FLAGSTAR BANCORP INC
Form 10-Q
August 06, 2018
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _________ to _________

Commission File Number: 001-16577

(Exact name of registrant as specified in its charter).

Michigan	38-3150651
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)
5151 Corporate Drive, Troy, Michigan	48098-2639
(Address of principal executive offices)	(Zip code)

(248) 312-2000
(Registrant’s telephone number, including area code)

Not applicable
(Former name, former address and formal fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ý No ¨.
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer¨	Accelerated filer ý
Non-accelerated filer o (Do not check if smaller reporting company)	Smaller reporting company ¨
	Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act ¨.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý.

As of August 2, 2018, 57,599,907 shares of the registrant’s common stock, $0.01 par value, were issued and outstanding.

Table of Contents

FLAGSTAR BANCORP, INC.
FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2018
TABLE OF CONTENTS

2

Table of Contents

GLOSSARY OF ABBREVIATIONS AND ACRONYMS

The following list of abbreviations and acronyms are provided as a tool for the reader and may be used throughout this Report, including the Consolidated Financial Statements and Notes:

Term	Definition	Term	Definition
AFS	Available for Sale	HELOC	Home Equity Lines of Credit
Agencies	Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and Government National Mortgage Association, Collectively	HELOAN	Home Equity Loan
ALCO	Asset Liability Committee	HOLA	Home Owners Loan Act
ALLL	Allowance for Loan & Lease Losses	Home equity	Second Mortgages, HELOANs, HELOCs
AOCI	Accumulated Other Comprehensive Income (Loss)	HTM	Held to Maturity
ASU	Accounting Standards Update	LIBOR	London Interbank Offered Rate
Basel III	Basel Committee on Banking Supervision Third Basel Accord	LHFI	Loans Held-for-Investment
C&I	Commercial and Industrial	LHFS	Loans Held-for-Sale
CDARS	Certificates of Deposit Account Registry Service	LTV	Loan-to-Value Ratio
CET1	Common Equity Tier 1	Management	Flagstar Bancorp’s Management
CFPB	Consumer Financial Protection Bureau	MBIA	MBIA Insurance Corporation
CLTV	Combined Loan to Value Ratio	MBS	Mortgage-Backed Securities
Common Stock	Common Shares	MD&A	Management's Discussion and Analysis
CRE	Commercial Real Estate	MSR	Mortgage Servicing Rights
DCB	Desert Community Bank	N/A	Not Applicable
DFAST	Dodd-Frank Stress Test	NYSE	New York Stock Exchange
DOJ	United States Department of Justice	OCC	Office of the Comptroller of the Currency
DTA	Deferred Tax Asset	OTTI	Other-Than-Temporary-Impairment
EVE	Economic Value of Equity	QTL	Qualified Thrift Lending
Fannie Mae	Federal National Mortgage Association	REO	Real estate and other nonperforming assets, net
FASB	Financial Accounting Standards Board	RWA	Risk Weighted Assets
FDIC	Federal Deposit Insurance Corporation	SEC	Securities and Exchange Commission
FHA	Federal Housing Administration	SFR	Single Family Residence
FHLB	Federal Home Loan Bank	TARP Preferred	Troubled Asset Relief Program Fixed Rate Cumulative Perpetual Preferred Stock, Series C
FICO	Fair Isaac Corporation	TDR	Trouble Debt Restructuring
FRB	Federal Reserve Bank	UPB	Unpaid Principal Balance
Freddie Mac	Federal Home Loan Mortgage Corporation	U.S. Treasury	United States Department of Treasury
FTE	Full Time Equivalent Employees	VIE	Variable Interest Entities
GAAP	United States Generally Accepted Accounting Principles	XBRL	eXtensible Business Reporting Language

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following is Management's Discussion and Analysis of the financial condition and results of operations of Flagstar Bancorp, Inc. for the second quarter of 2018, which should be read in conjunction with the financial statements and related notes set forth in Part I, Item 1 of this Form 10-Q and Part II, Item 8 of Exhibit 99.1 to our June 1, 2018 Form 8-K Report.

Certain statements in this Form 10-Q, including but not limited to statements included within the Management’s Discussion and Analysis of Financial Condition and Results of Operations, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. These statements are based on the current beliefs and expectations of our management. Actual results may differ from those set forth in forward-looking statements. See Forward-Looking Statements on page 35 of this Form 10-Q and Part I, Item 1A, Risk Factors of Flagstar Bancorp, Inc.'s 2017 Annual Report on Form 10-K for the year ended December 31, 2017. Additional information about Flagstar can be found on our website at www.flagstar.com.

Where we say "we," "us," "our," the "Company," "Bancorp" or "Flagstar," we usually mean Flagstar Bancorp, Inc. However, in some cases, a reference will include our wholly-owned subsidiary Flagstar Bank, FSB (the "Bank"). See the Glossary of Abbreviations and Acronyms on page 3 for definitions used throughout this Form 10-Q.

Introduction

We are a savings and loan holding company founded in 1993. Our business is primarily conducted through our principal subsidiary, the Bank, a federally chartered stock savings bank founded in 1987. We provide commercial and consumer banking services and we are the 5th largest bank mortgage originator in the nation. At June 30, 2018, we had 3,682 full-time equivalent employees. Our common stock is listed on the NYSE under the symbol "FBC." At June 30, 2018, we were no longer considered a "controlled company" for NYSE purposes, as on June 14, 2018, our former majority shareholder, MP Thrift Investments L.P., completed a secondary offering of eight million shares of common stock, reducing their common stock ownership from approximately 62 percent to 48 percent.

We have a relationship-based business model which leverages our full-service bank’s capabilities with our national mortgage platform to create and build financial relationships with our customers. At June 30, 2018, we operated 107 full service banking branches that offer a full set of banking products to consumer, commercial, and government customers. Our banking footprint spans throughout Michigan and contiguous states as well as the high desert region of California.

We originate mortgages through a wholesale network of brokers and correspondents in all 50 states, and our own loan officers from 88 retail locations in 31 states and two call centers, which includes our direct-to-consumer lending team. Flagstar is also a leading national servicer of mortgage loans and provides complementary ancillary offerings including, MSR lending, servicing advance lending and recapture services. Servicing and subservicing of loans provides fee income and generates a stable long-term source of funding through custodial deposits.

In the second quarter 2018, we signed a definitive agreement to acquire 52 Wells Fargo branches in Indiana, Michigan, Wisconsin and Ohio. We expect to close this transaction late in the fourth quarter of 2018.

Operating Segments

Our operations are conducted through our three operating segments: Community Banking, Mortgage Originations, and Mortgage Servicing. For additional information, please see MD&A - Operating Segments and Note 18 - Segment

Information.

4

Table of Contents

Selected Financial Ratios
(Dollars in millions, except share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(In millions, except per share data and percentages)			
Selected Mortgage Statistics:				
Mortgage rate lock commitments (fallout-adjusted) (1)	$9,011	$9,002	$16,734	$14,998
Mortgage loans sold and securitized	9,260	8,989	16,506	13,473
Selected Ratios:				
Interest rate spread (2)	2.58 %	2.59 %	2.56 %	2.55 %
Net interest margin	2.86 %	2.77 %	2.81 %	2.72 %
Return on average assets	1.12 %	1.04 %	0.97 %	0.91 %
Return on average equity	13.45 %	11.57 %	11.73 %	9.77 %
Equity-to-assets ratio (average for the period)	8.29 %	9.02 %	8.28 %	9.29 %
Efficiency ratio	74.4 %	72.0 %	76.9 %	74.2 %
Effective tax provision rate	20.4 %	31.8 %	20.2 %	32.3 %
Average Balances:				
Average interest-earning assets	$15,993	$14,020	$15,675	$13,187
Average interest-paying liabilities	13,164	11,804	13,069	11,066
Average stockholders' equity	1,475	1,418	1,445	1,382

	June 30, 2018	December 31, 2017	June 30, 2017
	(In millions, except per share data and percentages)		
Selected Statistics:			
Book value per common share	$25.61	$ 24.40	$ 24.64
Tangible book value per share (3)	$24.37	$ 24.04	$ 24.29
Number of common shares outstanding	57,598,406	57,321,228	57,161,431
Common equity-to-assets ratio	8.14 %	8.27 %	8.82 %
Capitalized value of mortgage servicing rights	1.34 %	1.16 %	1.14 %
Bancorp Tier 1 leverage (to adjusted avg. total assets) (4)	8.65 %	8.51 %	9.10 %
Bank Tier 1 leverage (to adjusted avg. total assets) (4)	9.04 %	9.04 %	10.26 %
Number of bank branches	107	99	99
Number of FTE employees	3,682	3,525	3,432

(1) Fallout adjusted refers to mortgage rate lock commitments which are adjusted by a percentage of mortgage loans in the pipeline that are not expected to close based on previous historical experience and the level of interest rates.
(2) Interest rate spread is the difference between the annualized yield earned on average interest-earning assets for the period and the annualized rate of interest paid on average interest-bearing liabilities for the period.
(3) Excludes goodwill and intangibles of $71 million, $21 million, and $20 million at June 30, 2018, December 31, 2017, and June 30, 2017, respectively. See Non-GAAP Financial Measures for further information.
(4) The Basel III transitional phase-in rules were applicable to December 31, 2017 and June 30, 2017.

Table of Contents

Overview

The second quarter of 2018 resulted in net income of $50 million, or $0.85 per diluted share, up $9 million or $0.14 per diluted share compared to the second quarter of 2017. For the six months ended June 30, 2018 compared to the same period in 2017, net interest income increased $41 million, or 23 percent, led by growth in average earning assets of $2.5 billion and a 9 basis point increase in net interest margin.

The Community Banking segment continued to perform well, boosted by the acquisitions of the Desert Community Bank ("DCB") branches and the Santander warehouse business late in the first quarter. When comparing the six months ended June 30, 2018 to the same period last year, average commercial loans have increased $1.4 billion, or 45 percent with growth across all portfolios and average deposits have increased $1.1 billion, or 13 percent.

During the first half of 2018, we sold $18.4 billion UPB of mortgage servicing rights with 100 percent of the sub-servicing retained, increasing the profitability of our servicing business. Since the beginning of 2018, we have increased the number of loans serviced by 93,000 or 21 percent and are well positioned to add more scale later this year.

Our fallout-adjusted lock volume for the first half of 2018 compared to the first half of 2017, increased 12 percent, or $1.7 billion, while the gain on sale margin fell 2 basis points to 0.74 percent. This was driven by a challenging mortgage environment resulting in significant pricing competition.

Earnings Performance

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	Change	2018	2017	Change
	(Dollars in millions, except share data)					
Net interest income	$115	$97	$18	$221	$180	$41
Provision (benefit) for loan losses	(1)	(1)	—	(1)	2	(3)
Total noninterest income	123	116	7	234	216	18
Total noninterest expense	177	154	23	350	294	56
Provision for income taxes	12	19	(7)	21	32	(11)
Net income	$50	$41	$9	$85	$68	$17
Income per share						
Basic	$0.86	$0.72	$0.14	$1.47	$1.18	$0.29
Diluted	$0.85	$0.71	$0.14	$1.45	$1.16	$0.29

Net income increased to $50 million or $0.85 per diluted share for the three months ended June 30, 2018, compared to $41 million or $0.71 per diluted share for the three months ended June 30, 2017. Net interest income increased $18 million for the three months ended June 30, 2018, compared to the same period in 2017, primarily driven by a higher net interest margin and a $2.0 billion increase in average interest-earnings assets, led by commercial loan growth. The $7 million increase in noninterest income primarily resulted from higher loan fees and charges and returns on MSRs, partially offset by lower gains on loan sales. Growth from acquisitions resulted in higher compensation and benefits, commissions and occupancy and equipment expenses.

Net income increased to $85 million or $1.45 per diluted share for the six months ended June 30, 2018 as compared to $68 million or $1.16 per diluted share for the six months ended June 30, 2017. Net interest income increased $41 million for the six months ended June 30, 2018, compared to the same period in 2017, primarily driven by a 19 percent increase in average interest-earning assets and an increase in net interest margin. The increase in noninterest income primarily resulted from higher gain on loan sales and loan fees and charges, partially offset by a lower return on MSRs. Our 2017 mortgage acquisitions drove an increase in originations resulting in higher volume driven expenses as well as an increase in compensation and benefits and occupancy and equipment expenses.

Additional details of each key driver have been further explained in Management's discussion below.

6

Net Interest Income

The following tables present, on a consolidated basis, interest income from average assets and liabilities, expressed in dollars and yields:

	Three Months Ended June 30,						
	2018				2017		
	Average Balance	Interest	Annualized Yield/ Rate		Average Balance	Interest	Annualized Yield/ Rate
	(Dollars in millions)						
Interest-Earning Assets							
Loans held-for-sale	$4,170	$ 47	4.50	%	$4,269	$	