

Federal Regulatory Changes Needed to Help Keep Mortgage Capital Flowing through Warehouse Lines of Credit

MBA RECOMMENDS

MBA requests the Board of Governors of the Federal Reserve System (Fed), Federal Deposit Insurance Corporation (FDIC), the Office of Comptroller of the Currency (OCC) and Office of Thrift Supervision (OTS) (collectively, “bank regulators”) study the current risk weightings for warehouse lines of credit for real estate financing and make appropriate changes to better reflect the risk associated with warehouse lines backed by Fannie Mae, Freddie Mac or Ginnie Mae eligible loans in the risk-based capital (RBC) rules.

WHAT IS WAREHOUSE LENDING?

Warehouse lending is a short-term revolving line of credit provided to a mortgage banking company to fund the closing of mortgages from the closing table to sale in the secondary market. The mortgage note is used as collateral for interim financing until the mortgage is sold and delivered to the permanent investor. Mortgage bankers draw upon the line of credit to fund a mortgage at closing or to purchase a closed loan from another originator. The line of credit is paid off when the loan is sold to the end investor. Warehouse lending contributes to the capacity the industry provides for originating loans for first-time homebuyers; refinancing troubled borrowers into new mortgages; assisting other borrowers in securing credit for residential mortgage transactions; and originating loans for the purchase, refinance or repositioning of rental properties.

Warehouse lenders serve as crucial short term lenders for mortgage bankers. For the originator that depends solely on warehouse lines of credit, a reduction in the availability of credit could extinguish its lending business and adversely impact the borrowers in its market, stifling the real estate recovery before it gets off the ground.

By way of background, warehouse lenders define three stages of the warehouse process:

1. Wet Funded Stage: Mortgage warehouse lenders frequently send money to the closing table on the day of

loan closing. The closing agent, simultaneous with the closing, assigns the mortgage to the warehouse lender. This is generally governed by closing instructions from the warehouse lender to the closing agent. The mortgage banker provides the warehouse lender with a Uniform Commercial Code (UCC) form that serves as collateral until the underlying collateral documentation is received from the closing table. Such documentation includes the mortgage note. According to the UCC, the UCC document is valid collateral for up to 20 days.

- 2. Dry Funded Stage:** This stage represents the period that the warehouse lender has the mortgage note and other collateral documents in its collateral vault.
- 3. Gestation Repo Stage:** Prior to delivery of a Ginnie Mae, Fannie Mae or Freddie Mac security (government MBS) to the secondary market, the mortgage banker will obtain an initial pool certification. Often, the certifying agent is the warehouse lender itself. Upon initial pool certification, the pool is said to be “in gestation” awaiting delivery to the takeout investor upon security issuance. Fifteen years ago, Wall Street firms would take delivery at this point and provide gestation repo funding from initial pool certification date to trade settlement. During the last ten years, commercial banks have added a gestation repo tranche to the typical warehouse line agreement in order not to lose this segment of the warehouse business.

LONG-TERM SOLUTION

MBA believes that the following Risk Based Capital (RBC) rules should be promulgated to more properly risk-weight these assets:

1. **Wet Funded Stage:** The current RBC weighting of 100 percent should be maintained until all collateral documents are received from the closing table.
2. **Dry Funded Stage:** Dry funded loans provide as collateral to the warehouse bank the mortgage note endorsed in blank. This allows the warehouse lender to step into the shoes of the mortgage lender and own these loans if the mortgage lender defaults. The warehouse lender also has a perfected interest in all forward sale agreements. So, not only does the warehouse lender have the ability to own the loan, it can deliver that loan into the secondary market within weeks at a pre-determined price. Thus, the warehouse lender has collateral that is perfected, has little credit risk (since newly originated), and has little market risk (since pre-sold into the secondary market). Present RBC rules for mortgage loans held by a bank require from 50 percent to 100 percent RBC weighting, depending on the mortgage's loan-to-value (LTV) ratio. For FHA and VA loans, the RBC weighting is 20 percent. Proposed Basel II "standardized approach" provides for RBC weightings from 20 percent to 150 percent depending on the LTV and whether the loan is current. MBA proposes that RBC weighting of 50 percent be accorded that portion of a warehouse line that is dry funded and is collateralized by loans conforming to Fannie Mae or Freddie Mac requirements, FHA loans, VA loans, Rural Housing Service loans and home equity conversion mortgages (HECM's).
3. **Gestation Repo Stage:** Upon initial pool certification, a new government MBS will be issued in a matter of days. Since the warehouse lender has a blanket lien on all forward sale commitments, these MBS are pre-sold. Present RBC rules call for zero percent capital on Ginnie Mae MBS and 10 percent on Fannie Mae and Freddie Mac MBS. MBA recommends a RBC weighting of not more than 20 percent for that portion of a warehouse line that is backed by gestation collateral.



1331 L Street, NW
Washington, DC 20005
www.mortgagebankers.org