FHN FINANCIAL
CAPITAL ASSETS CORP.

NOVEMBER 6, 2019

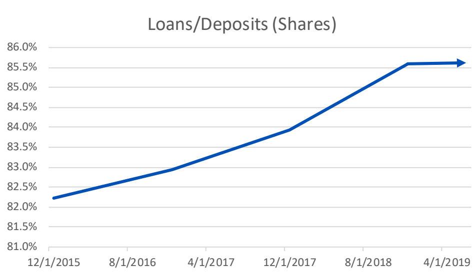
WEEKLY COMMENTS

Maintaining Liquidity Flexibility at Year End with the Loan Portfolio

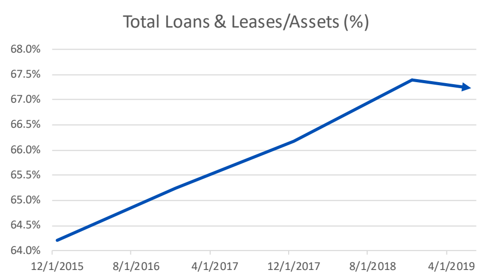
With year end approaching and liquidity constraints tightening for many institutions, it is important to know and document the marketability of your largest earning asset: the loan portfolio. The majority of portfolios that we analyze are investment-grade and can provide some much-needed price-efficient liquidity when a need arises if you know its utility ahead of time and are poised to react.

As we approach the end of the year and look towards 2020, there has been more and more concern about potential liquidity crunches at year end. Dramatic swings in the short-term funding space have brought to light concerns that the liquidity institutions have on their balance sheets must only be used for downturn conditions, per regulatory requirements, and not available to use as funding for daily operations.

The graphs below show the trend in Loan-to-Deposit (Shares) ratios for all US depositories over the last four years. As you can see, loan portfolios have steadily grown over the last couple of years, with institutions having, on average, a 22% larger loan portfolio than they had in 2015.



Source: S&P Global Market Intelligence



Source: S&P Global Market Intelligence

As Tom McLemore mentioned in his *Weekly Comments* last week, liquidity-driven bond trades are quite common these days. However, many institutions overlook the potential liquidity contained in the loan portfolio because its true liquidity profile can be difficult to measure compared to other investments. Most institutions we work with are surprised to learn about the liquidity embedded in their loans and how marketable the loans really are. Just like the bonds held in your investment portfolio, most loans are also very liquid, and many institutions utilize the retained mortgage loan portfolio to address balance sheet issues such as interest rate risk, liquidity shortfalls, and augmenting or preserving capital levels.

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Understanding the risk and liquidity profile of an institution's comprehensive and complex loan portfolio is a specialty of FHN Financial Capital Assets Corp. ("Capital Assets"). Our proprietary analytics, including tools like the Portfolio Performance Analysis ("PPA"), cover many key risk and performance metrics for mortgage, auto, commercial, and HELOC loans.

While it is important to evaluate the loan portfolio's risk profile, it is equally important to understand its liquidity profile. In other words, how much supplemental liquidity resides within my retained loan portfolio? Unfortunately, this exercise can be problematic for many institutions due to a variety of factors such as data integrity within their servicing systems, as well as an understanding of how well the loans were underwritten and documented at origination.

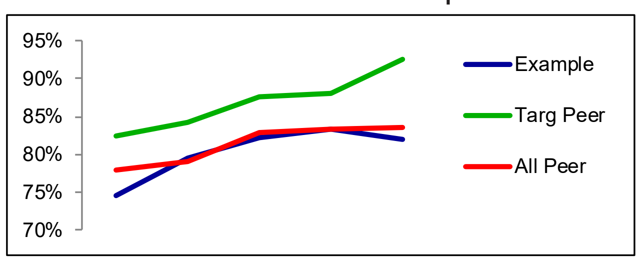
Analytics

The vast majority of the loans that financial institutions have originated over the years to hold in portfolio are investment grade, both in the quality of underwriting and documentation. At Capital Assets, we only consider loans to be investment grade if they are eligible to be securitized with one of the Agencies or if they can be traded price-efficiently with another financial institution.

There is a PPA available for almost all loan types, and within each PPA we've incorporated a Liquidity Waterfall Analysis report that is unique to each type. The Liquidity Waterfall Filter Analysis page reflected below can be found in the Mortgage PPA Executive Summary and it compares the three degrees of liquidity typically found in a mortgage portfolio. By evaluating the level of Agency and Private-grade loans, we can determine how liquid the portfolio is compared to peers and whether or not this sector of the portfolio is growing. Many institutions we work with include this information in their Liquidity Contingency Funding Plans as evidence that they have documented an additional source of price-efficient liquidity.

Column :	1	2	3	4
Line Item	Description	No. Of Loans	Principal Balance	% Of Total
1	C : Portfolio Grade			
2	Currently Delinquent 30 or More Days	84	9,361,286	2%
3	Hist. DQ 30 or More Days Last 12 Mos	180	14,903,321	3%
4	Borrow er Credit Score Under 660	100	9,575,511	2%
5	Co-Borrow er Credit Score Under 660	20	1,570,087	0%
6	DTI Ratio > 50 %	88	7,988,368	2%
7	DTI Ratio > 45 % Seasoned < 36 Mos	86	6,840,468	1%
8	Original Balance Under $15,000	122	17,462,299	3%
9	Current Balance Under $15,000	298	19,240,846	4%
10	Updated LTV > 80 % & O\O W\O PMI	36	3,311,725	1%
11	Amortized LTV > 95 % & O\O W\ PMI	14	832,572	0%
12	**Subtotal Portfolio Grade (C)**	**1,028**	**91,086,484**	**18%**
13	B : Private Grade			
14	Original Balance > Agency Maximum	68	8,923,332	2%
15	Updated LTV > 75 % & Second or NOO	88	9,968,069	2%
16	Updated LTV > 75 % & Cash Out Refi	162	16,806,375	3%
17	Amortized LTV > 75 % & Second or NOO	174	15,888,202	3%
18	Amortized LTV > 75 % & Cash Out Refi	76	5,518,110	1%
19	Interest Only Payments	14	736,126	0%
20	Adjustable Rate & Margin > 3.5 %	50	3,371,071	1%
21	Non-Agency Investor Eligible	38	3,758,046	1%
22	**Subtotal Private Grade (B)**	**670**	**64,969,331**	**13%**
23	A : Agency Grade			
24	No Data Exceptions Coded	3,774	352,350,005	69%
25	**Subtotal Agency Grade (A)**	**3,774**	**352,350,005**	**69%**
26	**Grand Total**	**5,472**	**508,405,820**	**100%**

Investment Grade Comparison



Investment Grade as a Percent of Total

	2014 Q1	2015 Q3	2016 Q4	2017 Q4	2019 Q3
Example	74.7%	79.6%	82.2%	83.3%	82.1%
Medium Sized Midw est Region	82.5%	84.3%	87.7%	88.0%	92.5%
All Portfolios	77.9%	79.1%	82.9%	83.3%	83.5%

Source: FHN Financial Capital Assets Corp.

Liquidity Verification

If needed, we can go a step further and give you a periodic liquidity validation analysis that involves reviewing risk-weighted samples of loan types and vintages. This due diligence allows us to determine the level of documentation for each loan, validates data integrity, and reconciles the servicing data to the actual loan file. This process provides indisputable evidence of the liquidity embedded in your loan portfolio. We can simultaneously explore the inclusion of potential loans for a "Prep and Hold" strategy during the process. During this process, we will work closely with your team to prepare detailed reports related to liquidity and any issues we may have encountered during our review. We can then hit the pause button on the process until the market provides an opportunity and then we can lock price on a pre-determined strategy, removing market risk. This gives you the ability to take advantage of the market and maximizes the price-efficient liquidity of your loans. Once we complete due diligence and lock price, the process moves on to the funding phase like a typical loan sale.

Conclusion

In the course of analyzing thousands of loan databases over the last three decades, we've found that upwards of 75% of loan portfolios are eligible for some kind of secondary market transaction to address a need, and/or fully support any liquidity challenges that a regulator may pose as well. The PPA can give institutions that want to be prepared for any potential liquidity need the ability to use the loan portfolio as an alternative source of price-efficient liquidity. A "Prep and Hold" strategy is also a good option to have in place should you have more specific liquidity needs, as it provides more flexibility with timing to achieve the most optimal pricing. To learn more about the PPA and loan strategies, contact your FHN Financial rep or Capital Assets directly at 800.456.5460.