fair value:
 - 90% limitation eliminated
- Significant investments in unconsolidated financial institutions and qualifying deferred tax assets

Regulatory Adjustments to Common Equity Tier 1 – Section 22b

10% and 15% Rules continued:

- 15% Rule:

deduct the total of the three items that exceed 17.85% (15% of 85%) of total adjusted CET1 capital reduced for the amounts deducted under the 10% thresholds

- Amount of assets deducted reduces RWA denominator

Phase In Period for Capital Deductions

10% and 15% deductions phased-in:

- 40% reduction in 2015, then 20% per year
- No Tier One deduction for amount not deducted from CET1
- 100% risk weight on eligible portion until 1/1/2018
- After 1/1/2018, risk weighted at 250%

Risk Weighting Loans

Single family one to four:

- Prudently underwritten first 50% (if bank holds first and second and no intervening, liens treated as first)
- Seconds, 90 day +, non-accrual, modified – 100%
 - HAMP loans are not modifications

Off Balance Sheet Exposures

Over the counter derivative contracts (e.g. mortgage banking derivatives)

- If less than one year and interest rate risk: 0% risk weight

Credit Enhancement Obligation

- Credit Enhancement Obligation is considered to be a synthetic securitization under BASEL III
- Risk Weighting Options
 - Weight at 1,250% - dollar for dollar
 - Use gross up method
 - Use simplified supervisory formula approach (“SSFA”)

Credit Enhancement Obligation

SSFA Calculator

- Demonstration of Calculator

Updated Accounting and Regulatory Guide

Accounting and Regulatory Guidance for the Mortgage Partnership Finance[®] Program

December 2013, Version 4

Bank Loan and Deposit Analysis

Footprint Institutions

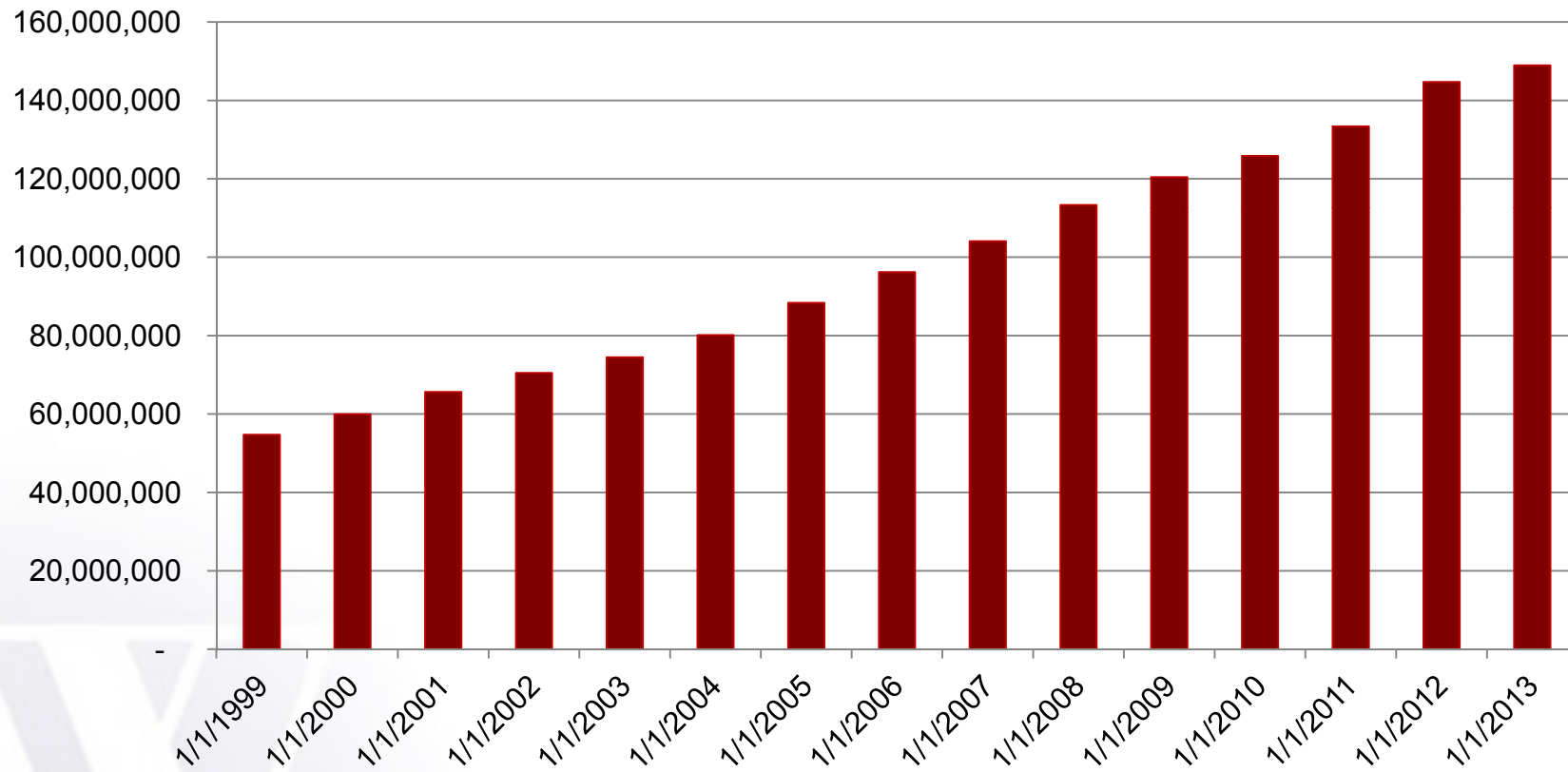
816 Banks in Colorado, Kansas, Nebraska, Oklahoma with less than \$5 billion in assets.

Peer Group

6,654 U.S. banks with less than \$5 billion in assets

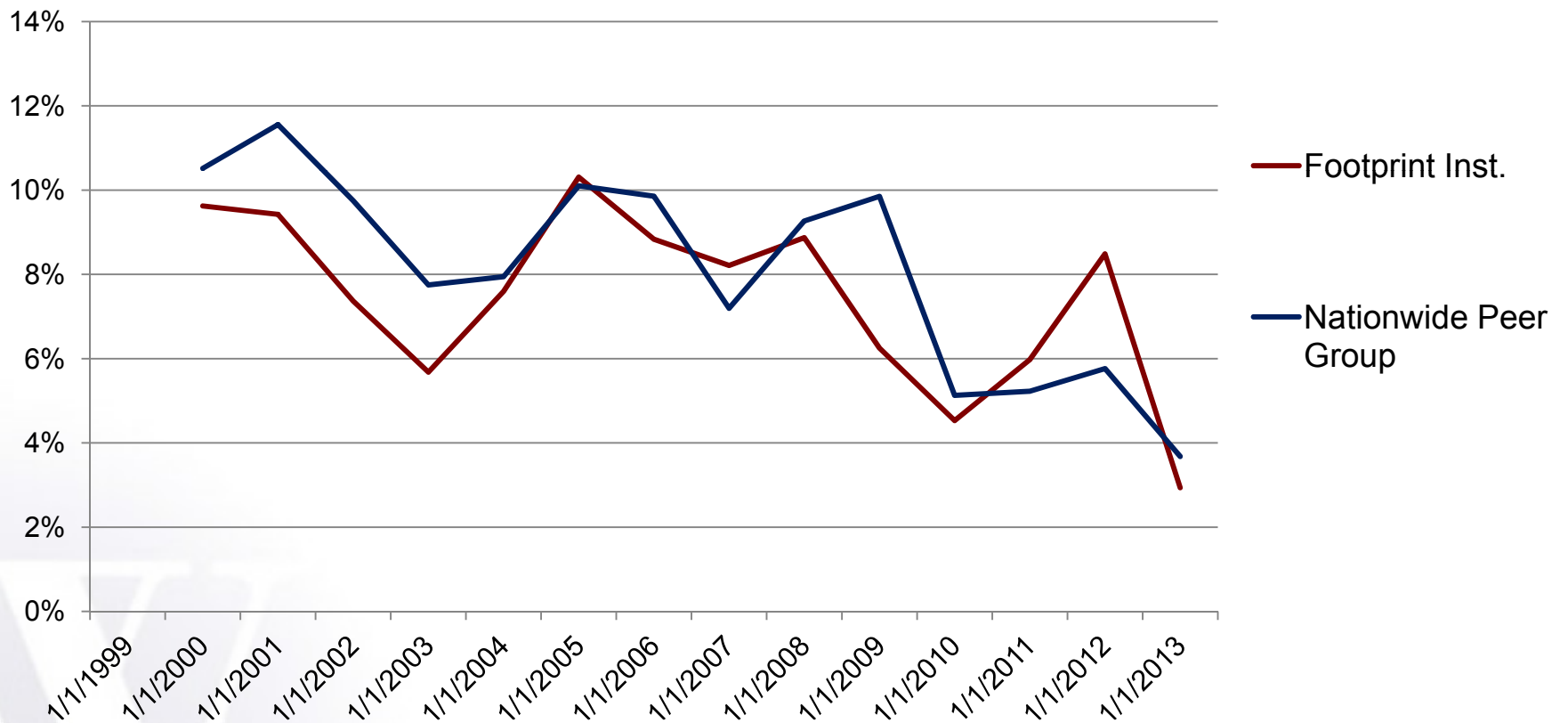
Bank Loan and Deposit Analysis

Total Deposits



Bank Loan and Deposit Analysis

Deposit Growth Rates



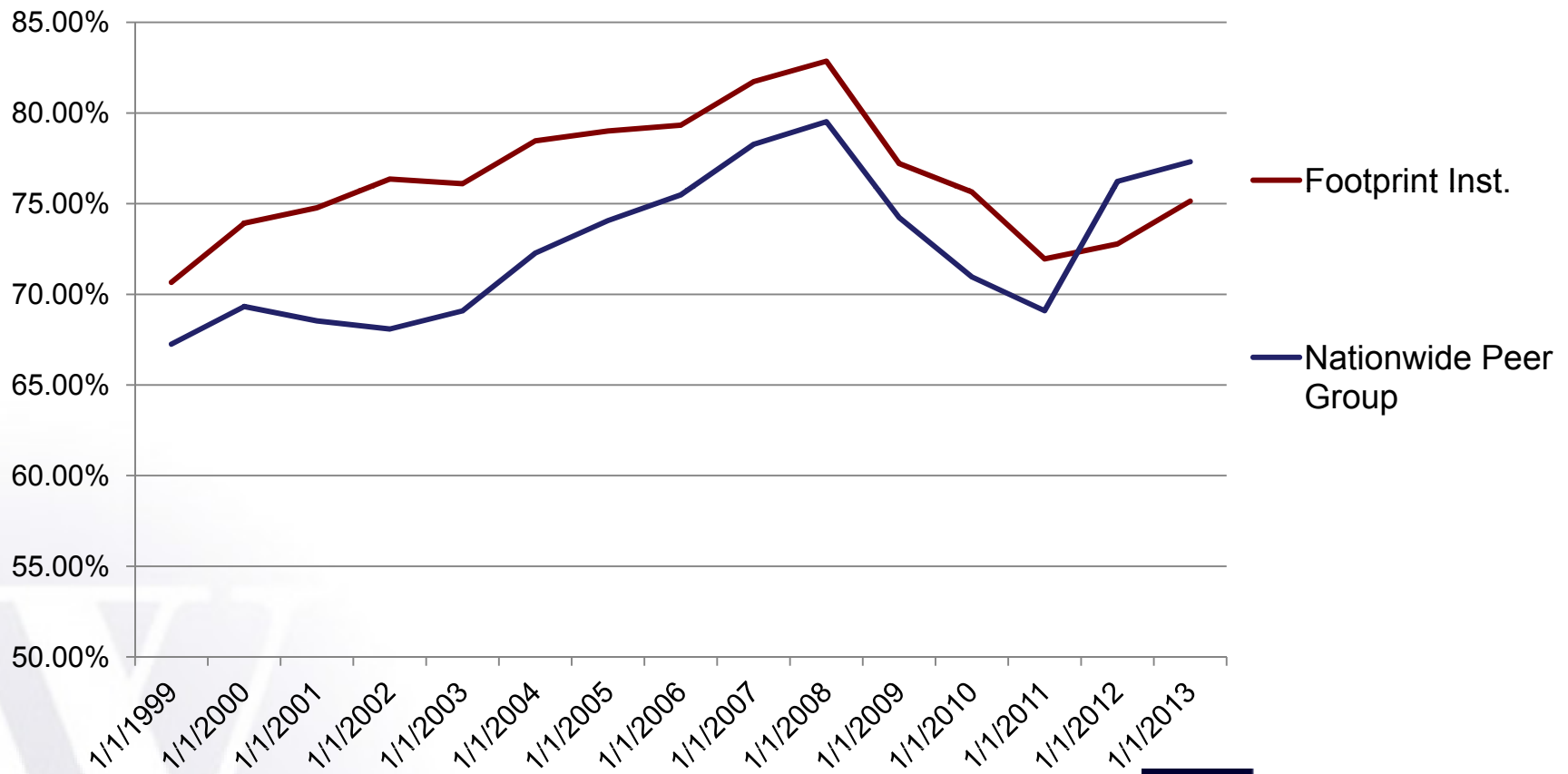
Bank Loan and Deposit Analysis

Loan Growth Rates



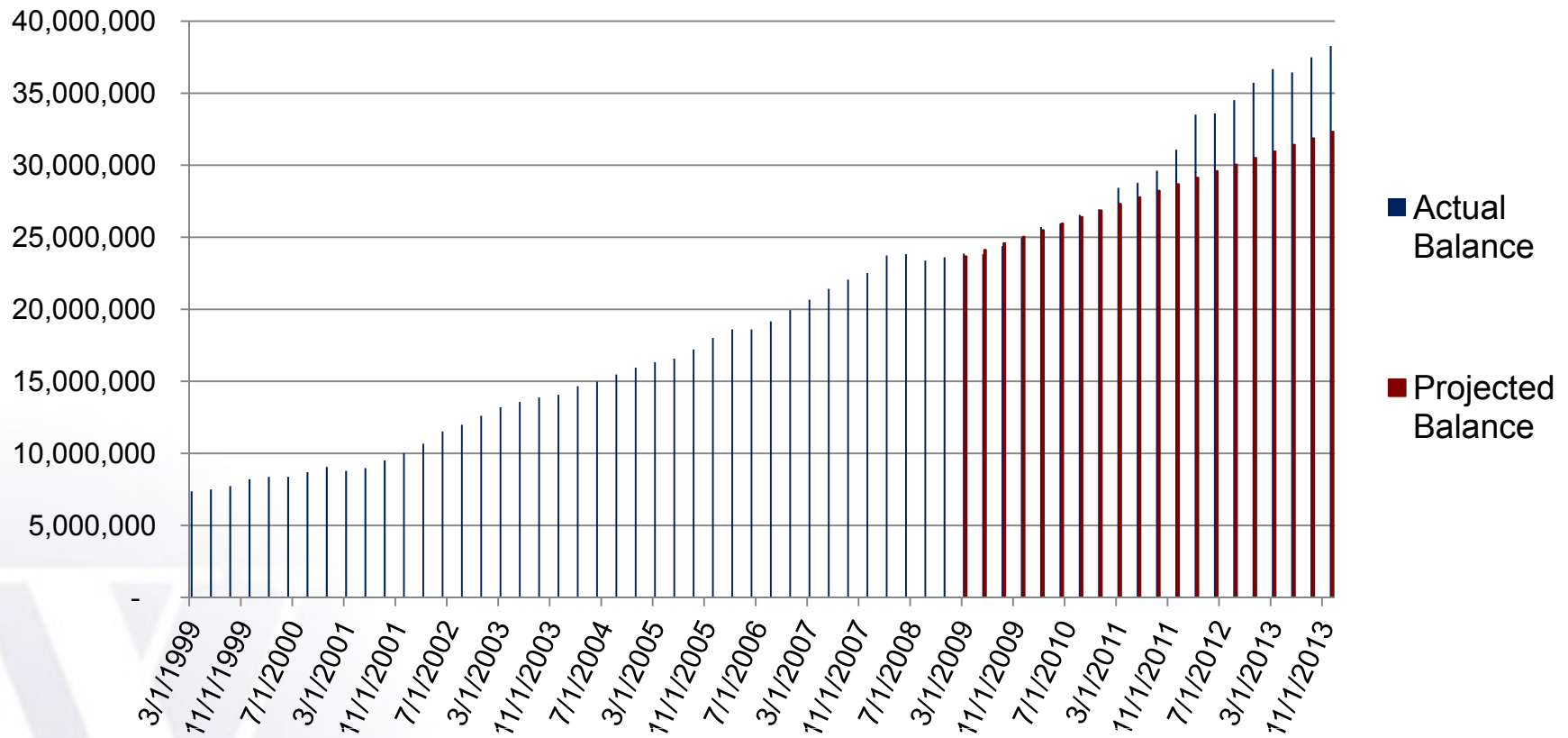
Bank Loan and Deposit Analysis

Loans to Deposits



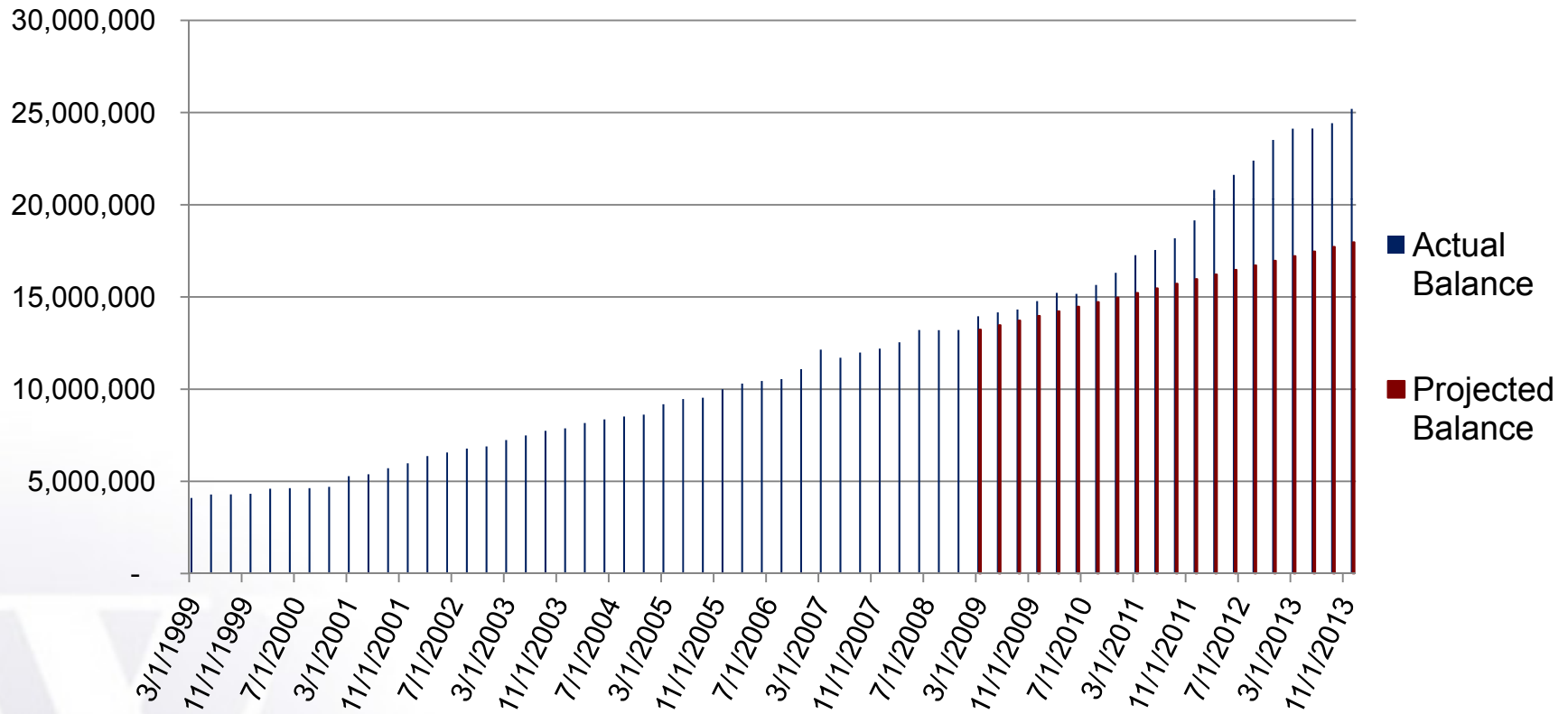
Bank Loan and Deposit Analysis

MMDA Surge Analysis



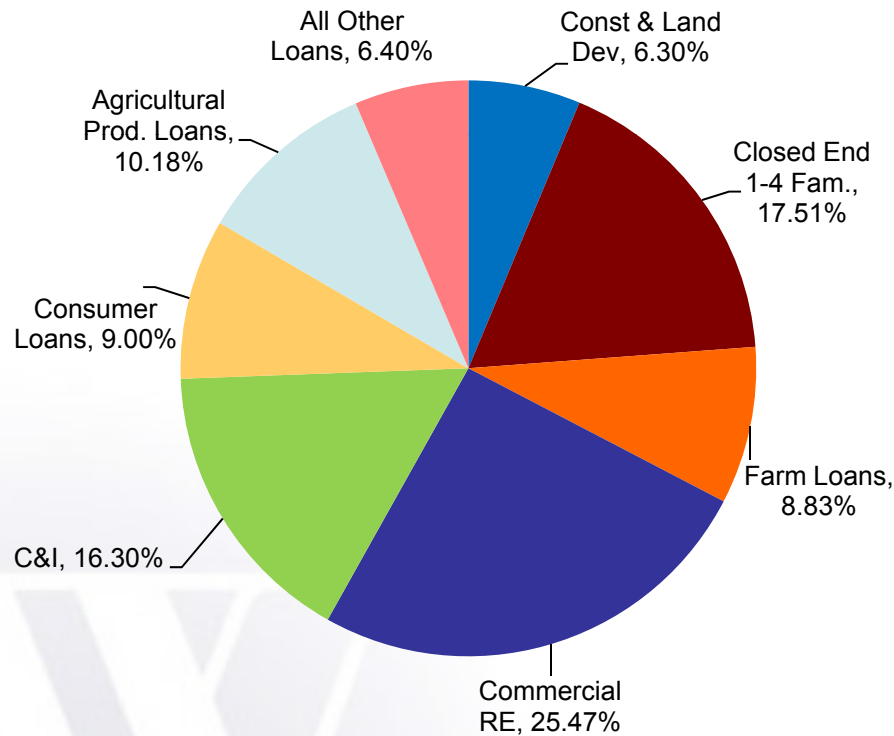
Bank Loan and Deposit Analysis

Savings Surge Analysis

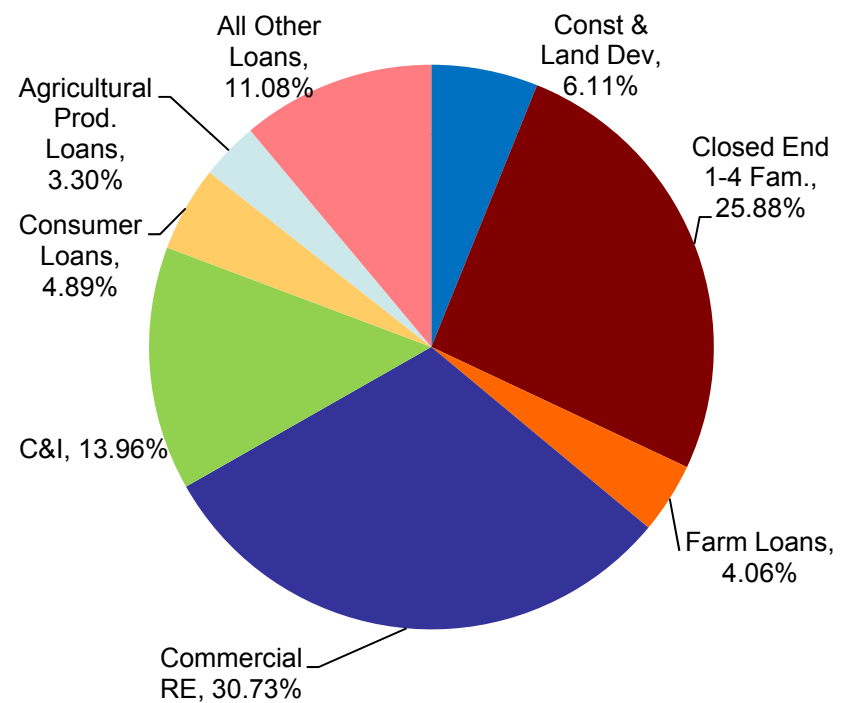


Bank Loan and Deposit Analysis

Loan Portfolio Composition: Footprint Institutions



Loan Portfolio Composition: Nationwide Per Group



Return on Regulatory Equity

20% Risk Weight

Fannie Mae TBA	
3.5% Coupon, delivery in March	
Pricing as of March 4, 2014	101.016
Yield as of February 28, 2014	3.34%
Par Coupon	3.50%
Implied Duration	6.35

50% Risk Weight

30 Year Mortgage	
FNMA yield	3.34%
Service Fee	0.25%
Guarantee Fee	0.50%
Total Yield	<u>4.09%</u>

100% Risk Weight

C & I as of November 4-8	
more than 365 days	4.56%

Return on Regulatory Equity

Targeted Return on Equity: 12.46%

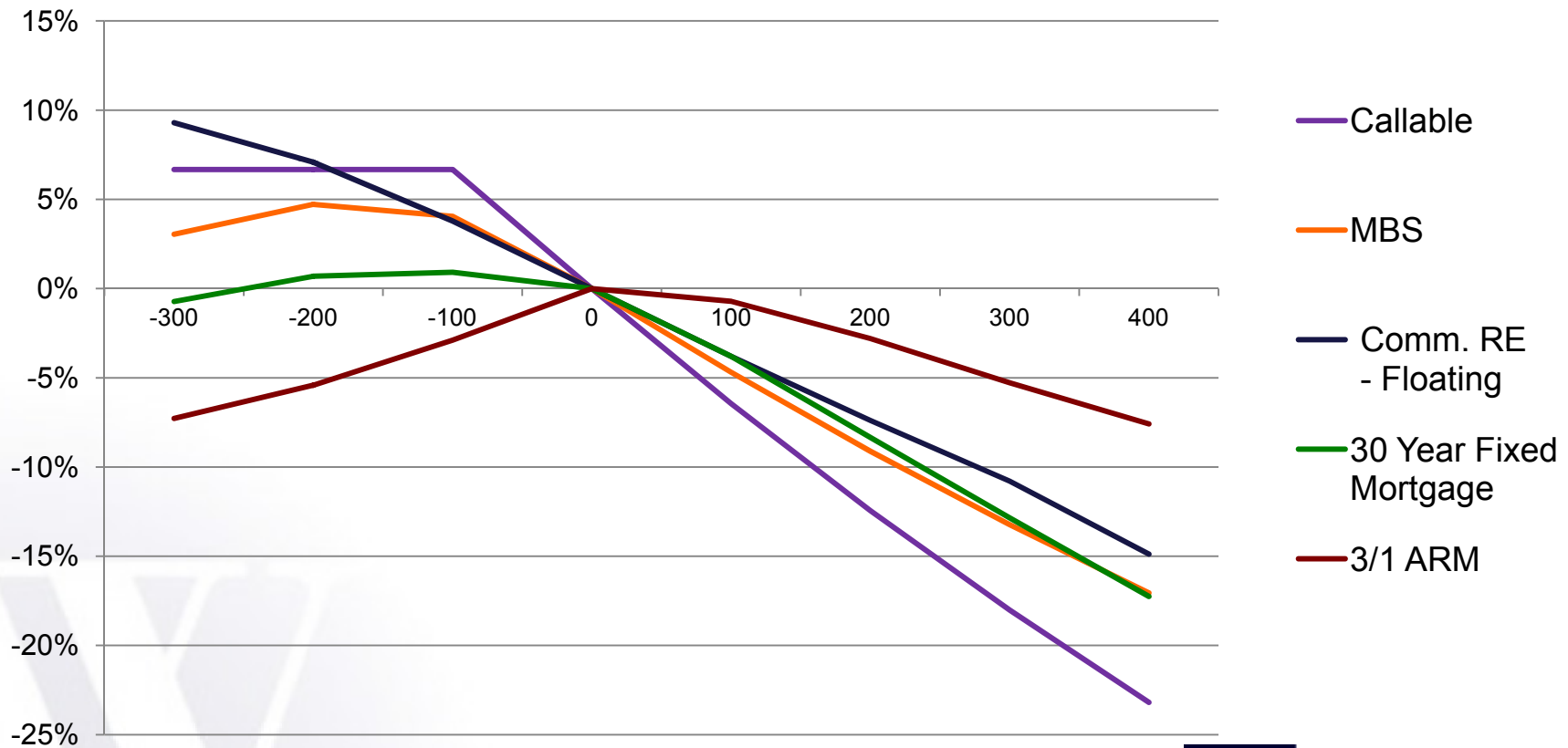
	98.40%	3.19%	3.14%
	1.60%	12.56%	0.20%
Agency MBS			3.34%

	96.00%	3.74%	3.59%
	4.00%	12.56%	0.50%
30 Yr Mtg			4.09%

	92.00%	3.86%	3.56%
	8.00%	12.56%	1.00%
C&I			4.56%

Price Volatility

Change in Price Given Change in Interest Rate



Wilary Winn LLC

Services and Contact Information

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