FHN FINANCIAL
CAPITAL ASSETS CORP.

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WEEKLY COMMENTS

Start the New Year off Right

As we make the turn into 2021, we are all still facing significant uncertainty and headwinds related to the state of the mortgage-lending industry. No doubt the low interest rates over the last year have, and will continue to, spur on record refinancing rates as we see continued rate restraints from the Fed as well as an aggressively priced secondary market. Add to that the fact that many small to medium-sized institutions have seen tremendous stress to their portfolios as new production has been eclipsed by run-off from the current refinance boom. This week's comments will discuss some options that may be on the table related to these various scenarios.

After the economic shocks to the economy following the onset of the pandemic and the related recession with many segments of the economy shut down, the mortgage-lending industry faced dramatic drops in the 10-year Treasury. There was a decline of over 120 bps from the beginning of 2020, with only a slight recovery in the fourth quarter. This led to another refinance wave that resulted (as covered in recent comments) in significant run-off in many/most mortgage portfolios. Even though many lenders faced record production and staffing constraints, the challenge has been growing the portfolio while seeing existing loans get paid off and replaced with lower rate loans.

Lower-Yielding Portfolios with Increased Interest Rate Risk

This trend has caused more overall portfolio stress since now lenders face lower yields and longer duration on average by boarding significant long/low segments that can impact future earnings and increase interest rate risk. In a cruel twist, one of the few options to curb shrinking portfolios was to race to the bottom and compete with other lenders to keep their loans from refinancing with a new lenders.

This has no doubt caused lenders to start worrying about the long-term effects of boarding longer-term, lower-coupon fixed-rate loans in their portfolios. So what to do?

Options for Managing Excessive Long-Lows

One option that may be considered is for loans that fit a particular mold (fixed, low-rate, plain vanilla, and fully underwritten and documented) is selling some of this product after origination to one of the agencies. This hasn't been considered often due to the fact that certain institutions may not be current Fannie/Freddie approved lenders or servicers. And because the process of getting that approval can be time-consuming and frankly, onerous, most lenders simply avoid that process or consider using a less cost-effective correspondent channel.

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Direct selling of new production can actually be an efficient way to shed some of the longer-term, lower-rate loans and monetize that production now without adding too much of that product to the portfolio. FHN Financial Capital Assets Corp. (Capital Assets) can be the solution to the lack of approved status issue since we can facilitate these trades utilizing our existing seller status with each agency.

On the servicing front, these trades would have to be done servicing released, but Capital Assets can also work with each agency to facilitate that transfer as well. That way, the staffing impact on these loan sales would be minimal once this is established and allow for a steady ongoing sale of this specific product based on the internal needs of each institution.

Monetizing a Gain While Shedding the Risk

The end game here is therefore to monetize this loan production into a very lucrative secondary market while removing the longer-term issue of boarding excessive long/low fixed-rate production while maintaining the option to manage these sales based on current production. At the same time, there are no immediate requirements to get agency approvals but, should that be a longer-term initiative, the experience of selling now with Capital Assets' assistance can only help establish a model for doing so in the future.

If you have interest, please reach out, and we can discuss how best to get the process set up and operational. You can contact your FHN Financial rep or Capital Assets directly at 800.456.5460. With Capital Assets' involvement, the lead-time would be minimal and allow a lender to move quickly into this solution, especially as you start to implement your 2021 business plans.