

Hillenbrand's View on Atlanta FHLB Venture

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WASHINGTON — A new mortgage program from the Federal Home Loan Bank of Atlanta is expected to generate at least \$5 billion of purchases in the next year and may expand to five other Home Loan banks within a month, according to the bank's partner.

Eric Hillenbrand, who runs [Hillenbrand Partners](#), the Chicago investment firm seeking to purchase mortgages from the Atlanta bank's members, said he has had discussions with several other Home Loan banks and hopes to offer the Global Mortgage Alliance Program as widely as possible.

"The fundamental premise here is that we have 8,200 members that are part of the Home Loan Bank System," Mr. Hillenbrand said. "The community banks have great relationships with their customers. We do not want to get in the middle of that. ... For the community banks, all we want to do is provide liquidity."

The program, which the Federal Housing Finance Board approved last week, effectively would cast the Atlanta bank as an intermediary between its members with limited securitization capabilities and Hillenbrand Partners. Though the program has been welcomed by some as an innovative alternative to Home Loan bank mortgage purchase programs, many in the industry are reacting cautiously.

Most industry representatives say they know little about the new program, which was not revealed until a contentious Finance Board meeting May 9, and they offered only qualified support.

"Anything that solves concerns about banks' holding mortgages on their books moves the ball in the right direction," said Joe Pigg, a senior counsel at the American Bankers Association.

Kathy Gibbons, the senior director of government affairs at the Mortgage Bankers Association, would say only that her trade group "has encouraged the Federal Home Loan banks to participate actively in the mortgage market and use their resources to support competition."

Much of the industry's concern centers on the new program's risk profile and its economical value to Home Loan bank members. A key question remains how it will be priced. Skeptics note that most small banks do not securitize their mortgages in the private sector because the process is too expensive, and they wonder how the program can cut costs enough to make joining worthwhile.

"The Home Loan bank members who like" the other programs "will certainly look at this, but they might not see this as being useful to them," one industry source said.

Neither Mr. Hillenbrand nor executives at the Atlanta bank would offer details about the pricing structure. But Mr. Hillenbrand said he recognizes the program has to be priced appropriately.

"We would not have thought about engaging in this program unless we thought we would have highly competitive pricing," he said.

Some have suggested that the new program could eventually replace the Mortgage Partnership Finance and Mortgage Partnership programs, but Atlanta bank officials insist they are not about to abandon support for either.

"From my point of view, we're still a member-driven organization, so our goal is to provide members with as much choice as possible," William Ott, the Atlanta bank's interim chief executive, said in an interview last week.

Observers said that tactic likely will soothe bankers who have relied on the current mortgage programs for a decade and might be reluctant to change.

"It will take quite some time to develop a new product that all the banks are comfortable with," said Brian Harris, an analyst with Moody's Investors Service Corp. "For the foreseeable future, I would expect ... [the other programs] to be operational."

The new program is being pitched as a way to reduce risks at the Home Loan banks. Without the ability to securitize their mortgage portfolios, the banks must keep the loans on the books and are vulnerable to changing interest rates.

The Home Loan Bank of Seattle abandoned its mortgage program in 2005 because it could not control the risks. The situation was so severe there that the bank posted a profit of just \$2 million for that year. With its mortgage program shuttered, the bank's profits grew to \$26 million last year.

The Home Loan Bank of Chicago has also run into problems with its mortgage portfolio. Regulators from the Finance Board began investigating the bank's management of interest rate risk last month.

The Chicago bank's first-quarter profits fell 59% from a year earlier, to \$23 million, according to a filing last week with the Securities and Exchange Commission. The filing warned that declines would likely continue through the rest of the year, in part because of lower volume in the Mortgage Partnership Finance program.

The Atlanta bank's program would eliminate the interest rate risk that has dogged the other programs, because the mortgages would not be left on the Home Loan bank's balance sheet. Instead, community banks would sell mortgages to Mr. Hillenbrand's firm, which would package them for securitization and pay the Atlanta bank a fee for sending the members its way.

Several sources said that even though the interest rate risk would be eliminated, operational risk could remain.

"I think it would be primarily tied to how the Atlanta bank manages its people and systems and controls," Mr. Harris said.

Some Home Loan banks did not have proper risk controls in place when they instituted prior mortgage programs, he said. "One of the issues that over time became apparent on MPP and MPF was the need for risk models and risk expertise within the Home Loan banks. Looking back on those programs, that was certainly one of the hidden costs."

Mr. Ott rejected such notions and pointed to the Atlanta bank's history of managing risk.

"This bank has a very, very strong operational process with the MPP and MPF program and is known to have a strong operational risk profile in this particular area," he said. "This product runs right off the same platform and backbone. It will not have any additional risk."

Though the new program is not seen as an immediate threat to the others, several observers said they expect the Atlanta bank's plans to drive up competition between the Home Loan banks and Fannie Mae and Freddie Mac.

"I'm sure that's the intention," Mr. Pigg said. "The whole purpose behind mortgage programs is to create additional competition, and that's good for banks."

But Mr. Hillenbrand said he doubts his program will cut much into the government-sponsored enterprises' business.

"From what we see, Fannie and Freddie have the largest institutions. We're really trying to get down to the communities of America," he said.

Others wonder whether the new program could be the final nail in the coffin for the retained earnings debate that embroiled the 12 Home Loan banks last year.

A Finance Board proposal would have required each Home Loan bank to cut cash dividends in half until retained earnings reached \$50 million plus 1% of

nonadvance assets. The proposal was tabled in December but the board is expected to release a plan soon to require the Home Loan banks to hold more retained earnings against their mortgage assets.

But since mortgages would never touch the Home Loan bank's books under the new program, further discussion over retained earnings could be moot.

"If this program were to really take off, it would significantly change the discussion," Mr. Pigg said. "If there's less risk involved, then you don't need to be talking about increasing retained earnings."

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