



# Post-crisis Mortgage Lending by Community Banks

William Bassett and John Driscoll  
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# Introduction

- Lax mortgage lending standards contributed to the housing boom and bust
- Large fines, aggressive putbacks, and increased regulation as a result of problems in mortgage origination, servicing, and foreclosure highlight risks in business line going forward
- Adjustment to that environment has material costs (fixed and variable), only some of which can be passed on to customers
- **Policy Concern**: If smaller BHCs are unable to generate the scale economies required to absorb the fixed costs or achieve profit margins to justify increased risks, will overall mortgage availability be curtailed?



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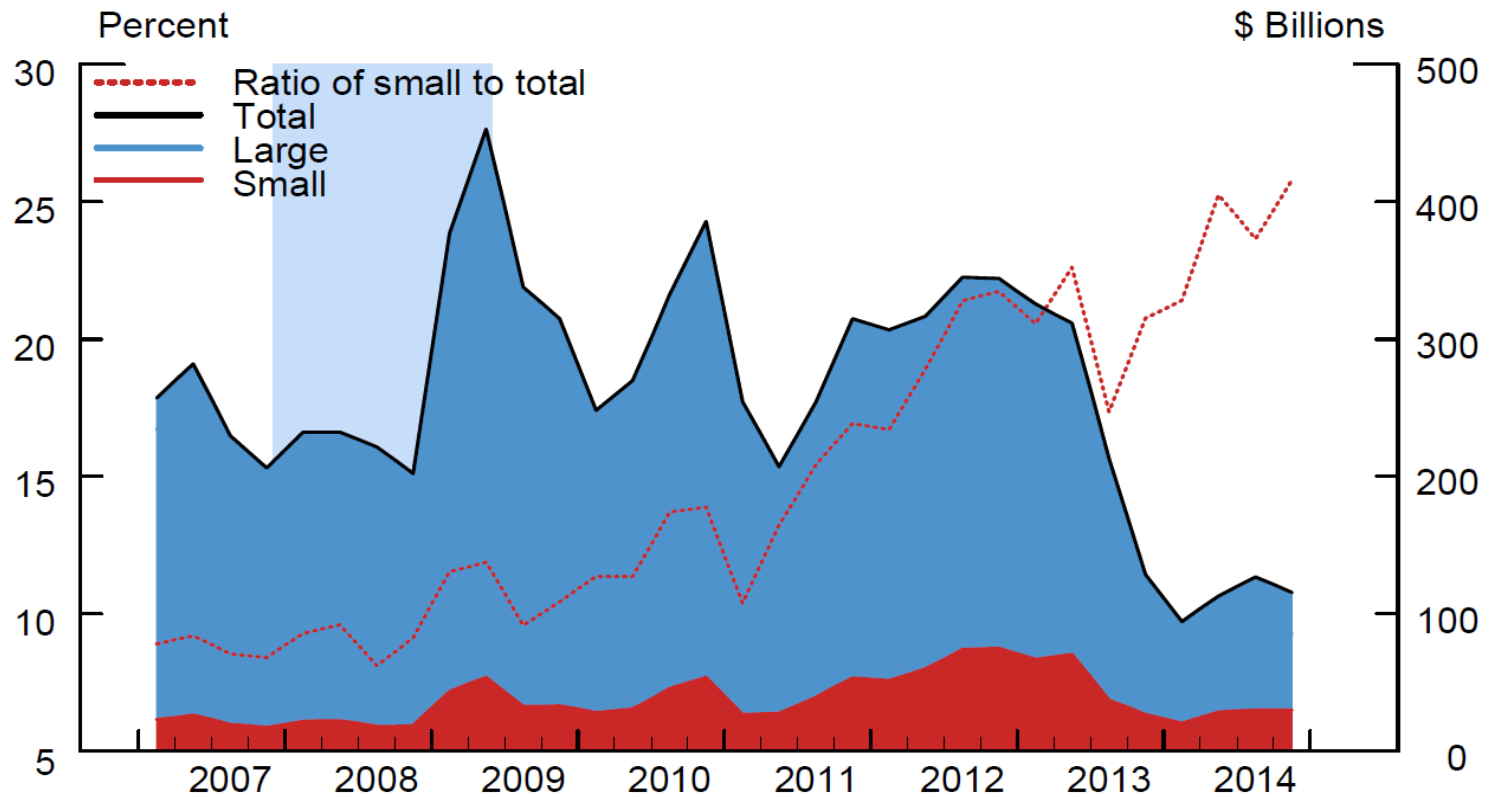
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# What Do the Data Say?

- Schedule P from Call Reports and FR Y-9C
  - Collects the volumes and income from originations, sales, securitization, and servicing of residential mortgages, or “Mortgage Banking”
  - Begins in 2007 for banks with assets > \$1 B. or \$10 M. of originations for sale or securitization
  - All BHCs with assets > \$500 M. (used to) file Y-9C;
- Other bank characteristics from Call and Y-9C
- Branch-weighted local economic conditions

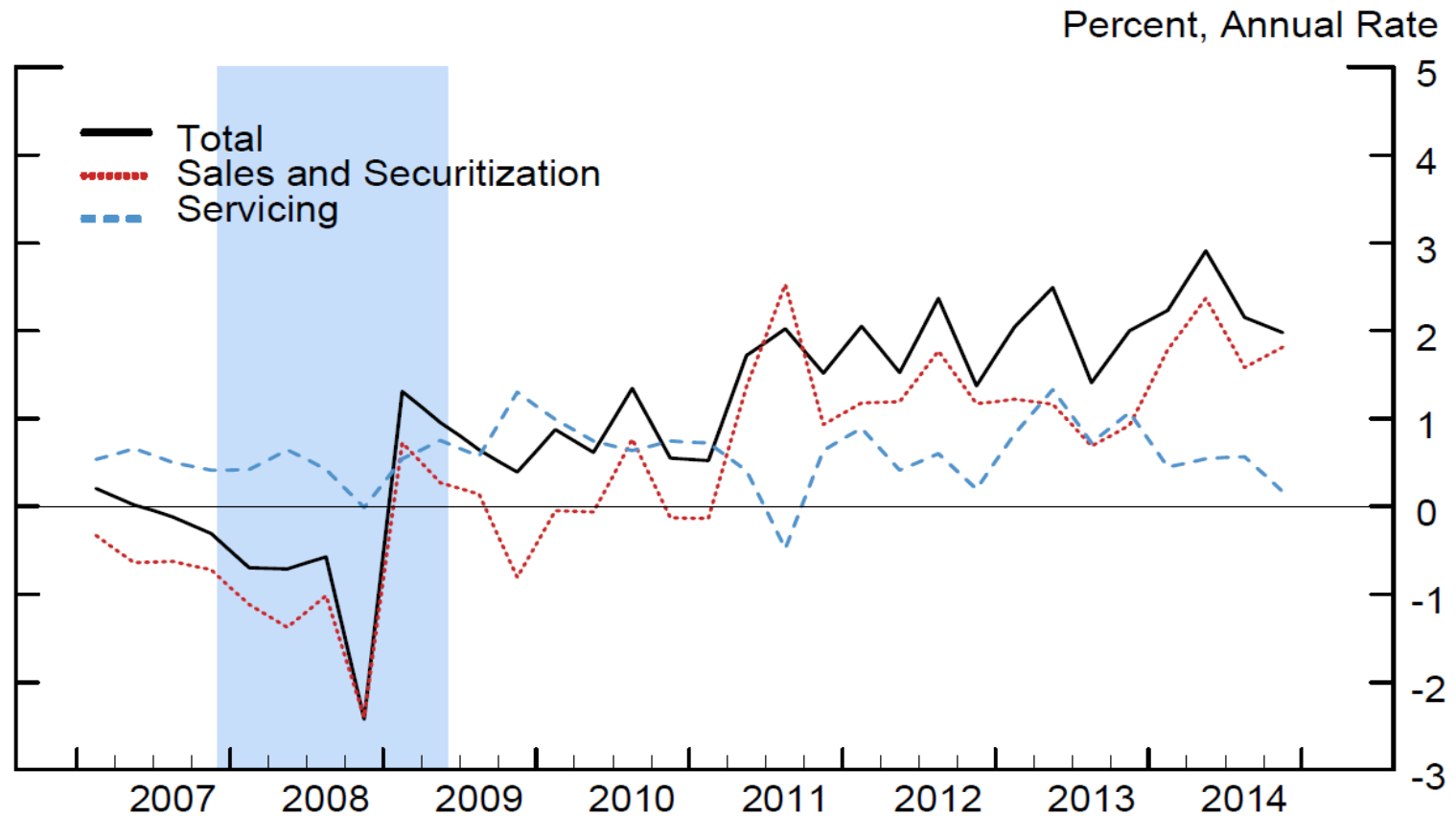


# Mortgage Originations for Sale by BHC Size



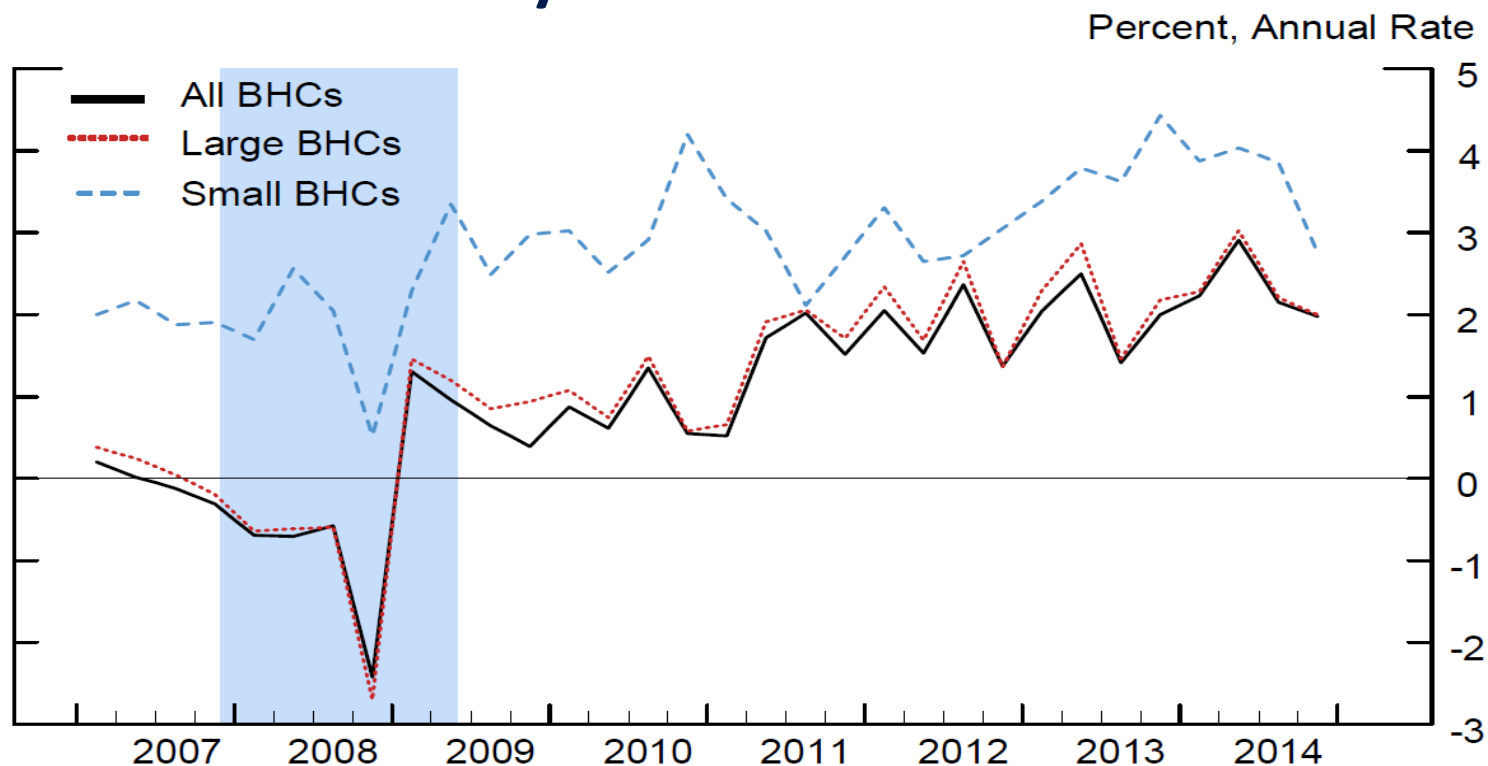


# Estimated Return to Mortgage Banking





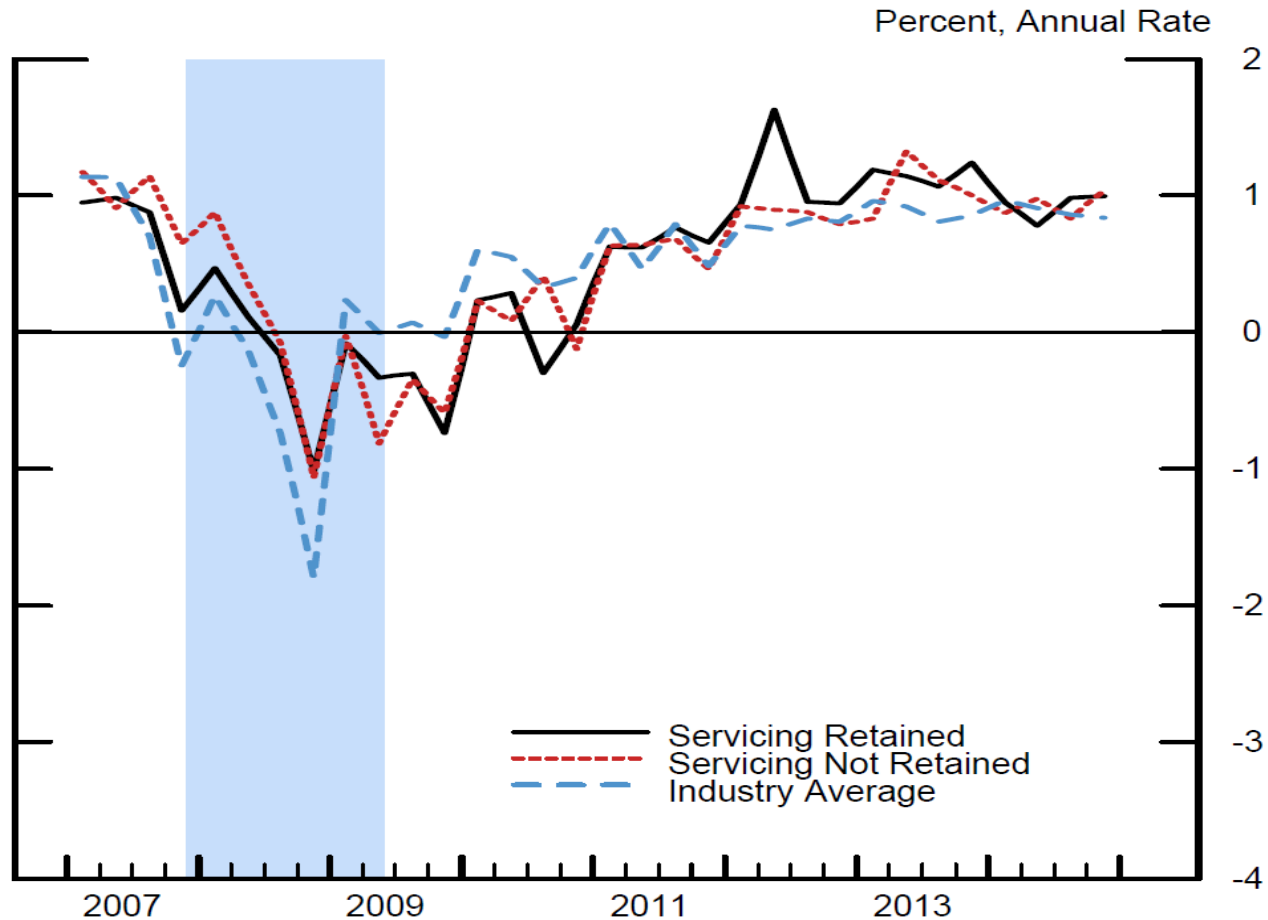
# Gross Returns to Mortgage Banking, by Bank Size



Note: Small BHCs are those with less than \$20 billion in assets.

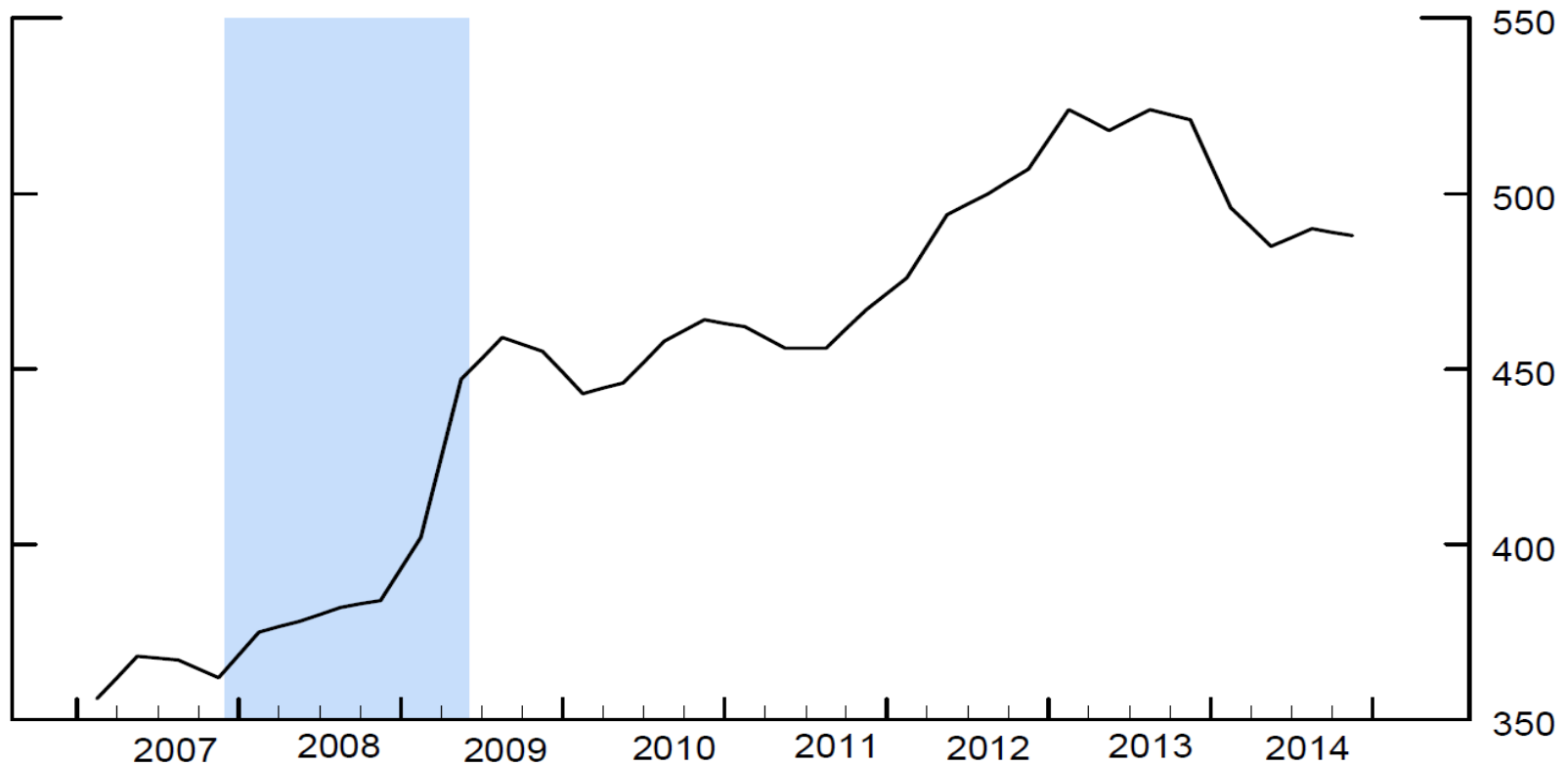


# ROA: Banks with \$1 to \$10 B. in Assets





# Number of Banks with Mortgage Banking Revenue







# Summary Thus Far

- Small banks have become a bigger part of the mortgage banking market
- They have higher estimated returns than large banks
- The overall number of banks engaging in mortgage banking is rising



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# Regression Analysis

- Question: Does increased small bank participation in mortgage banking (2007 to 2014) just reflect improved banking and economic conditions?
- Participation = F(Size, Year, *Size\*Year*, other controls)
  - Use ~6,000 bank-year observations; ~1,000 unique BHCs
  - Filtered for core lending and deposit taking businesses and other outliers
  - 59% of bank-year observations in sample show participation



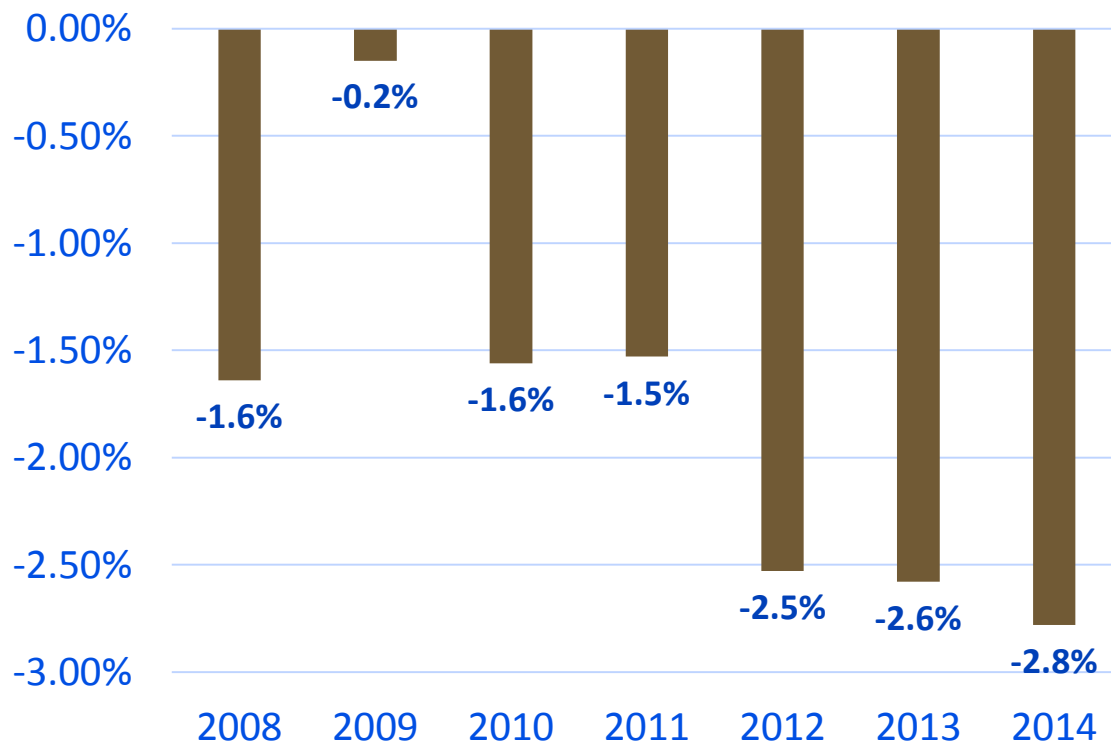
# Key Variable Values

|                              | <u>Full Sample</u> |           | <u>Participants</u> |           | <u>Non-Participants</u> |           |
|------------------------------|--------------------|-----------|---------------------|-----------|-------------------------|-----------|
|                              | Mean               | Std. Err. | Mean                | Std. Err. | Mean                    | Std. Err. |
| Total assets (\$billions)    | 16.40              | 142.59    | 26.92               | 185.54    | 1.53                    | 5.65      |
| Change personal inc.         | 1.66               | 2.93      | 1.65                | 2.90      | 1.69                    | 2.96      |
| Change house prices          | -0.51              | 6.13      | -0.31               | 5.77      | -0.80                   | 6.58      |
| Change employment            | 0.25               | 1.79      | 0.24                | 1.75      | 0.26                    | 1.83      |
| Average personal inc.        | 39,795             | 4,588     | 39,596              | 4,586     | 40,076                  | 4,579     |
| Core loans / assets          | 62.67              | 12.26     | 63.82               | 11.38     | 61.05                   | 13.23     |
| Core deposits / assets       | 64.18              | 9.17      | 63.76               | 9.33      | 64.77                   | 8.92      |
| Noninterest income / assets  | 1.10               | 0.86      | 1.28                | 0.97      | 0.84                    | 0.57      |
| Net interest income / assets | 3.32               | 0.51      | 3.27                | 0.51      | 3.39                    | 0.50      |
| Delinquency rate             | 3.40               | 2.50      | 3.23                | 2.23      | 3.64                    | 2.81      |
| Leverage ratio               | 7.83               | 2.34      | 7.59                | 2.13      | 8.17                    | 2.56      |
| Assets mat. < 1 year         | 35.89              | 11.81     | 37.03               | 11.67     | 34.29                   | 11.83     |



## Marginal Effect of Asset Size on Participation in Mortgage Banking Has Declined

- Key results:
  - Marginal effect of “Size” is 0.47, but...
  - Size\*Year is more negative over time
- Asset size less a driver of participation recently, after controlling for:
  - Economic conditions
  - Long- and short-run bank characteristics



# Conclusions and Caveats

- Conclusions
  - Smaller BHCs have not been, on net, deterred from engaging in mortgage banking post-crisis
  - Have become a more important part of the market
  - Have profited from their activities
- Caveats
  - What about BHCs < \$500 million?
  - What about competing with nonbank financial firms?
  - What did pre-2007 look like?

