

Written Statement

by

The Warehouse Lending Project

to the House Financial Services Committee

hearing entitled

Promotion of Bank Liquidity through Deposit Insurance,

Hope for Home Owners and Other Enhancements

Tuesday, February 3, 2009

The Warehouse Lending Project respectfully requests that this statement be included as part of the record for the Committee hearing on the *“Promotion of Bank Liquidity through Deposit Insurance, Hope for Home Owners and Other Enhancements.”* The Warehouse Lending Project (WLP) is a coalition of independent mortgage bankers that are working together to address the vital issue of the availability of short term commercial lines of credit, known as “warehouse lines,” utilized to originate residential mortgages that are sold into the secondary mortgage market.

Despite the massive efforts of financial regulators and Congress to stabilize our financial system, additional steps are needed. We concur with the view that the financial recovery must start with stabilizing the housing market, and the provisions of HR 703 provide important additional support to that effort. However, as the Federal Reserve, Treasury and Congress seek to stimulate home purchases and low-rate refinances, steps must be taken to address a capacity crunch in the warehouse lending market that threatens to restrict mortgage funding capacity for borrowers.

What is Warehouse Lending?

Warehouse lending is a critical link in the housing finance chain. Because Fannie Mae, Freddie Mac and the government housing finance agencies (FHA, VA and Rural Housing Service) do not operate in the primary market, warehouse lending is the mechanism by which non-depository mortgage bankers fund loans that are eventually sold into the secondary market. Mortgage bankers establish revolving credit lines with commercial banks or similar commercial lenders that they draw upon to fund the mortgages they originate to consumers. Once the mortgages are funded and closed they serve as collateral for the advances on the credit line, reducing the risk to the warehouse lender until the mortgage is sold. The proceeds from the sale of the loan are then used to repay the advances on the warehouse line of credit.

Mortgage bankers that utilize warehouse lines are responsible for approximately 41% of all residential mortgages originated in the U.S. Moreover, mortgage bankers originate **nearly 55% of all FHA loans**, which have become the only viable mortgage option for many homebuyers and refinancers.

Why is There a Capacity Problem Now?

Since the beginning of this financial crisis, the availability of warehouse lines has steadily declined. Both bank and non-bank warehouse lenders exited the business as the market shrank and liquidity tightened. In addition, several banks left the business due to its relatively steep capital requirements and a desire to limit their residential mortgage lending exposures. As a result, **since 2005, the number of financial institutions offering warehouse lines of credit to independent mortgage bankers has declined from a peak of around 115 to less than 30 today. The total aggregate capacity of warehouse lines has shrunk to approximately \$25 billion, a decline of approximately 90% from the peak.**

Until recently this decline in warehouse capacity had little or no impact on the availability of residential mortgages, as the economic crisis drove a sharp contraction in mortgage lending volumes. However this situation began to change in mid-2008 as the volume of FHA lending –

the core business for traditional mortgage bankers – increased dramatically, accounting for an estimated 30% of all originations by the fourth quarter of 2008. With FHA volumes running high, mortgage bankers’ usage of their existing warehouse facilities increased significantly. In late 2008, the Federal Reserve took further steps to lower interest rates throughout the economy. Mortgage rates have recently declined to record low levels, driving refinance applications sharply higher¹ and finally having a salutary impact on home purchases.² Proposals to enhance tax credits for home purchases should add further impetus to the housing recovery, hopefully putting a much-needed bottom in the market.

Mortgage bankers are working hard to meet the upsurge in consumer mortgage demand by hiring additional staff and taking other steps to handle the sharp spike in loan applications. Factors such as staffing, systems and facilities for lending activities are all within the control of mortgage bankers and they can and will do what is necessary to meet consumer demand for mortgage credit by addressing those factors. However, a key factor that governs a mortgage banker’s ability to timely originate loans in its pipeline is having an adequate supply warehouse lines of credit, a factor that is largely outside their control.

With loan volumes rising, mortgage bankers have sought to increase their line capacity only to find fewer lenders in the market. Few warehouse lenders are offering lines to new customers. Even well-capitalized mortgage banks with strong track records are reporting difficulties securing new lines. Line increases from current relationships are difficult to secure, and some lenders have had their lines reduced. Warehouse line pricing has also increased, with most mortgage bankers reporting sharply higher spreads, a cost that will ultimately be passed on to consumers. Finally, the long-term commitment of some of the remaining warehouse lenders is in doubt as a result of financial difficulties, capital challenges, and acquisitions by parent institutions that previously exited warehouse lending.

These constraints to warehouse lending availability have arisen at a time when the risks inherent in warehouse lending have declined. The economic/mortgage crisis has caused a significant tightening in underwriting standards. Moreover, the vast majority of loans being originated today by mortgage bankers are eligible for sale or placement with one of the three government instrumentalities/agencies, enhancing the quality of the collateral. Unfortunately, capital and liquidity constraints, as well as aversion to any additional exposure to residential mortgage assets, have made it difficult for warehouse lenders to respond to these market signals.

How Large is the Warehouse Lending Shortfall?

Using the Mortgage Bankers Association’s baseline projection of \$2 trillion in home mortgage originations in 2009, the WLP estimates an \$18 billion gap in warehouse credit line availability that would be needed to support the expected volume of mortgage banker originations (see Exhibit 1). **This funding gap translates into a potential \$370 billion shortfall in home mortgage availability in 2009.** The WLP estimate assumes that bank-affiliated lenders will

¹ MBA Weekly Application Survey, October 1, 2008 through January 29, 2009.

² “Existing Home Sales Show Strong Gain in December,” National Association of Realtors, January 26, 2009.

pick a portion of the market, but the largest banks are already experiencing origination backlogs of their own³, and community banks simply do not have the processing capacity to take up such a large share of the market.

Impact on the Housing Market

On one critical point the WLP would like to be clear – in the face of ongoing federal efforts to maintain low interest rates to stimulate housing, the lack of warehouse credit is an issue that will hurt borrowers more than it will impact lenders in the near term. While lenders will be busy and will benefit from increased loan volumes, higher fees, and wider margins on loan sales, **the desired benefits of lower interest rates will not be fully realized by borrowers unless the warehouse lending shortage is addressed quickly.**

No lender can take loan applications that they cannot reasonably expect to fund. Without adequate warehouse capacity, lenders will be forced to **increase interest rates, raise discount points and charge fees for longer interest rate locks in order to reduce demand and manage their loan application pipelines.** In addition, constrained warehouse lending capacity will cause the mortgage market to experience **extended loan processing times, unintended rate lock expirations** and other related problems for borrowers.

It is widely acknowledged that achieving stability in the U.S. housing market is a precondition to a broader economic recovery. However, neither the Fed's interest rate policy nor the proposed tax incentives for home buyers will have their intended impact without widespread availability of mortgage credit in the primary market, which depends upon adequate supplies of warehouse credit lines. Increasing demand for mortgage credit without ensuring adequate funding capacity in the primary market is like adding several lanes to an already jammed toll road, but keeping a two-lane tollbooth.

What are the Policy Options?

The market needs a significant increase in warehouse capacity now. From discussions the WLP and our lenders have had with several of the remaining warehouse lenders, **it does not appear that the market on its own can generate any significant new capacity at this time.** Moreover, the precarious condition of some of the remaining warehouse providers suggests there are real risks of an even further contraction. Any solution must leverage the operational capacity of the existing warehouse lenders, while using federal guarantees or a federal borrowing facility to increase capacity until the private market recovers.

We ask the Committee on Financial Services to do two things:

1. Include provisions in H.R. 703 giving authority to the Federal Reserve and the Department of the Treasury, working together, to establish facilities that will provide additional liquidity to warehouse lenders for the express purpose of ensuring adequate

³ "Lenders Backlogged by Refinance Rush," Dina ElBoghdady, Washington Post, January 9, 2009.

availability of funding for FHA, VA and GSE-eligible loans. Such a facility could be structured to boost capacity for warehouse credit lines by lending against, or through purchases of participation interests in, existing and new warehouse credit lines. Alternatively, Congress could authorize the creation of a structured financing vehicle with funding notes guaranteed by the U.S. Treasury or another government agency with the ability to offer a guarantee backed by the full faith and credit of the U.S. Government. A federal guarantee program would limit federal outlays, lower regulatory capital charges on warehouse facilities, and make it easier to attract participation interests from other banks or private investors.

2. Authorize the Federal Housing Finance Authority (FHFA) to temporarily permit Fannie Mae and Freddie Mac to purchase participations or syndicated interests in warehouse lines of credit in order to expand the supply of funds to warehouse lending. Both Fannie and Freddie are highly experienced mortgage investors who could make significant amounts of additional funds available to warehouse lending through their purchase of participation interests. Such purchases would very much be in line with Fannie and Freddie's public policy mandate of providing additional liquidity to the mortgage market.

Mortgage bankers typically originate loans for sale and then sell those loans to investors over a 15-18 day time period, thus allowing a turn over in the average warehouse lines of some 20 times a year. As a result of this significant multiplier effect, \$18 billion in federal guarantees, loans or participation purchases would make possible an additional \$370 billion in home mortgage loans. Therefore, WLP estimates that the potential \$370 billion shortfall could be met with an additional \$18 billion in warehouse lending capacity. This additional liquidity will head off potentially severe primary market bottlenecks and help ensure that borrowers, the housing market and the broader economy capture the full benefits of lower interest rates and other home purchase incentives.

The WLP has begun the more detailed work of developing the financial structures that could be used to implement these suggestions. We stand ready to work with committee staff on the details of both the federal purchase or guarantee program and the temporary GSE participation interests. Thank you for the opportunity to be heard on this important issue.

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EXHIBIT 1

Estimated Warehouse Lending Gap

1. Estimated 2009 Home Mortgage Originations	\$2.0 trillion
2. Mortgage Banker Market Share	41%
3. Total mortgage banker originations (line 1* line 2)	\$820 billion
4. Estimated <u>current</u> WH lines from major lenders	\$25 billion
5. Average sustainable long-term line usage @ 70% (.7 * line 4)	\$18 billion
6. Estimated maximum funding capacity from <u>existing</u> warehouse lines (line 5 * 20)	\$360 billion
7. Estimated funding gap due to reduced warehouse line capacity (line 3 - line 6)	\$460 billion
8. Adjusted funding gap (.8* line 6)†	\$368 billion
9. Estimated shortfall in warehouse lending capacity (line 7/20)†	\$18 billion

† This is a baseline estimate of the additional warehouse line capacity (line 9) that would be needed to accommodate projected funding gap in 2009 (line 8). Higher loan origination volume in 2009 and/or increased mortgage banker market share as a result of increased use of FHA loans would produce a larger gap/need.

Sources/Derivation of Estimates:

1. Most recent published estimate: MBA forecasts \$2.0T in home mortgage originations for 2009 (rev. 12-11-08).
2. Based on 2007 HMDA data LARs submitted by non-federally supervised lenders. This estimate excludes from the mortgage banker market share ALL RETAIL originations reported on the Countrywide Home Loans (non-bank) LAR.
4. Unofficial estimate from Reynolds Consulting.
5. This is an estimate of the average sustainable line usage over a full year. Lenders cannot maintain a line in 100% drawdown. Line usage must accommodate peaks and troughs through monthly and seasonal funding cycles. Based on historical experience, a 70% average would represent heavy usage over a one-year period.
6. Assumes typical loan stays in warehouse facility for 18 days, and lines can be turned over 20 times in one year.
8. Assumes banks and thrifts will be able to absorb 20% of mortgage banker volume in 2009.