

Citi Juices Jumbo Lending As MBS Market Revives

By Sara Lepro (featuring Mary Beth Sullivan)

On the heels of the first jumbo mortgage securitization since the crisis, Citigroup Inc. is cranking up originations of such loans to meet resurgent demand from borrowers and investors.

“We’re finding that the demand for jumbo loans is becoming very strong, particularly in New York and California,” said Sanjiv Das, the chief executive of the company’s CitiMortgage unit. “In fact, it is a priority for us ... to provide jumbo loans through our retail products [business] right now.”

As the originator and underwriter in last month’s securitization, Citi learned firsthand that such loans are now in demand in the capital markets. Investors put in six times as many orders as the \$238 million of bonds.

“We were pleasantly surprised by how well this deal was received,” Das said.

Such a reception would have been hard to imagine just a few months ago, when the only mortgage-backed securities investors would touch were guaranteed by Fannie Mae, Freddie Mac or the Government National Mortgage Association. Jumbo loans, typically made to wealthy borrowers, are too large to receive federal guarantees. In most areas the conforming limit is \$417,000; in some expensive markets it is as high as \$729,750.

The securitization, sponsored by Redwood Trust Inc., demonstrated that investors, hungry for yield in an environment of low interest rates, are now willing to take the credit risk of mortgage-backed without a federal stamp.

“Investors are really the ones driving the bus and will be the ones to dictate when the nonagency markets come back,” said Paul Bossidy, CEO of Clayton Services LLC, a due diligence firm.

Some red flags have been raised about the loans in the deal, which

have interest rate features that were popular during the bubble years.

All the loans had a fixed interest rate for just the first five years, with an adjustable rate for the rest of the 30-year term, and the majority of the loans let the borrower pay only the interest for the first 10 years.

“If mortgage rates rise, property values remain flat and the extension of credit is limited, we believe borrowers may face difficulties refinancing,” a group of Standard & Poor’s analysts wrote in a report last week.

S&P did not rate the deal, but offered an unsolicited evaluation of it, “because we believe the transaction is important to the marketplace and that our views can add value for investors.”

Das wouldn’t comment on S&P’s critique. Moody’s Investors Service, the only one of the three major credit rating agencies to rate the deal, gave the senior bonds a triple-A rating, noting the high credit scores and incomes of the borrowers and the substantial documentation obtained in the underwriting of the loans.

Michael Youngblood, founder and principal of Five Bridges Advisors LLC, said S&P’s unsolicited assessment was a healthy sign for the recovering private MBS market.

“I’m pleased to see that there is greater disagreement about new pools rather than the monotonous unanimity that we got used to in the last decade,” he said. “And I’m hopeful that there will be more differences of opinion going forward.”

Since the Redwood deal, Das said, Citi has been approached by a number of investment funds about doing similar deals. “Clearly, their investors are telling them that they are interested in this asset class, and I think those investors are predominantly mutual funds,

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hedge funds and banks that want more exposure in U.S. residential” mortgages.

However, Das stressed that the \$2 trillion-asset Citi would be happy to make the loans and hold on to them for the time being. “Lenders are starting to feel more comfortable about lending on balance sheet,” Das said. “We also have a fair amount of balance sheet and so don’t feel compelled to do a deal like this in a hurry.” (New accounting rules require banks to reflect securitized loans on their balance sheets anyway.)

That sentiment is in itself a good sign for the mortgage market, analysts said.

“The jumbo mortgages are a good kind of bellwether indicator in terms of the overall market, because I think that indicates a confidence level,” said Les Riedl, chief executive of Speer & Associates, a financial services consulting firm in Atlanta. “The lenders see the risks at this point being very manageable.”

And many institutions now have the wherewithal to make such loans.

“There has been a tightening of credit, but many of the financial institutions kind of broadly across the country now are holding record liquidity and have significantly more capital than they had before the downturn,” said Chris Gamaitoni, an analyst at Compass Point Research and Trading LLC. “And they are starting to get pressure to put that capital to use.”

Some analysts said the renewed focus on jumbo loans will also help lenders attract the lucrative affluent client and be able to place them in other products.

“A lot of financial services companies increasingly view the mortgage as an important relationship-oriented product,” said Mary Beth Sullivan, a managing partner at Capital Performance Group LLC, a Washington management consulting firm. “I think you are seeing how credit, especially for the more affluent consumer, could be leading the charge for new customers.”

What about the inherent risks in adjustable rates and interest-only features?

“It’s not bad if they’re done with the pre-bubble underwriting standards,” Gamaitoni said. “A hybrid ARM on a jumbo loan is not necessarily a terrible product at all. ... All those products have been around for a long period of time and worked relatively well until basically we moved in to giving those loans to people who had no shot to repay.”

Citigroup today is launching a 30-year fixed jumbo mortgage with a 5.625% interest rate — well below recent prevailing rates in the 6% range — and a five-year hybrid adjustable rate jumbo mortgage with a 4.875% rate.

The idea, Das said, is to “energize that end of the market so we continue to create liquidity in the housing market. We know that it will eventually flow to the rest of the market.”

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