



Insider

The MPP Performance Report: A Four Year History

The Mortgage Purchase Program (MPP) has provided a new sale outlet for Federal Home Loan Bank of Indianapolis (FHLBI) members. As of April 30, 2005, MPP completed its fourth year of operation. This issue of the *Insider* will consider MPP's historical performance during this period.

During MPP's first four years of operation, the FHLBI purchased over \$14.3 billion in mortgages. Participants were a diverse group that included large mortgage banking operations, thrifts, agricultural banks, commercial banks, and credit unions. A total of 95 institutions had been approved to sell loans to the FHLBI; 15 more had applications in process.

This *Insider* was written by James B. Eibel, CFA, vice president and marketing representative. Back issues of the *Insider* are available at www.fhlbi.com.

Lender Risk Account (LRA) Performance

The primary distinctive of MPP is its credit structure. The program's credit structure can create significant value for loan sellers (Exhibit 1). Rather than guarantee fees, a combination of supplemental mortgage insurance and the member-owned lender risk account (LRA) are used for credit enhancement.

The LRA provides credit support after borrower's equity and primary mortgage insurance. This non-interest bearing account is owned by loan sellers. If loan losses are low, sellers will receive LRA rebates as income. If losses are high, LRA funds will be exhausted and supplemental

mortgage insurance and the FHLBI will absorb any further losses.

In addition to the prospect of earning additional income through the LRA, MPP's credit cost structure was generally below that of other outlets. On average, MPP's credit structure produced annual savings of approximately 3.9 to 6.7 basis points versus the guarantee fee structures of Freddie Mac and Fannie Mae (Exhibit 2). In terms of up-front pricing, this difference alone would have provided MPP with approximately 15 to 30 basis points of pricing advantage. MPP pricing was further enhanced by the value of the LRA.

It should be noted that an average of 7.3 basis points or nearly half of MPP's credit structure cost was used to fund seller-owned LRAs. After four years of opera-

Exhibit 1. MPP Credit Structure



Exhibit 2. Credit Enhancement Costs (bps)

	<u>MPP</u>	<u>Freddie Mac</u>	<u>Fannie Mae</u>
Average Guarantee Fee*	0.0	23.0	20.2
Average SMI Premium**	9.0	0.0	0.0
Average LRA Premium**	7.3	0.0	0.0
Totals	16.3	23.0	20.2

*As of 12/31/03

**MPP portfolio averages as of 4/30/05



tion, a total of \$10.5 million had already collected in these accounts. Of these funds, \$278,659 had been utilized to cover loan losses and \$64,350 had been disbursed to sellers. Based on loan balances and the average annualized 7.3 basis point funding rate, these accounts were projected to grow by over \$500,000 per month, net of loan losses.

If the first four years of operation are indicative, the majority of current and future LRA funds will be returned to sellers as income (Exhibit 3). Of the 151 closed Master Commitment Contracts (MCCs), only six (4%) had incurred any LRA charges. It should be noted that all of these contracts were filled by sellers engaged in third-party originations. On an annualized basis, the average LRA

Exhibit 3. LRA Credit Performance

April 2001-2005

<u>LRA age</u>	<u>Number</u>	<u>Number with losses</u>	<u>Average annualized losses</u>
Less than 1 year	58	0	0.0000%
1-2 years	62	1	0.0002%
2-3 years	26	4	0.0015%
3 years or more	5	1	0.0022%
Totals	151	6	0.0041%

charge was negligible (.0041% of loans sold). If this experience were to persist over the life of the LRA (11 years), the total loss rate would be less than half of one basis point (0.0045%).

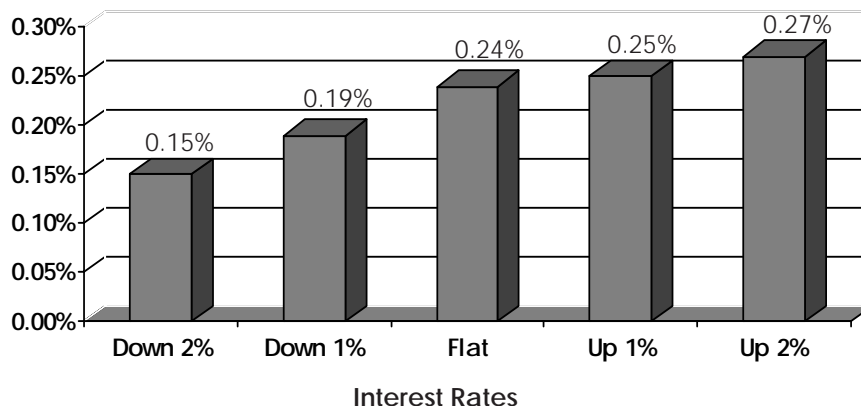
As of April 2005, the vast majority of MPP sellers did not capitalize their LRAs on-balance sheet. If low loan losses persist, account growth will make LRAs a signifi-

cant economic asset for MPP's customers. As a result, it is likely that many MPP sellers will recognize these accounts in their future financial reporting.

Whether MPP sellers elect to capitalize the account or not, the value the LRA should be considered when determining best execution for loan sales. While a variety of assumptions are required for valuation, Exhibit 4 estimates that LRA added an average of 15 to 27 basis points during the first four years of operation. This projection utilized historical aggregate MPP data, Wall Street dealer consensus prepayment speeds, and each scenario's market 30 year mortgage rate as a discount rate.

Exhibit 4. Estimated LRA Present Value/Total MPP Purchases

As of April 30, 2005



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Phone Directory

To speak with a representative, call 800.442.2568 or 800.274.4636

Marketing	Area Code 317
Brian Fike	465.0430
Bill McDowell	465.0429
Frank Abercrombie	465.0427
Jim Eibel	465.0423
Chuck Rainey	465.0422
Scott Schmitt	465.0540
MPP	
Doug Iverson	465.0559
Don Erwin	465.0547
Cathy Garrett	465.0553