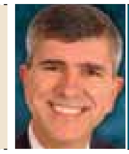

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Tracking Mortgage Banking Data

Call reports can offer a snapshot of where the industry is — and where it's headed

It's often the case that those who are most successful in the real estate finance industry are those who have gained a better understanding of the industry's drivers of success. These go well beyond just the product and the person who originates it. Mortgage businesses' success is influenced heavily by an understanding of numerous factors, including:

- **Mortgage:** product, coupon, age, balance, status, etc.
- **Mortgagor:** income, marital status, dependents, current debt-to-income ratio, lien, etc.
- **Property:** original value, current value, loan-to-value ratio, rental potential, property type, etc.
- **Demographics:** population growth, immigration, internal migration, etc.
- **Macro and micro economy:** inflation, unemployment, permits issued, yield curves, etc.
- **Investors:** government-sponsored enterprises, private investors, traders, banks, etc.
- **Competition:** mortgage lenders, servicers, banks, brokers, etc.

Although the prospect of considering all of these factors at once can feel overwhelming, the good news is that there's a wealth of information available to help assess these drivers. The bad news, however, is that most of this data requires sophisticated software or armies of analysts to decipher. Nonetheless, when it comes to publicly available data sets, what they tell us and their implications, bank call reports can be especially enlightening — and well worth learning more about if you aren't familiar with them already.

Taking a closer look

Banks are required to file detailed financial reports with regulators every quarter. These reports, titled call reports, are available to the public. Each quarter, companies can download these files in their entirety and look for trends, risks and opportunities for their mortgage-industry clients. Because of the economic crisis the U.S. has experienced throughout the last five years, there has been a dramatic change in the composition of the banking industry.

For instance, through December 31, 2007, there were 8,534 financial institutions in the U.S. reporting to the Federal Deposit Insurance Corp. (FDIC). At the end of 2012, that number was down to 7,083. There were 1,577 banks that either closed or were merged with other institutions — comprising 18 percent of our nation's financial institutions — in the same time frame. In previous years, newly chartered banks often balanced these figures. For instance, in 2007, 181 new institutions were chartered and 321 charters were absorbed in mergers,

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CLOSED BANKS

REGION	NUMBER OF CLOSED/ MERGED BANKS	ASSETS (thousands)
Arizona	28	$7,401,491
Atlantic	405	$1,258,507,213
California	84	$145,078,096
Central	672	$504,594,934
Florida	125	$80,669,030
Michigan	36	$100,603,452
Nevada	22	$396,309,366
Ohio and Indiana	59	$186,055,055
Territories	6	$34,864,059
West	140	$202,152,030
Total	**1,577**	**$2,916,234,726**

Source: Level1Analytics LLC

BANK ASSETS

	DEC. 31, 2012	DEC. 31, 2007
Cash and federal funds	14%	9%
Securities:		
—Mortgage-backed securities	11%	8%
—Other securities	9%	7%
Loans:		
—Real estate loans	28%	36%
—Other loans	24%	24%
Mortgage-servicing rights	0%	0%
All other assets	13%	15%

Source: Federal Deposit Insurance Corp.

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according to the FDIC. This past year, however, no new charters were issued, marking the first year in FDIC history that no new reporting institutions were added.

As you can see in the first table below, the closed banks were broadly distributed geographically. The largest closings include such familiar names as Wachovia, Washington Mutual Inc., National City Corp. and Countrywide Financial.

Interestingly, however, total bank assets are up. Assets grew from about $13 trillion in 2007 to nearly $14.5 trillion at the end of 2012. Unsurprisingly, there's been an increasing concentration of assets among the larger banks. For instance, the top five banks — ranked by assets — accounted for 38 percent of total assets in 2007; as of the end of 2012, however, that figure increased to 43 percent, according to data from the Federal Reserve. In fact, the top 100 banks control 80 percent of total assets.

Additionally, this increased asset volume may be misleading. The distribution of these assets on the banks' balance sheets shows an increased aversion to risk, as well as an intensifying focus on increasing risk-based capital requirements.

As you can see in the second table, total loans as a percent of total assets has decreased from 60 percent in 2007 to 52 percent at the end of 2012. This represents more than $200 billion less in loans made. Real estate loans are down more than $670 billion, mitigated to an extent by an increase in consumer lending. Less risky assets such as cash, federal funds and securities are up from 24 percent of total assets to 34 percent.

This trend has been matched by a concomitant change in the liability side of the balance sheet. Over the past five years, depositors apparently have been flocking to the safety of deposits insured by the FDIC. Although longer term, fixed-rate time deposits are down materially, checking and savings accounts have soared. Because banks have been somewhat reluctant to lend, this influx of cash has resulted in a substantial reduction in other borrowed funds. Total risk-based capital ratios have increased from a weighted average of 13.4 percent in 2007 to 16.3 percent today.

Overall analysis

Banks today appear to be capitalized adequately and flush with cash. Although other information sources indicate that mortgage lending is booming, it's apparent — and sensible — that banks are not keeping these assets on their books. They are being sold to the agencies, which in turn are selling them as securities (in large part to the Federal Reserve).

Accordingly, this seems to indicate that banks are not willing to invest in mortgage loans at today's artificially low returns. As returns shift to a more normal risk-adjusted level, it may be expected that more bank assets would migrate from cash securities back to loans. Many mortgage professionals certainly would agree that the industry needs to reduce its reliance on the government as the sole buyer of mortgage loans.

Mortgage-servicing rights are even more problematic. Under the proposed Basel III rules, intangible assets — including mortgage-servicing rights — would be limited to 10 percent of Tier 1 capital. Currently, 812 banks are already in excess of this 10 percent threshold, and 309 of them have mortgage- servicing rights on their balance sheets, including several of the largest institutions. If Basel III is implemented, it would be expected that these institutions would stop amassing servicing and allow it to run off — or perhaps execute some bulk sales. Servicing market values are currently below their true worth, which may present an opportunity for other institutions to grow that line of business.

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There's an old saying that goes, "If you don't know where you are going, any road will take you there." This quote illustrates that you must have a goal before you can begin to develop a strategy to achieve it. Likewise, mortgage banks and brokerages must have a clear understanding of where they are today — and where their industry is today — before they embark on any strategic journey. Gaining a more comprehensive understanding of the drivers of success will greatly facilitate this. ●