MORTGAGE BANKERS ASSOCIATION

May 28, 2020

The Honorable Jerome H. Powell
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

RE: Request for Clarifying Guidance on Independent Mortgage Banks Eligibility Under the Main Street Loan Program.

Dear Chairman Powell:

The Mortgage Bankers Association (MBA)[1] is writing to request that the Federal Reserve (the Fed) issue guidance clarifying certain aspects of the Main Street Loan Program (MSLP) in order to provide the opportunity for MBA member companies take advantage of the benefits of the program. Specifically, we request that the Fed (i) clarify that mortgage companies with a an "originate and sell" business model are eligible borrowers under the MSLP; (ii) modify the method for determining maximum loan amounts under all three facilities of the MSLP; and (iii) clarify that there is no requirement that the MSLP debt take senior position to any of the borrower's existing secured debt, including warehouse debt. Without such guidance, independent mortgage banks (IMBs) that must rely on warehouse lines of credit to fund their core business operations - mortgage origination and refinancing – would essentially be shut out of the MSLP.

MBA welcomes the MSLP and applauds the Fed for setting up the facilities under the authority of section 13(3) for lending to small and medium-sized businesses under the program. This is especially important to the MBA because independent mortgage banks (IMBs) that are ineligible borrowers under the Paycheck Protection Program (PPP) due to that Program's employee threshold restriction, would be able to obtain much-needed funds under the MSLP to stay afloat and continue their important business operations.

The MSLP consists of three facilities – the Main Street New Loan Facility (MSNLF), the Main Street Priority Loan Facility (MSPLF) and the Main Street Expanded Loan Facility (MSELF). All three facilities have some of the same features, including borrower eligibility, and a borrower can

[1]The MBA is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,300 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mba.org

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apply for a loan only under one of the three facilities. Because these facilities allow businesses with up to 15,000 employees or up to $5 billion in 2019 annual revenues participate as eligible borrowers, it is a critical source of funds for mortgage companies that need immediate infusion of funds to stay in business - especially because of the financial strain caused by the current pandemic.

Nonbank financial institutions are a critical source of capital for households and small businesses. In particular, IMBs play a vital role in the U.S. mortgage finance market, and many, just like other businesses, are feeling the negative impact of COVID-19 on their operations and the important services they provide to households and businesses. As you are aware, a host of recent events, including margin calls on hedged loan pipelines, have depleted cash reserves for otherwise healthy IMBs, some of which may struggle to survive without a stable source of liquidity. Additional cash flow pressures are mounting as more borrowers are entering forbearance and servicers will be required to remit P&I and T&I funds to GSEs on many of these loans for a minimum period of 4 months

IMBs' need for available operating funds exists despite access to other sources of credit. Specifically, IMBs typically finance their loan origination and refinancing operations using with warehouse lines of credit that are subject to strict covenants that dictate the use of the funds. As a general matter, an IMB would obtain a warehouse line from a lender, and as the line is used to finance mortgage loan originations and refinancing, the debt is recorded on the IMB's balance sheet as a liability whereas, the mortgage loan that is financed by the warehouse debt is recorded on the balance sheet as an asset. Nevertheless, the drawn portion of the warehouse line is recorded as debt/liability on the balance sheet.

Due to the very limited permissible uses of funds from warehouse lines of credit, funds from that credit source are not available for operating funds. MBA is concerned that (I) the way that the three facilities under the MSLP describe the maximum eligible loan amount will operate to exclude any IMB with a warehouse line (drawn or undrawn) from being able to obtain a loan under this program; and (II) the requirement under the MSPLF and the MSELF that the loan be "senior to, or pari passu with, in terms of priority and security, the Eligible Borrower's other loans or debt instruments, other than mortgage debt" would operate to shut out IMBs .

I. IMB Eligibility under the MSLP

In the Frequently Asked Questions (FAQs) released by the Fed on May 27, 2020 describing the MSLP, section E.1.(2) describes businesses that are ineligible borrowers under the MSLP. According to this section, businesses engaged in lending - including banks, life insurance companies, finance companies, investment companies, or other businesses whose stock in trade is money and which are engaged in financing – are ineligible borrowers under the MSLP. However, there is a limited waiver of ineligibility for mortgage companies that are primarily engaged in servicing loans, and mortgage companies that originate and sell loans within 14 days of origination.[2]

The requirement that the loans be sold within 14 days of closing creates a situation that would shut out IMBs from the MSLP. As a general matter, the business model of an IMB is origination and subsequent sale of mortgage loans. These companies do not make loans and hold them in their portfolios in the ordinary course of their businesses (i.e., these loans are held in available-for-sale, rather than held-to-maturity, portfolios). In most cases, these loans are sold into the secondary market within 14 days of closing. There are cases, however, where the loan sales are not completed within 14 days. Sometimes loans being aggregated for bulk sale, or hard to place loans, may be retained or held on warehouse lines of credit for more than 14 days.

Regardless of the time between closing and sale of the loans, the fact is that the in the ordinary course of business the all loans are intended for quick sale into the secondary market, and even those held beyond 14 days are rarely, if ever, held to maturity. In fact, the only way for non-depository mortgage bankers to stay in business is to sell virtually all of the loans they originate – most of the time within a week or two after closing, but on occasion these loan sales take longer.

MBA urges the Fed to issue guidance and update the MSLP FAQs to clarify the application of the 14-day sale requirement for purposes of determining mortgage company eligibility under the MSLP. It should be noted that these warehouse lines of credit are routinely disregarded by rating agencies when determining the leverage ratios of IMBs and do not factor into the ultimate credit rating issued. We ask that the guidance and updated FAQs specifically state that mortgage companies that originate and sell loans "in the ordinary course of their business" would be eligible borrowers under the MSLP – without regard to whether every single loan is actually sold with 14 days.

II. Calculation of Maximum Loan Amount under the MSLP

Under the MSNLF, the maximum amount a borrower could be eligible for is ***the lesser*** ***of:***

(i) *$25 million or*
(ii) *an amount that, when added to the Eligible Borrower's existing outstanding and committed but undrawn debt, does not exceed four times the Eligible Borrower's 2019 earnings before interest, taxes, depreciation, and amortization ("EBITDA").*

Under the MSPLF, the maximum amount a borrower could be eligible for is ***the lesser*** ***of:***

[2] Specifically, the waiver provides that "[a] *mortgage servicing company that disburses loans and sells them within 14 calendar days of loan closing is eligible. Mortgage companies primarily engaged in the business of servicing loans are eligible. Mortgage companies that make loans and hold them in their portfolio are not eligible"*

(i) $25 million or

(ii) an amount that, when added to the Eligible Borrower's existing outstanding and undrawn available debt, does not exceed six times the Eligible Borrower's adjusted 2019 earnings before interest, taxes, depreciation, and amortization ("EBITDA").

Under the MSELF, the eligible maximum amount is ***the lesser of:***

(i) $200 million,

(ii) (ii) 35% of the Eligible Borrower's existing outstanding and undrawn available debt that is pari passu in priority with the Eligible Loan and equivalent in secured status (i.e., secured or unsecured), or

(iii) (iii) an amount that, when added to the Eligible Borrower's existing outstanding and undrawn available debt, does not exceed six times the Eligible Borrower's adjusted 2019 earnings before interest, taxes, depreciation, and amortization ("EBITDA".

Under all three facilities, there is a calculated amount that is a function of debt structure and earnings, which would result in a negative number (less than zero) for IMBs that must include warehouse debt in the calculated amount. Thus, under item (ii) in the MSNLF and MSPLF, and item (iii) in the MSELF, the calculation for an IMB that will produce a number that is less than zero (0) would make this provision inoperable. The problem exists because of the calculation that takes into consideration an IMB's warehouse debt/lines of credit. The effect is that with a zero maximum eligible amount, the borrower would essentially be ineligible for the loan.

By including warehouse debt in the calculation, the Fed essentially makes ineligible any business that relies heavily on short-term revolving credit facilities to finance assets that are typically sold shortly thereafter, such as IMBs and floorplan financing companies. To rectify the problem, MBA strongly recommends that the Fed issue guidance immediately clarifying that a mortgage company's warehouse line of credit is not included in the calculated debt structure for purposes of determining maximum loan size under item (ii) in the MSNLF and MSPLF, and item (iii) under the MSELF. Without this clarifying guidance, any business that operates using warehouse credit lines would be ineligible for a loan under all three MSLP facilities because the maximum eligible loan amount would generally be zero. The following is an example of the issue with real numbers from an IMB:

MSNLF: COMPANY A (with warehouse lines of credit):	12.31.19	
Balance Sheet warehouse bank liability aka "existing outstanding's"	$448,445,553	
Undrawn but available warehouse lines of credit aka "undrawn debt"	284,554,447	
Subtotal - Total warehouse facility amount	733,000,000	
All other balance sheet debt	25,771,191	
Total debt structure	$758,771,191	a
EBITDA	$40,298,423	
Times 4	x 4	
4 x EBITDA	$161,193,692	b
An amount when added to "a" does not exceed "b"	zero	
	INDICATED LN AMT	

Eligible maximum loan amount is the lesser of (i) $25 million or (ii) an amount that when added to $758,771,191 does not exceed $161,193,692. Thus the difference between "a" and "b" is a negative $597,577,499. Thus the maximum loan amount is zero.

Because the total debt structure already significantly exceeds 4 x adjusted EBITDA, the maximum loan amount the borrower would be eligible for would be zero.
To correct the issue, MBA requests that warehouse lines be removed from the calculated debt structure.

Revising the above example to exclude warehouse financing from the calculation would result in the IMB being eligible for up to $135 million in financing:

MSNLF: COMPANY A (without warehouse lines of credit):	12.31.19	
Balance Sheet warehouse bank liability aka "existing outstanding's"	$0.00	
Undrawn but available warehouse lines of credit aka "undrawn debt"	0.00	
Subtotal - Total warehouse facility amount	0.00	
All other balance sheet debt	25,771,191	
Total debt structure	$25,771,191	a
EBITDA	$40,298,423	
Times 4	x 4	
4 x EBITDA	$161,193,692	b
An amount when added to "a" does not exceed "b"	$135,422,501	
	INDICATED LN AMT	

Eligible maximum loan amount is the lesser of (i) $25 million or (ii) an amount that when added to $25,771,191 does not exceed $161,193,692. Thus the difference between a and b is $135,422,501. Thus the maximum loan amount is $135,422,501.

The issue is exactly the same under the MSPLF and the MSELF. The inclusion of warehouse debt and undrawn lines would create a negative number, and therefore, a zero under item (ii) in the MSPLF and item (iii) in the MSELF, which would make the provision inoperable.

III. Position of MSPLF and MSELF Debt

The requirement that the MSPLF and MSELF debt be "senior to, or pari passu with, in terms of priority and security, the Eligible Borrower's other loans or debt instruments, other than mortgage debt" adds some level of confusion to the program, which if not clarified by the Fed, could operate to shut out IMBs that must rely on warehouse loans for their core business activities.

As a general matter, warehouse loans are secured by the underlying mortgages they fund. Hence, if the IMB borrower fails or is terminated, the collateral is sold to recover the warehouse debt. A loan under either the MSPLF or MSELF may be secured or unsecured. It is impossible that a bank would allow an unsecured MSPLF or MSELF debt take a senior or pari passu position to a secured warehouse debt. That would be tantamount to agreeing that if the IMB borrower fails, the unsecured MSPLF or MSELF debt would be paid first using the proceeds from the sale of collateral securing the warehouse loan. It is inconceivable that any warehouse lender would agree to that, and as such, IMBs that must rely on warehouse loans would be unable to qualify for unsecured MSPLF or MSELF loans. IMBs would only be able to obtain unsecured MSLP loans because these entities have only one type of collateral for securing loans and such collateral is used to secure warehouse loans. Hence, a requirement that unsecured MSPLF or MSELF debt take a senior position to secured warehouse debt would shut IMBs out of these two Main Street lending programs.

Recommended Clarifications

MBA respectfully requests guidance providing the following clarification.

I. Mortgage companies that originate and sell loans "in the ordinary course of their business" would be eligible borrowers under the MSLP – without regard to whether the company sells every single loan within 14 days

II. The following language in item (ii) of the MSNLF and MSPLF and item (iii) of the MSELF: "***an amount that, when added to the Eligible Borrower's existing outstanding and committed but undrawn debt …"***, should be modified or revised to say:

"an amount that, when added to the Eligible Borrower's existing outstanding and committed but undrawn debt (excluding credit lines or debt used only to finance inventory, such as warehouse lines), …"

III. The requirement that MSPLF and MSELF debt be "senior to or pari passu with, in terms of priority and security, the Eligible Borrower's other loans or debt instruments, excludes mortgage debt. In effect, the MSPLF or MSELF debt is not required to be senior to, or pari passu with, the borrower's mortgage debt. Requested guidance should either clarify that "mortgage debt" includes warehouse debt, or clearly state that secured warehouse debt is also excluded, i.e., that warehouse debt is excluded from debt that MSPLF or MSELF debt will take a senior or pari passu position.

Conclusion

MBA is concerned that unless the Fed issues the requested clarifying guidance, many IMBs that were in good financial standing prior to the onset of the COVID-19 pandemic would be unable to obtain the necessary funds to continue their vital operations, including maintaining payroll and supporting U.S. businesses and households through mortgage finance activities.

Moreover, it is important to point out that many IMBs will be under severe cash strain over the next 6-12 months as a result of advances that they will need to make on delinquent loans in Fannie Mae and Freddie Mac securitizations. Hence, we believe that immediate clarifying guidance that would allow IMBs borrow under the Main Street Lending Program to meet their obligations under the CARES Act would help stabilize the housing finance market, as well as help ensure that IMBs continue to provide their vital mortgage finance services to U.S. businesses and households.

Thank you for your time and attention to this very important matter. As we are all aware, COVID-19 is causing unprecedented difficulties for all businesses, some of which are on the verge of failing, and being able to access necessary funds through this excellent program will make the difference between survival and failure for them. MBA stands ready to work with the Agencies to ensure that IMBs that are also dealing with the impact of the COVID-19 pandemic on their cash flows and business operations are not left out of this program. We are willing and available to get on a phone conference to discuss this issue in greater details. Please contact me at pmills@mba.org or (202) 557-2878 if you would like to set up a call, or if you have any questions.

Sincerely,

Pete Mills
Senior Vice President Residential Policy & Member Engagement
Mortgage Bankers Association