FLAGSTAR BANCORP INC
Form 10-Q
November 06, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2017
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _________ to _________

Commission File Number: 001-16577

(Exact name of registrant as specified in its charter).

Michigan	38-3150651
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)
5151 Corporate Drive, Troy, Michigan	48098-2639
(Address of principal executive offices)	(Zip code)

(248) 312-2000
(Registrant’s telephone number, including area code)

Not applicable
(Former name, former address and formal fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ý No ¨.
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	ý
Non-accelerated filer	o (Do not check if smaller reporting company)	Smaller reporting company	¨
		Emerging growth company	¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act ¨.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No ý.

As of November 2, 2017, 57,181,536 shares of the registrant’s common stock, $0.01 par value, were issued and outstanding.

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GLOSSARY OF ABBREVIATIONS AND ACRONYMS

The following list of abbreviations and acronyms are provided as a tool for the reader and may be used throughout this Report, including the Consolidated Financial Statements and Notes:

Term	Definition	Term	Definition
AFS	Available for Sale	HELOC	Home Equity Lines of Credit
Agencies	Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and Government National Mortgage Association, Collectively	HELOAN	Home Equity Loan
ALCO	Asset Liability Committee	Home equity	second mortgages, HELOANs, HELOCs
ALLL	Allowance for Loan & Lease Losses	HTM	Held to Maturity
AOCI	Accumulated Other Comprehensive Income (Loss)	LIBOR	London Interbank Offered Rate
ASU	Accounting Standards Update	LHFI	Loans Held-for-Investment
Basel III	Basel Committee on Banking Supervision Third Basel Accord	LHFS	Loans Held-for-Sale
C&I	Commercial and Industrial	LTV	Loan-to-Value
CDARS	Certificates of Deposit Account Registry Service	Management	Flagstar Bancorp’s Management
CFPB	Consumer Financial Protection Bureau	MBIA	MBIA Insurance Corporation
CLTV	Combined Loan to Value	MBS	Mortgage-Backed Securities
Common Stock	Common Shares	MD&A	Management's Discussion and Analysis
CRE	Commercial Real Estate	MSR	Mortgage Servicing Rights
DFAST	Dodd-Frank Stress Test	N/A	Not Applicable
DOJ	United States Department of Justice	NYSE	New York Stock Exchange
DTA	Deferred Tax Asset	OCC	Office of the Comptroller of the Currency
EVE	Economic Value of Equity	OTTI	Other-Than-Temporary-Impairment
Fannie Mae/FNMA	Federal National Mortgage Association	QTL	Qualified Thrift Lending
FASB	Financial Accounting Standards Board	RWA	Risk Weighted Assets
FDIC	Federal Deposit Insurance Corporation	SEC	Securities and Exchange Commission
FEMA	Federal Emergency Management Agency	SFR	Single Family Residence
FHA	Federal Housing Administration	TARP Preferred	Troubled Asset Relief Program Fixed Rate Cumulative Perpetual Preferred Stock, Series C
FHLB	Federal Home Loan Bank	TDR	Trouble Debt Restructuring
FICO	Fair Isaac Corporation	UPB	Unpaid Principal Balance
FRB	Federal Reserve Bank	U.S. Treasury	United States Department of Treasury
Freddie Mac	Federal Home Loan Mortgage Corporation	VIE	Variable Interest Entities
FTE	Full Time Equivalent	XBRL	eXtensible Business Reporting Language
GAAP	United States Generally Accepted Accounting Principles		

PART I. FINANCIAL INFORMATION
ITEM 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following is Management's Discussion and Analysis of the financial condition and results of operations of Flagstar Bancorp, Inc. for the third quarter of 2017, which should be read in conjunction with the financial statements and related notes set forth in Part I, Item 1 of this Form 10-Q and Part II, Item 8 of Flagstar Bancorp, Inc.'s 2016 Annual Report on Form 10-K for the year ended December 31, 2016.

Certain statements in this Form 10-Q, including but not limited to statements included within the Management’s Discussion and Analysis of Financial Condition and Results of Operations, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. These statements are based on the current beliefs and expectations of our management. Actual results may differ from those set forth in forward-looking statements. See Forward-Looking Statements on page 38 of this Form 10-Q and Part I, Item 1A, Risk Factors of Flagstar Bancorp, Inc.'s 2016 Annual Report or Form 10-K for the year ended December 31, 2016. Additional information about Flagstar can be found on our website at www.flagstar.com.

Where we say "we," "us," "our," the "Company," "Bancorp" or "Flagstar," we usually mean Flagstar Bancorp, Inc. However, in some cases, a reference to "we," "us," "our," the "Company" or "Flagstar" will include our wholly-owned subsidiary Flagstar Bank, FSB (the "Bank"). See the Glossary of Abbreviations and Acronyms on page 3 for definitions used throughout this Form 10-Q.

Introduction

We are a leading Michigan-based savings and loan holding company founded in 1993. Our business is primarily conducted through our principal subsidiary, the Bank, a federally chartered stock savings bank founded in 1987. Based on our assets at September 30, 2017, we are one of the largest banks headquartered in Michigan, providing commercial, small business, and consumer banking services, and the 5th largest bank mortgage originator in the nation. At September 30, 2017, we had 3,495 full-time equivalent employees inclusive of account executives and loan officers. Our common stock is listed on the NYSE under the symbol "FBC." As of September 30, 2017, we are considered a controlled company for NYSE purposes, because approximately 62.3 percent of our common stock is owned by MP Thrift Investments, L.P. which is managed by MatlinPatterson, a leading global alternative asset manager.

We have a unique, relationship-based business model which leverages our full-service bank’s capabilities with our national mortgage customer base to create and build enduring commercial relationships with growth opportunities. Our banking network emphasizes the delivery of a complete set of banking and mortgage products and services and we distinguish ourselves by crafting specialized solutions for our customers, local delivery, high quality customer service and competitive product pricing. Our community bank growth model has focused on attracting seasoned bankers with larger, regional bank lending experience who can bring their long-term customer relationships to Flagstar. At September 30, 2017, we operated 99 full service banking branches throughout Michigan's major markets where we offer a full set of banking products to consumer, commercial, and government customers.

We originate mortgages through a wholesale network of brokers and correspondents in all 50 states, as well as 95 retail locations in 27 states, representing the combined retail branches of Flagstar and Opes Advisors' mortgage division. The Bank has the opportunity to expand these relationships by providing warehouse lending, mortgage servicing and other services to our third party originators. Servicing and subservicing of loans provides fee income and generates a stable long-term source of funding through company controlled deposits.

We believe our transformation into a strong commercial bank, our flexible mortgage servicing platform, and focus on service creates a significant competitive advantage in the markets in which we compete. The management team we have assembled is focused on developing substantial and attractive growth opportunities that generate profitable results from operations. We believe our lower risk profile and strong capital level position us to take advantage of opportunities to deliver attractive shareholder returns over the long term.

Operating Segments

Our operations are conducted through our three operating segments: Community Banking, Mortgage Originations, and Mortgage Servicing. Additionally, our Other segment includes the remaining reported activities. For additional information, please see MD&A - Operating Segments and Note 19 - Segment Information.

Selected Financial Ratios
(Dollars in millions, except share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016 (1)	2017	2016 (1)
Selected Mortgage Statistics:				
Mortgage rate lock commitments (fallout-adjusted) (2)	$8,898	$8,291	$23,896	$23,281
Mortgage loans sold and securitized	8,924	8,723	22,397	23,611
Selected Ratios:				
Interest rate spread	2.58 %	2.36 %	2.56 %	2.43 %
Net interest margin	2.78 %	2.58 %	2.74 %	2.62 %
Return on average assets	0.99 %	1.61 %	0.94 %	1.40 %
Return on average equity	11.10 %	16.53 %	10.23 %	12.59 %
Return on average common equity	11.10 %	17.45 %	10.23 %	14.52 %
Equity/assets ratio (average for the period)	8.95 %	9.75 %	9.16 %	11.05 %
Efficiency ratio	73.5 %	59.9 %	73.9 %	66.9 %
Effective tax provision rate	32.4 %	34.3 %	32.3 %	33.8 %
Average Balances:				
Average common shares outstanding	57,162,025	56,580,238	57,062,696	56,556,188
Average fully diluted shares outstanding	58,186,593	57,933,806	58,133,296	57,727,262
Average interest-earning assets	$14,737	$12,318	$13,709	$11,944
Average interest paying liabilities	$12,297	$9,773	$11,481	$9,600
Average stockholders' equity	$1,471	$1,379	$1,412	$1,515

	September 30, 2017	December 31, 2016	September 30, 2016 (1)
Selected Statistics:			
Book value per common share	$ 25.38	$ 23.50	$ 22.72
Tangible book value per share (3)	$ 25.01	$ 23.50	$ 22.72
Number of common shares outstanding	57,181,536	56,824,802	56,597,271
Equity-to-assets ratio	8.60 %	9.50 %	9.01 %
Common equity-to-assets ratio	8.60 %	9.50 %	9.01 %
Capitalized value of MSRs	1.15 %	1.07 %	0.96 %
Bancorp Tier 1 leverage (to adjusted avg. total assets) (4)	8.80 %	8.88 %	8.88 %
Bank Tier 1 leverage (to adjusted avg. total assets)	9.38 %	10.52 %	10.55 %
Number of banking centers	99	99	99
Number of FTE	3,495	2,886	2,881

(1) Includes redemption of TARP Preferred occurring on July 29, 2016, which resulted in a reduction of $372 million in stockholder's equity. Also, includes $250 million issuance of 6.125% Senior Note occurring on July 11, 2016, which was used to redeem and bring current the dividends on the TARP Preferred.

(2) Fallout adjusted refers to mortgage rate lock commitments which are adjusted by a percentage of mortgage loans in the pipeline that are not expected to close based on previous historical experience and the level of interest rates.

(3) Excludes goodwill and intangibles of $21 million, zero, and zero at September 30, 2017, December 31, 2016, and September 30, 2016, respectively, included in Other Assets on the Consolidated Statement of Financial Condition. See Non-GAAP Financial Measures for further information.

(4) Basel III transitional.

Executive Overview

The third quarter 2017 resulted in solid earnings of $40 million, or $0.70 per diluted share. Our transformation into a strong commercial bank continued this quarter. In the nine months ended September 30, 2017, net interest income was $47 million on average earning asset growth of $1.8 billion, or 15 percent led by increases in our commercial loan portfolio. The expansion of our commercial loan portfolio has generated net interest income growth and provides earnings stability in a challenging mortgage environment. We also continued to maintain solid liquidity and disciplined deposit growth, which saw total average deposits increase $244 million, or 3 percent in the first nine months of 2017 driven by higher retail deposits.

Even in the currently challenging mortgage market, our mortgage closings increased 3 percent in the nine months ended September 30, 2017 compared to the first nine months ended September 30, 2016 driven by our 2017 acquisitions of Opes Advisors (Opes) and the delegated correspondent business of Stearns Lending (Stearns). Our gain on loan sale margin was 84 basis points at September 30, 2017 reflecting the increase in distributed retail due to the integration of Opes. We believe this shift in mix should positively impact our gain on sale margin going forward.

Our noninterest expense increased $47 million in the first nine months ended September 30, 2017 compared to the nine months ended September 30, 2016 largely due to our ongoing growth initiatives and operating expenses from Opes. The remaining expenses, associated with balance sheet expansion and growing Community Bank revenues, reflected our cost discipline and had a very low, incremental efficiency ratio. Credit costs were negligible, as net charge-offs, nonperforming loans and delinquencies remain at very low levels.

The federal banking agencies issued a notice of proposed rulemaking (NPR) regarding several proposed simplifications of the Basel III capital rules. If enacted as proposed, these changes would accelerate the capital formation necessary to support further balance sheet growth, improve our capital flexibility to better manage the uncertainties of the MSR market and allow us to hold more MSRs which are a high yielding asset that we fund efficiently and hedge well. We believe this should improve our position to continue to execute on our business strategy, matching superior asset generation capabilities, supported by the capital and liquidity to grow the Bank prudently, thereby creating value for our shareholders.

Earnings Performance

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2017	2016	Change	2017	2016	Change
	(Dollars in millions, except share data)					
Net interest income	$103	$80	$23	$283	$236	$47
Provision (benefit) for loan losses	2	7	(5)	4	(9)	13
Total noninterest income (1)	130	156	(26)	346	389	(43)
Total noninterest expense	171	142	29	465	418	47
Provision for income taxes	20	30	(10)	52	73	(21)
Net income	$40	$57	$(17)	$108	$143	$(35)
Income per share						
Basic	$0.71	$0.98	$(0.27)	$1.90	$2.21	$(0.31)
Diluted	$0.70	$0.96	$(0.26)	$1.86	$2.16	$(0.30)

(1)

Included in both the three and nine months ended September 30, 2016 is a $24 million benefit ($16 million after tax benefit) related to a decrease in the fair value of the Department of Justice ("DOJ") settlement liability.

Net income decreased $17 million for the three months ended September 30, 2017, compared to the three months ended September 30, 2016. Net interest income increased $23 million for the three months ended September 30, 2017, compared to the three months ended September 30, 2016 primarily driven by a $2.4 billion increase in interest-earning assets led by strong commercial loan growth and higher LHFS along with an increase in average rates. The improvement in net interest income was more than offset by a $29 million increase in noninterest expense primarily driven by ongoing growth initiatives and operating expenses associated with the recent acquisition of Opes and a $26 million decrease in noninterest income primarily resulting from a $24 million decrease in the fair value of the DOJ settlement liability we recognized in the third quarter of 2016.

Net income decreased $35 million for the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016. Net interest income increased $47 million for the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016, primarily driven by growth in interest-earning assets, partially offset by a $9 million increase in interest expense related to our Senior Notes which were issued in the third quarter 2016 to fund the redemption of our TARP Preferred. The increase in net interest income was offset by an increase in noninterest expense of $47 million, primarily driven by an increase in operating expenses associated with our 2017 acquisitions of Opes and Stearns. In addition, we had a decrease in noninterest income of $43 million, primarily due to lower net gain on loan sales and a $24 million decrease in the fair value of the DOJ settlement liability recognized in the third quarter of 2016. In the nine months ended September 30, 2017, our provision for loan losses of $4 million reflects the strong credit quality of our loan portfolios and the sustained low level of net charge-offs. The $9 million benefit for loan losses for the nine months ended September 30, 2016 resulted primarily from the sale of $1.2 billion UPB of performing residential first mortgage loans and $110 million UPB of nonperforming, TDR and non-agency loans.

Net Interest Income

The following tables present, on a consolidated basis, interest income from average assets and liabilities, expressed in dollars and yields:

	Three Months Ended September 30,					
	2017			2016		
	Average Balance	Interest	Annualized Yield/ Rate	Average Balance	Interest	Annualized Yield/ Rate
	(Dollars in millions)					
Interest-Earning Assets						
Loans held-for-sale	$4,476	$ 45	3.99 %	$3,416	$ 30	3.51 %
Loans held-for-investment						
Residential first mortgage	2,594	22	3.32 %	2,090	17	3.17 %
Home equity	486	6	5.11 %	460	6	5.03 %
Other	26	—	4.52 %	30	—	4.59 %
Total Consumer loans	3,106	28	3.61 %	2,580	23	3.52 %
Commercial Real Estate	1,646	19	4.43 %	1,082	9	3.43 %
Commercial and Industrial	1,073	13	4.77 %	633	7	4.27 %
Warehouse Lending	978	12	4.82 %	1,553	17	4.21 %
Total Commercial loans	3,697	44	4.63 %	3,268	33	3.96 %
Total loans held-for-investment (1)	6,803	72	4.16 %	5,848	56	3.77 %
Loans with government guarantees	264	3	4.58 %	432	4	3.88 %
Investment securities	3,101	20	2.58 %	2,516	16	2.55 %
Interest-earning deposits	93	—	1.23 %	106	—	0.48 %
Total interest-earning assets	14,737	140	3.77 %	12,318	106	3.42 %
Other assets	1,702			1,830		
Total assets	$16,439			$14,148		
Interest-Bearing Liabilities						
Retail deposits						
Demand deposits	$489	$ —	0.14 %	$509	$ —	0.20 %
Savings deposits	3,838	7	0.76 %	3,751	8	0.77 %
Money market deposits	276	—	0.57 %	250	—	0.41 %
Certificates of deposit	1,182	4	1.19 %	1,071	3	1.05 %
Total retail deposits	5,785	11	0.78 %	5,581	11	0.75 %
Government deposits						
Demand deposits	250	—	0.43 %	243	—	0.39 %
Savings deposits	362	1	0.71 %	478	1	0.52 %
Certificates of deposit	329	1	0.89 %	355	—	0.52 %
Total government deposits	941	2	0.70 %	1,076	1	0.49 %
Wholesale deposits and other	35	—	1.49 %	—	—	—%
Total interest-bearing deposits	6,761	13	0.78 %	6,657	12	0.71 %
Short-term Federal Home Loan Bank advances and other	3,809	11	1.17 %	1,073	1	0.44 %
Long-term Federal Home Loan Bank advances	1,234	6	1.99 %	1,576	7	1.81 %
Other long-term debt	493	7	5.09 %	467	6	4.86 %
Total interest-bearing liabilities	12,297	37	1.19 %	9,773	26	1.06 %
Noninterest-bearing deposits (2)	2,244			2,469		
Other liabilities	427			527		
Stockholders’ equity	1,471			1,379		
Total liabilities and stockholders' equity	$16,439			$14,148		

Net interest-earning assets	$2,440			$2,545		
Net interest income		$ 103			$ 80	
Interest rate spread (3)		2.58	%		2.36	%
Net interest margin (4)		2.78	%		2.58	%
Ratio of average interest-earning assets to interest-bearing liabilities		119.9	%		126.0	%

(1) Includes nonaccrual loans, for further information relating to nonaccrual loans, see Note 4 - Loans Held-for-Investment.

(2) Includes noninterest-bearing company controlled deposits that arise due to the servicing of loans for others.

(3) Interest rate spread is the difference between rates of interest earned on interest-earning assets and rates of interest paid on interest-bearing liabilities.

(4) Net interest margin is net interest income divided by average interest-earning assets.

	Nine Months Ended September 30,							
	2017				2016			
	Average Balance	Interest	Annualized Yield/ Rate		Average Balance	Interest	Annualized Yield/ Rate	
	(Dollars in millions)							
Interest-Earning Assets								
Loans held-for-sale	$4,014	$ 119	3.96	%	$3,071	$ 83	3.64	%
Loans held-for-investment								
Residential first mortgage	2,497	62	3.34	%	2,365	56	3.14	%
Home equity	453	17	5.04	%	485	19	5.23	%
Other	26	1	4.52	%	29	1	4.82	%
Total Consumer loans	2,976	80	3.61	%	2,879	76	3.51	%
Commercial Real Estate	1,482	47	4.15	%	936	24	3.40	%
Commercial and Industrial	929	33	4.71	%	601	19	4.12	%
Warehouse Lending	840	30	4.70	%	1,279	41	4.25	%
Total Commercial loans	3,251	110	4.45	%	2,816	84	3.94	%
Total loans held-for-investment (1)	6,227	190	4.05	%	5,695	160	3.72	%
Loans with government guarantees	300	10	4.41	%	450	12	3.40	%
Investment securities	3,093	59	2.55	%	2,589	50	2.58	%
Interest-earning deposits	75	1	1.08	%	139	1	0.50	%
Total interest-earning assets	13,709	379	3.68	%	11,944	306	3.40	%
Other assets	1,697				1,767			
Total assets	$15,406				$13,711			
Interest-Bearing Liabilities								
Retail deposits								
Demand deposits	$502	$ 1	0.16	%	$479	$ 1	0.17	%
Savings deposits	3,899	22	0.76	%	3,720	21	0.78	%
Money market deposits	264	1	0.49	%	285	1	0.44	%
Certificates of deposit	1,116	9	1.12	%	789	7	1.21	%
Total retail deposits	5,781	33	0.76	%	5,273	30	0.77	%
Government deposits								
Demand deposits	228	1	0.41	%	234	1	0.39	%
Savings deposits	410	2	0.59	%	432	2	0.52	%
Certificates of deposit	314	1	0.73	%	563	1	0.35	%
Total government deposits	952	4	0.59	%	1,229	4	0.42	%
Wholesale deposits and other	16	—	1.21	%	—	—	—	%
Total interest-bearing deposits	6,749	37	0.74	%	6,502	34	0.70	%
Short-term Federal Home Loan Bank advances and other	3,028	23	1.01	%	1,190	4	0.41	%
Long-term Federal Home Loan Bank advances	1,211	17	1.92	%	1,587	22	1.88	%
Other long-term debt	493	19	5.06	%	321	10	4.05	%
Total interest-bearing liabilities	11,481	96	1.12	%	9,600	70	0.97	%
Noninterest-bearing deposits (2)	2,098				2,101			
Other liabilities	415				495			
Stockholders’ equity	1,412				1,515			
Total liabilities and stockholders' equity	$15,406				$13,711			
Net interest-earning assets	$2,228				$2,344			
Net interest income		$ 283				$ 236		
Interest rate spread (3)			2.56	%			2.43	%
Net interest margin (4)			2.74	%			2.62	%

Ratio of average interest-earning assets to interest-bearing liabilities	119.4 %	124.4 %

(1) Includes nonaccrual loans, for further information relating to nonaccrual loans, see Note 4 - Loans Held-for-Investment.

(2) Includes noninterest-bearing company controlled deposits that arise due to the servicing of loans for others.

(3) Interest rate spread is the difference between rates of interest earned on interest-earning assets and rates of interest paid on interest-bearing liabilities.

(4) Net interest margin is net interest income divided by average interest-earning assets.

Rate/Volume Analysis

The following tables present the dollar amount of changes in interest income and interest expense for the components of interest-earning assets and interest-bearing liabilities. The table distinguishes between the changes related to average outstanding balances (changes in volume while holding the initial rate constant) and the changes related to average interest rates (changes in average rates while holding the initial balance constant). The rate/volume variances are allocated to rate.

	Three Months Ended September 30, 2017 Versus 2016 Increase (Decrease) Due to:		
	Rate	Volume	Total
	(Dollars in millions)		
Interest-Earning Assets			
Loans held-for-sale	$6	$ 9	$15
Loans held-for-investment			
Residential first mortgage	1	4	5
Total Consumer loans	1	4	5
Commercial Real Estate	5	5	10
Commercial and Industrial	1	5	6
Warehouse Lending	1	(6)	(5)
Total Commercial loans	7	4	11
Total loans held-for-investment	8	8	16
Loans with government guarantees	1	(2)	(1)
Investment securities	—	4	4
Total interest-earning assets	$15	$ 19	$34
Interest-Bearing Liabilities			
Interest-bearing deposits	$1	$ —	$1
Short-term Federal Home Loan Bank advances and other	7	3	10
Long-term Federal Home Loan Bank advances	1	(2)	(1)
Other long-term debt	—	1	1
Total interest-bearing liabilities	9	2	11
Change in net interest income	$6	$ 17	$23

	Nine Months Ended September 30, 2017 Versus 2016 Increase (Decrease) Due to:		
	Rate	Volume	Total
	(Dollars in millions)		
Interest-Earning Assets			
Loans held-for-sale	$10	$ 26	$36
Loans held-for-investment			
Residential first mortgage	3	3	6
Home equity	—	(2)	(2)
Total Consumer loans	3	1	4

Commercial Real Estate	9	14	23
Commercial and Industrial	4	10	14
Warehouse Lending	3	(14)	(11)
Total Commercial loans	16	10	26
Total loans held-for-investment	19	11	30
Loans with government guarantees	2	(4)	(2)
Investment securities	(1)	10	9
Total interest-earning assets	$30	$ 43	$73
Interest-Bearing Liabilities			
Interest-bearing deposits	$1	$ 2	$3
Short-term Federal Home Loan Bank advances and other	14	5	19
Long-term Federal Home Loan Bank advances	—	(5)	(5)
Other long-term debt	4	5	9
Total interest-bearing liabilities	19	7	26
Change in net interest income	$11	$ 36	$47

Comparison to Prior Year Quarter

Net interest income increased $23 million or 29 percent for the three months ended September 30, 2017, compared to the same period in 2016. This increase was primarily driven by growth in interest-earning assets and an increase in average rates within the LHFI and LHFS portfolios. This was partially offset by an increase in average rates and average balance on short-term FHLB advances.

Our net interest margin for the three months ended September 30, 2017 was 2.78 percent, compared to 2.58 percent for the three months ended September 30, 2016. The net 20 basis point increase was driven by an increase in higher yielding commercial loans and higher interest income on LHFS. This increase was partially offset by higher average rates on short-term FHLB advances.

For the three months ended September 30, 2017 as compared to the three months ended September 30, 2016, total interest-earning assets increased $2.4 billion to $14.7 billion, led by growth in LHFS primarily due to accumulation of loans in support of residential mortgage backed securitizations. Additionally, the $955 million increase in LHFI average balance was primarily driven by a $526 million increase in consumer loans through the addition of high quality jumbo loans and HELOCs and a $429 million increase in average commercial loans was consistent with our strategy to grow the community bank. Average warehouse loans have decreased $575 million which is more than offset by increases in our C&I and CRE portfolios demonstrating our shift to higher yielding loans.

Average interest-bearing liabilities increased $2.5 billion for the three months ended September 30, 2017, compared to the three months ended September 30, 2016. The increase was primarily driven by a $2.7 billion increase in short-term FHLB advances used to fund our most liquid assets including LHFS.

Comparison to Prior Year to Date

Net interest income increased $47 million for the nine months ended September 30, 2017, compared to the same period in 2016, primarily driven by growth in interest-earning assets, led by an increase in LHFS, and an increase in average rates. This was partially offset by an increase in average rates and average balances of borrowings, primarily related to short-term FHLB advances and the issuance of our Senior Notes in the third quarter 2016.

Our net interest margin for the nine months ended September 30, 2017 was 2.74 percent, compared to 2.62 percent for the nine months ended September 30, 2016. The net 12 basis point increase was positively impacted by an increase in market rates, a higher yielding commercial loan portfolio and stable core deposits. This improvement was partially offset by higher rates on short-term FHLB advances driven by an increase in market rates and the issuance of our Senior Notes in the third quarter 2016.

For the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016, average interest-earning assets increased $1.8 billion, led by a $943 million increase in LHFS due to extending turn times and accumulation of loans in support of residential mortgage backed securitizations. The combined $939 million increase in average investment securities and average commercial loans was consistent with our strategy to grow the community bank and enhance the yield on our interest-earning assets. Commercial loans increased 15 percent due to growth in the CRE and C&I portfolios, including growth in home builder lending all of which more than offset the decrease in warehouse lending.

Average interest-bearing liabilities increased $1.9 billion for the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016. The increase was primarily driven by a net $1.5 billion increase in FHLB advances used to fund balance sheet growth, $247 million increase in total deposits and the issuance of our Senior Notes in the third quarter 2016.

Provision (Benefit) for Loan Losses

Comparison to Prior Year Quarter

The provision (benefit) for loan losses was a provision of $2 million during the three months ended September 30, 2017, compared to a provision of $7 million during the three months ended September 30, 2016. During the three months ended September 30, 2017, the $2 million provision reflects continued low level of net charge-offs and the strong credit quality of our loan portfolios. The $7 million provision during the three months ended September 30, 2016 was largely to reserve for loans with government guarantees.

Comparison to Prior Year to Date

The provision (benefit) for loan losses was a provision of $4 million for the nine months ended September 30, 2017, compared to a benefit of $9 million during the nine months ended September 30, 2016. The $4 million provision for the nine months ended September 30, 2017 reflects continued low level of net charge-offs and the strong credit quality of the loan portfolio. The $9 million benefit for the nine months ended September 30, 2016 resulted primarily from the sale of $1.2 billion UPB of performing residential first mortgage loans and $110 million UPB of nonperforming, TDR and non-agency loans.

For further information on the provision for loan losses see MD&A - Allowance for Loan Losses.

Noninterest Income

The following tables provide information on our noninterest income along with additional details related to our net gain on loan sales and other mortgage metrics:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2017	2016	Change	2017	2016	Change
	(Dollars in millions)					
Net gain on loan sales	$75	$94	$ (19)	$189	$259	$ (70)
Loan fees and charges	23	22	1	58	56	2
Deposit fees and charges	5	5	—	14	17	(3)
Loan administration income	5	4	1	16	14	2
Net return (loss)on mortgage servicing rights	6	(11)	17	26	(21)	47
Representation and warranty benefit	4	6	(2)	11	12	(1)
Other noninterest income	12	36	(24)	32	52	(20)
Total noninterest income	$130	$156	$ (26)	$346	$389	$ (43)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(Dollars in millions)			
Mortgage rate lock commitments (fallout-adjusted) (1)	$8,898	$8,291	$23,896	$23,281
Net margin on mortgage rate lock commitments (fallout-adjusted) (1) (2)	0.84 %	1.13 %	0.79 %	1.05 %
Gain on loan sales LHFS + net return (loss) on the MSR	$81	$83	$215	$223
Mortgage loans sold and securitized	8,924	8,723	22,397	23,611
Net margin on loans sold and securitized	0.84 %	1.08 %	0.84 %	1.03 %

(1) Fallout adjusted refers to mortgage rate lock commitments which are adjusted by a percentage of mortgage loans in the pipeline that are not expected to close based on our historical experience and the level of interest rates.

(2) Gain on sale margin is based on net gain on loan sales related to LHFS to fallout-adjusted mortgage rate lock commitments.

Comparison to Prior Year Quarter

Total noninterest income decreased $26 million during the three months ended September 30, 2017, compared to the same period in 2016.

Net gain on loan sales decreased $19 million during the three months ended September 30, 2017, compared to the three months ended September 30, 2016. The net gain on loan sales margin decreased 24 basis points with fallout adjusted lock yields decreasing 0.29 basis points to 0.84 percent primarily due to more competitive pricing. Lower margins were partially offset by a 7.3 percent increase in fallout adjusted mortgage locks driven primarily by the Opes and Stearns acquisitions that occurred in 2017.

Net return on MSRs (including the impact of economic hedges) increased $17 million during the three months ended September 30, 2017, compared to the three months ended September 30, 2016. The increase was primarily driven by improvements in fair value due to a more stable prepayment environment and improvements in our hedging program, partially offset by a decrease in service fee income resulting from lower MSR balance due to sales that occurred throughout 2017.

Other noninterest income decreased $24 million during the three months ended September 30, 2017, compared to the three months ended September 30, 2016 due to a $24 million reduction in the DOJ settlement liability that occurred in the third quarter of 2016.

Comparison to Prior Year to Date

Total noninterest income decreased $43 million during the nine months ended September 30, 2017, compared to the same period in 2016.

Net gain on loan sales decreased $70 million during the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016. The net gain on loan sales margin decreased 19 basis points primarily driven by more competitive pricing and our decision to extend turn times on sales of LHFS which shifts earnings from gain on sale to net interest income. During the nine months ended September 30, 2017, turn times on sales of LHFS were an average of 52 days compared to an average of 35 days during the nine months ended September 30, 2016. As of September 30, 2017, we continue to selectively decide whether to extend turn times on sale of LHFS if, in its estimation, such extensions provide favorable economics. The decrease in net gain on loan sales was also attributed to the sale of performing LHFI that occurred during the nine months ended September 30, 2016 which resulted in a $14 million gain. The decreases in net gain on loan sales were partially offset by a shift in mix which includes an increase in distributed retail due to the integration of Opes.

Deposit fees and charges decreased $3 million during the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016. The decrease was primarily due to lower exchange fee income resulting from limitations set by the Durbin amendment, which became applicable to the Bank on July 1, 2016.

Net return on MSRs was $26 million for the nine months ended September 30, 2017, compared to a loss of $21 million during the nine months ended September 30, 2016. The $47 million increase was primarily driven by a more stable prepayment environment and improvements in our hedging program, partially offset by lower servicing fee income resulting from a lower MSR balance and higher transaction costs driven by MSR sales that occurred in the first nine months of 2017. During the nine months ended September 30, 2017, we sold MSRs with a fair value of $260 million.

Other noninterest income decreased $20 million during the nine months ended September 30, 2017, compared to the nine months ended September 30, 2016. The decrease was primarily due to a $24 million reduction in the DOJ settlement liability that occurred in the third quarter of 2016.

Noninterest Expense

The following table sets forth the components of our noninterest expense:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2017	2016	Change	2017	2016	Change
	(Dollars in millions)					
Compensation and benefits	$76	$69	$7	$219	$ 203	$ 16
Commissions	23	16	7	49	40	9
Occupancy and equipment	28	21	7	75	64	11
Loan processing expense	15	13	2	41	40	1
Legal and professional expense	7	5	2	22	20	2

Other noninterest expense	22	18	4	59	51	8
Total noninterest expense	$171	$142	$29	$465	$418	$47
Efficiency ratio	73.5 %	59.9 %	13.6 %	73.9 %	66.9 %	7.0 %

	September 30, 2017	June 30, 2017	Change	September 30, 2017	December 31, 2016	Change
Number of FTE	3,495	3,432	63	3,495	2,886	609

Comparison to Prior Year Quarter

Noninterest expense increased $29 million to $171 million during the three months ended September 30, 2017, compared to $142 million during the three months ended September 30, 2016. The increase is driven by growth initiatives and operating expenses associated with the recent acquisition of Opes which will support future revenue growth. Increases in those related expenses include an increase in compensation and benefits due to higher headcount, an increase in commissions attributable to increased loan production, and an increase in occupancy and equipment costs to support the capital needs of our expanded business.

Comparison to Prior Year to Date

Noninterest expense increased $47 million to $465 million during the nine months ended September 30, 2017, compared to $418 million during the nine months ended September 30, 2016. The increase was primarily driven by higher operating expenses associated with growth initiatives and our 2017 acquisitions of Opes and Stearns, including an increase in compensation and benefits due to an increase in headcount and higher commissions. Additionally, noninterest expense increased as a result of higher occupancy and equipment to support the capital needs of our expanded business and an increase in advertising related to a direct mail and brand awareness campaign.

Provision (benefit) for Income Taxes

Our provision for income taxes for the three and nine months ended September 30, 2017 was $20 million and $52 million, respectively, compared to a provision of $30 million and $73 million during the three and nine months ended September 30, 2016, respectively.

Our effective tax provision rate for the three and nine months ended September 30, 2017 was 32.4 percent and 32.3 percent, respectively, compared to 34.3 percent and 33.8 percent for the three and nine months ended September 30, 2016, respectively.

Our effective tax provision rate for the three and nine months ended September 30, 2017 differs from the combined federal and state statutory tax rate primarily due to a benefit from tax-exempt earnings, partially offset by nondeductible expenses.

For further information, see Note 15 - Income Taxes.

Loan Originations, Sales and Servicing

The majority of our total loan originations during the nine months ended September 30, 2017 represented mortgage loans that were collateralized by residential first mortgages on single-family residences and were eligible for sale to the Agencies. During the nine months ended September 30, 2017, sales of loans totaled $22.4 billion, or 90.8 percent of originations compared to $23.6 billion, or 99.0 percent of originations during the nine months ended September 30, 2016, with the decrease primarily due to the accumulation of loans in support of our residential mortgage backed securitizations. As of September 30, 2017, we had outstanding commitments to sell $6.6 billion of mortgage loans. Generally, these commitments are funded within 120 days. At September 30, 2017 and December 31, 2016, consumer LHFS totaled $4.9 billion and $3.2 billion, respectively, which are primarily residential mortgage loans. The $1.7 billion increase is the result of seasonally higher mortgage activity and the accumulation of loans in support of our next residential mortgage backed securitization.

On October 31, 2017, the Company closed on a securitization of $576 million of residential mortgage-backed certificates (RMBS) issued by Flagstar Mortgage Trust 2017-2 (FSMT 2017-2). On July 31, 2017, the Company closed on a securitization of $444 million of RMBS issued by Flagstar Mortgage Trust 2017-1 (FSMT 2017-1). Both loan sales are comprised of loans Flagstar originated through our retail, broker and correspondent channels. The collateral consists of high-quality 15 to 30 year, fully amortizing conforming and jumbo fixed-rate loans.

In addition, we originate or purchase residential first mortgage loans, other consumer loans, and commercial loans for our LHFI portfolios. Our revenues include noninterest income from sales of residential first mortgages to the Agencies, net interest income, and revenue from servicing of loans for others.

We utilize multiple production channels to originate or acquire mortgage loans on a national scale to generate high returns on capital. This helps grow the servicing business and provides stable, low cost funding for the Community Bank segment. We continue to leverage technology to streamline the mortgage origination process, thereby bringing service and convenience to borrowers and correspondents. We also continue to make available to our customers various web-based tools that facilitate the mortgage loan process through each of our production channels. We intend to continue to seek new ways to expand our relationships with borrowers and correspondents to provide the necessary capital and liquidity to grow the Mortgage Servicing and the Community Bank segments.

The following table presents loan originations by portfolio:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(Dollars in millions)			
Consumer loans				
Residential first mortgage	$9,572	$9,192	$24,659	$23,856
Home equity (1)	94	50	225	137
Total consumer loans	9,666	9,242	24,884	23,993
Commercial loans (2)	265	248	932	496
Total loan originations	$9,931	$9,490	$25,816	$24,489

(1) Includes second mortgage loans, HELOC loans, and other consumer loans.
(2) Includes commercial real estate and commercial and industrial loans.

Additionally, our Mortgage Servicing segment provides servicing of residential mortgages for our own LHFI portfolio and may service or subservice loans which we have sold or securitized. Mortgage loans are serviced and subserviced for others on a fee for service basis and we may also collect ancillary fees and earn income through the use of noninterest-bearing escrows. Revenue for those serviced and subserviced loans is earned on a contractual fee basis, with the fees varying based on our responsibilities and the status of the underlying loans.

The following table presents the UPB (net of write downs) of residential loans serviced and subserviced and the number of accounts associated with those loans.

	September 30, 2017		December 31, 2016	
	Amount	Number of accounts	Amount	Number of accounts
	(Dollars in millions)			
Residential loan servicing				
Serviced for own loan portfolio (1)	$7,376	31,135	$5,816	29,244
Serviced for others	21,342	87,215	31,207	133,270
Subserviced for others (2)	62,351	296,913	43,127	220,075
Total residential loans serviced	$91,069	415,263	$80,150	382,589

(1) Includes LHFI (residential first mortgage and home equity), LHFS (residential first mortgage), loans with government guarantees (residential first mortgage), and repossessed assets.
(2) Includes temporary short-term subservicing performed as a result of sales of servicing-released MSRs. Includes repossessed assets.

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OPERATING SEGMENTS

Overview

For detail on each segment's objectives, strategies, and priorities, please read this section in conjunction with Note 19 - Segment Information, and other sections of this report for a full understanding of our consolidated financial performance.

The following table presents net income (loss) by operating segment:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2017	2016	Change	2017	2016	Change
	(Dollars in millions)					
Community Banking	$10	$7	$ 3	$26	$34	$ (8)
Mortgage Originations	31	39	(8)	87	99	(12)
Mortgage Servicing	(4)	(3)	(1)	(12)	(9)	(3)
Other	3	14	(11)	7	19	(12)
Total net income	$40	$57	$ (17)	$108	$143	$ (35)

Community Banking

Comparison to Prior Year Quarter

During the three months ended September 30, 2017, the Community Banking segment reported net income of $10 million, compared to $7 million for the three months ended September 30, 2016. The increase in net income was primarily due to a $9 million increase in net interest income from higher average loan balances, led by growth in commercial loans and higher average loan yields as well as a $6 million improvement in provision for loan losses due to improved credit quality. These increases were partially offset by a $7 million increase in noninterest expense driven by higher volume-driven expenses and growth initiatives which will support future revenue growth.

Comparison to Prior Year to Date

During the nine months ended September 30, 2017, the Community Banking segment reported net income of $26 million, compared to $34 million for the nine months ended September 30, 2016. The $8 million decrease in net income was primarily due to a $15 million decrease in net gain on loans sales and a $12 million increase in provision for loan losses, primarily resulting from the sale of performing residential loans out of the LHFI portfolio during the nine months ended September 30, 2016. These decreases were partially offset by a $21 million increase in net interest income due to loan growth, led by an increase in commercial loans and higher average loan yields.

Mortgage Originations

Comparison to Prior Year Quarter

The Mortgage Originations segment's net income decreased $8 million to $31 million during the three months ended September 30, 2017, compared to $39 million in the three months ended September 30, 2016. The decrease was primarily due to a $24 million increase in noninterest expense during the three months ended September 30, 2017, primarily driven by higher compensation and benefits due to growth initiatives and higher commissions resulting from higher loan production. Additionally, the net gain on loans sales decreased $16 million driven by a 29 basis point decrease in margin resulting from a more competitive market and product mix. These decreases in net income were partially offset by a $17 million increase in the net return on MSRs driven by increases in the interest rate environment experienced during the third quarter of 2017 which resulted in lower prepayments and favorable fair value adjustments, as well as a $10 million increase in net interest income primarily due to an increase in mortgage volume and the benefit of extended turn times which shifts earnings from gain on sale to net interest income.

Comparison to Prior Year to Date

The Mortgage Originations segment's net income decreased $12 million to $87 million during the nine months ended September 30, 2017, compared to $99 million in the nine months ended September 30, 2016. The decrease was primarily due to a $55 million decrease in net gain on loan sales driven by a 26 basis point decrease in margin resulting from product mix and a more competitive market. Other noninterest expense increased $39 million primarily due to higher operating expenses associated with growth initiatives, which include an increase in compensation and benefits and higher commissions resulting from an increase in mortgage volume. These decreases in net income were partially offset by a $47 million increase in net return on MSRs primarily due to an increase in the interest rate environment in the first nine months of 2017 which resulted in lower prepayments and favorable fair value adjustments. Net interest income increased $29 million primarily resulting from an increase in mortgage activity and the benefit of extending turn times.

Mortgage Servicing

Comparison to Prior Year Quarter

The Mortgage Servicing segment reported a net loss of $4 million for the three months ended September 30, 2017, compared to a net loss of $3 million for the three months ended September 30, 2016. The increase in net losses is primarily due to a decrease in loan administration income, partially offset by higher subservicing fees driven by an increase in average portfolio volume and an improvement in other noninterest expenses.

Comparison to Prior Year to Date

The Mortgage Servicing segment reported a net loss of $12 million for the nine months ended September 30, 2017, compared to a net loss of $9 million for the nine months ended September 30, 2016. The increase in net losses is primarily due to a decrease in loan administration income and a decrease in net interest income due to lower average company controlled deposits, partially offset by higher subservicing fees driven by higher average portfolio volume.

Other

Comparison to Prior Year Quarter

For the three months ended September 30, 2017, the Other segment's net income was $3 million, compared to net income of $14 million for the three months ended September 30, 2016. The $11 million decrease is primarily due to a $24 million decrease in the fair value of the DOJ settlement liability which was recorded in the third quarter of 2016. This decrease is partially offset by an increase in net interest income due to higher average investment balances due to the pulling ahead of planned purchases of investments to take advantage of a higher market return.

Comparison to Prior Year to Date

For the nine months ended September 30, 2017, the Other segment's net income was $7 million, compared to net income of $19 million for the nine months ended September 30, 2016. The $12 million decrease was primarily due a $24 million decrease in the fair value of the DOJ settlement liability which was recorded in the third quarter of 2016, partially offset by decrease in noninterest expense.

RISK MANAGEMENT

Like all financial services companies, we engage in business activities and assume the related risks. The risks we are subject to in the normal course of business include, but are not limited to, credit, regulatory compliance, legal, reputation, liquidity, market, operational, and strategic. We have made significant investments in our risk management activities which are focused on ensuring we properly identify, measure and manage such risks across the entire enterprise to maintain safety and soundness and maximize profitability. We hold capital to protect from the risk of unexpected loss.

A comprehensive discussion of risks affecting us can be found in the Risk Factors section included in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016. Some of the more significant processes used to manage and control credit, liquidity, market, and operational risks are described in the following paragraphs.

Credit Risk

Credit risk is the risk of loss to us arising from an obligor’s inability or failure to meet contractual payment or performance terms. We provide loans, extend credit, purchase securities, and enter into financial derivative contracts, all of which have related credit risk.

We maintain a strict credit limit, in compliance with regulatory requirements, in order to maintain a diversified loan portfolio and manage our credit exposure to any one borrower or obligor. Under the Home Owners Loan Act ("HOLA"), savings associations are generally subject to national bank limits on loans to one borrower. Generally, per HOLA, the Bank may not make a loan or extend credit to a single or related group of borrowers in excess of 15 percent of Tier 1 and Tier 2 capital plus any portion of the allowance for loan losses not included in Tier 2 capital. This lending limit was $249 million as of September 30, 2017. Flagstar maintains a maximum internal Bank limit of $100 million (commitment level) to any one borrower/obligor relationship, which is more conservative than the limit required by HOLA. All credit exposures that exceed $50 million must be approved by the Board of Directors.

The majority of our credit risk is associated with lending activities, as the acceptance and management of credit risk is central to profitable lending. We manage our credit risk by establishing sound credit policies for underwriting and adhering to well controlled processes. We utilize various credit risk management and monitoring activities to mitigate risks associated with loans that we hold, acquire, and originate.

Loans held-for-investment

The following table summarizes loans held-for-investment by category:

	September 30, 2017	December 31, 2016	Change
	(Dollars in millions)		
Consumer loans			
Residential first mortgage	$2,665	$ 2,327	$338
Home equity	496	443	53
Other	26	28	(2)
Total consumer loans	3,187	2,798	389
Commercial loans			
Commercial real estate (1)	1,760	1,261	$499
Commercial and industrial	1,097	769	328
Warehouse lending	1,159	1,237	(78)

Total commercial loans	4,016	3,267	749
Total loans held-for-investment	$7,203	$ 6,065	$1,138

(1) Includes $270 million and $245 million of owner occupied commercial real estate loans at September 30, 2017 and December 31, 2016, respectively.

Loans held-for-investment increased $1.1 billion, at September 30, 2017 from December 31, 2016. This increase was due to our continued effort to grow both the consumer loan portfolio and commercial loan portfolio.

The commercial loan portfolio growth strengthens our Community Banking segment by improving margins through the additions of higher yielding loans. As a result, the commercial loan portfolio has grown $749 million, or 23 percent, since December 31, 2016. During the nine months ended September 30, 2017, our CRE portfolio grew $499 million and C&I $328 million.

For further information, see Note 4 - Loans Held-for-Investment.

Residential first mortgage loans. We originate or purchase various types of conforming and non-conforming fixed and adjustable rate loans underwritten using Fannie Mae and Freddie Mac guidelines for the purpose of purchasing or refinancing owner occupied and second home properties. The LTV requirements vary depending on occupancy, property type, loan amount, and FICO scores. Loans with LTVs exceeding 80 percent are required to obtain mortgage insurance. We hold for investment, higher yielding loans and loans that will diversify or enhance the interest rate characteristics of our balance sheet.

The following table presents our total residential first mortgage LHFI by major category:

	September 30, 2017	December 31, 2016
	(Dollars in millions)	
Current estimated LTV ratios		
Less than 80% and refreshed FICO scores (1):		
Equal to or greater than 660	$2,389	$ 2,077
Less than 660	76	95
80% and greater and refreshed FICO scores (1):		
Equal to or greater than 660	132	78
Less than 660	8	9
U.S. government guaranteed	60	68
Total	$2,665	$ 2,327
Geographic region		
California	$1,059	$ 858
Michigan	267	236
Florida	193	193
Texas	174	138
Washington	160	136
Illinois	97	84
Arizona	73	65
New York	72	68
Colorado	66	60
Maryland	65	59
Others	439	430
Total	$2,665	$ 2,327

(1) FICO scores are updated at least on a quarterly basis or sooner if available.

Home equity. Our home equity portfolio includes first and second lien positions for HELOANs and HELOCs. These loans require full documentation and are underwritten and priced in an effort to ensure high credit quality and loan profitability. Our debt-to-income ratio on second mortgages is capped at 43 percent and for HELOCs is capped at 45 percent. We currently limit the maximum CLTV to 89.99 percent and FICO scores to a minimum of 660. Current second mortgage loans/HELOANS are fixed rate loans and are available with terms up to 15 years. HELOC loans are adjustable-rate loans that contain a 10-year interest-only draw period followed by a 20-year amortizing period.

Commercial and industrial loans. Commercial and industrial LHFI facilities typically include lines of credit and term loans and leases to businesses for use in normal business operations to finance working capital, equipment and capital purchases, acquisitions and expansion projects. We lend to customers with a history of profitability and a long-term business model. Generally, leverage conforms to industry standards and the minimum debt service coverage is 1.20. Most of our C&I loans earn interest at a variable rate.

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The following table presents our total C&I LHFI by borrower's geographic location and industry type:

	Michigan	Texas	Florida	California	Tennessee	Other	Total	% by industry
	(Dollars in millions)							
September 30, 2017								
Industry Type								
Financial & Insurance	$23	$—	$50	$ —	$ 12	$228	$313	28.5 %
Services (1)	71	73	—	34	—	114	292	26.6 %
Manufacturing	61	5	—	23	—	87	176	16.0 %
Healthcare	29	7	1	1	44	27	109	9.9 %
Distribution	57	—	—	2	—	—	59	5.4 %
Servicing advances	—	—	21	—	—	25	46	4.2 %
Rental & leasing	44	—	—	—	—	2	46	4.2 %
Government & education	9	—	—	—	—	36	45	4.1 %
Commodities	5	—	—	—	—	6	11	1.0 %
Total	$299	$85	$72	$ 60	$ 56	$525	$1,097	100.0 %
Percent by state	27.3 %	7.7 %	6.6 %	5.5 %	5.1 %	47.9 %	100.0 %	

(1) Includes unsecured home builder loans of $98 million at September 30, 2017.

Commercial real estate loans. Flagstar has a well-diversified commercial real estate portfolio, largely based in Michigan. Generally, the maximum LTV is 80 percent, or 85 percent for owner-occupied real estate, and debt service coverage of 1.20 to 1.35 times. This portfolio also includes owner occupied real estate loans and secured home builder loans.

In 2016, we launched a national home builder finance program to grow our balance sheet, increase commercial deposits and develop incremental revenue through our retail purchase mortgage channel. We finance and have active relationships with homebuilders nationwide. At September 30, 2017, home builder loans totaled $516 million. Of that $98 million is unsecured which is included in our C&I portfolio and $418 million is collateralized which is included in our CRE portfolio. We had an additional $505 million of unused home builder lending commitments at September 30, 2017.

The following table presents our total CRE LHFI by borrower's geographic location and collateral type:

	Michigan	Florida	California	Colorado	Texas	Ohio	Other	Total (1)
	(Dollars in millions)							
September 30, 2017								
Collateral Type								
Single family residence (2)	$54	$78	$ 28	$ 80	$81	$—	$51	$372
Retail (3)	185	30	7	—	—	5	14	241
Apartments	125	23	—	7	—	47	39	241
Industrial	155	—	35	—	—	—	4	194
Office	164	—	19	—	—	—	—	183
Land - Residential (4)	11	21	32	24	11	—	31	130
Hotel/motel	79	—	—	—	—	—	35	114
Senior Living facility	50	—	—	—	—	12	10	72
Parking garage/Lot	68	—	—	—	—	—	—	68
Non Profit	37	—	—	—	—	—	10	47
Shopping Mall (5)	27	—	—	—	—	—	—	27
Marina	23	—	—	—	—	—	—	23
Movie Theater	20	—	—	—	—	—	—	20

All other (6)	21	—	1	—	—	—	6	28
Total	$1,019	$152	$ 122	$ 111	$92	$64	$200	$1,760
Percent by state	57.9 %	8.6 %	6.9 %	6.3 %	5.2 %	3.6 %	11.4 %	100.0 %

(1) Includes $270 million of commercial owner occupied real estate loans at September 30, 2017.
(2) Includes home builder loans secured by SFR 1-4 properties whether under construction or completed.
(3) Includes multipurpose retail space, neighborhood centers, strip centers and single-use retail space.
(4) Land residential includes development and unimproved vacant land.
(5) Comprised of one shopping mall with an anchor store.
(6) All other primarily includes: condominium, mini storage facilities, ice arena, golf course, gas station, car wash, etc.

Warehouse lending. We offer warehouse lines of credit to other mortgage lenders which allow the lender to fund the closing of residential mortgage loans. Each extension, advance, or draw-down on the line is fully collateralized by residential mortgage loans and is paid off when the lender sells the loan to an outside investor or, in some instances, to the Bank. For the three months ended September 30, 2017, the warehouse advance amount of loans sold to the Bank totaled $2.9 billion or 36.3 percent. For the nine months ended September 30, 2017, the warehouse advance amount of loans sold to the Bank totaled $8.0 billion or 38.5 percent.

Underlying mortgage loans are predominantly originated using the Agencies' underwriting standards. The guideline for debt to tangible net worth is 15 to 1. Despite the contraction in warehouse lending which occurred in the first quarter 2017, we are continuing to focus on increasing market share in the warehouse lending market through our strategic initiative to increase lending to customers who originate loans they then sell to outside third party investors. We have a national platform with relationship managers covering both coasts and a large Michigan-based sales team. The aggregate committed amount of adjustable-rate warehouse lines of credit granted to other mortgage lenders at September 30, 2017 was $2.7 billion, of which $1.2 billion was outstanding, compared to $2.9 billion at December 31, 2016, of which $1.2 billion was outstanding.

Credit Quality

Trends in certain credit quality characteristics such as nonperforming loans and past due statistics remain very strong and continue to show improvement. This is predominantly a result of effectively managing credit risks and sales of legacy portfolios that included nonperforming and TDR loans which have been replaced by new loans with strong credit characteristics. The credit quality of our loan portfolios is demonstrated by low delinquency levels, minimal charge-offs and low levels of nonperforming loans.

For all loan categories within the consumer and commercial loan portfolio, loans are placed on nonaccrual status when any portion of principal or interest is 90 days past due (or nonperforming), or earlier when we become aware of information indicating that collection of principal and interest is in doubt. While it is the goal of management to collect on loans, we attempt to work out a satisfactory repayment schedule or modification with past due borrowers and will undertake foreclosure proceedings if the delinquency is not satisfactorily resolved. Our practices regarding past due loans are designed to both assist borrowers in meeting their contractual obligations and minimize losses incurred by the Bank. When a loan is placed on nonaccrual status, the accrued interest income is reversed. Loans return to accrual status when principal and interest become current and are anticipated to be fully collectible.

Nonperforming assets

The following table sets forth our nonperforming assets:

	September 30, 2017	December 31, 2016	
	(Dollars in millions)		
LHFI			
Consumer loans			
Residential first mortgage	$14	$ 18	
Home equity	1	4	
Commercial			
CRE	1	—	
Total nonperforming LHFI	16	22	
TDRs			
Consumer loans			
Residential first mortgage	11	11	
Home equity	4	7	
Total nonperforming TDRs	15	18	
Total nonperforming LHFI and TDRs (1)	31	40	
Real estate and other nonperforming assets, net	9	14	
LHFS	8	6	
Total nonperforming assets	$48	$ 60	
Nonperforming assets to total assets (2)	0.24%	0.39	%
Nonperforming LHFI and TDRs to LHFI	0.44%	0.67	%
Net charge-offs to LHFI ratio (annualized) (1)	0.08%	0.13	%
Nonperforming assets to LHFI and repossessed assets (2)	0.58%	0.90	%
Nonperforming assets to Tier 1 capital (to adjusted total assets) + ALLL (2)(3)	2.57%	3.93	%

(1) Includes less than 90 day past due performing loans placed on nonaccrual. Interest is not being accrued on these loans.

(2) Ratio excludes LHFS.

(3) Refer to MD&A - Use of Non-GAAP Financial Measures for calculation of ratio.

At September 30, 2017, we had $48 million of nonperforming assets compared to $60 million of nonperforming assets at December 31, 2016. This decrease was primarily due to a $7 million decrease in nonperforming consumer LHFI offset by a $1 million increase in nonperforming commercial LHFI at September 30, 2017 compared to December 31, 2016. Additionally, nonperforming TDRs decreased $3 million at September 30, 2017 compared to December 31, 2016. The overall improvement in our nonperforming assets is due to our continued effort to grow our loan portfolio with strong credit quality loans combined with a slowing emergence of nonperforming loans driven by decreased levels of delinquencies.

The ratio of nonperforming assets, excluding LHFS, to total assets decreased to 0.24 percent at September 30, 2017 from 0.39 percent at December 31, 2016. Net charge-offs in the third quarter 2017 were 0.08 percent of LHFI compared to 0.13 percent at December 31, 2016.

The following table sets forth activity related to our nonperforming LHFI and TDRs:

	Three Months Ended September	Nine Months Ended September

	30, 2017	2016	30, 2017	2016
	(Dollars in millions)			
Beginning balance	$30	$44	$40	$66
Additions	5	7	19	30
Reductions				
Principal payments and loan sales	(2)	(2)	(6)	(9)
Charge-offs	—	—	(2)	(4)
Returned to performing status	(1)	(8)	(1)	(15)
Transfers to REO	(1)	(1)	(19)	(28)
Total nonperforming LHFI and TDRs (1)	$31	$40	$31	$40

(1) Includes less than 90 day past due performing loans which are deemed nonaccrual. Interest is not being accrued on these loans.

As of September 30, 2017, nonperforming consumer loans decreased $9 million from December 31, 2016, due to the sale of nonperforming loans and improvements to the overall credit quality of our loan portfolios. We had a decrease in additions to nonperforming LHFI and TDRs along with an increase in loans returning to performing status during both the three and nine months ended September 30, 2017 as compared to the three and nine months ended September 30, 2016, respectively. During the three months ended September 30, 2017, we had no charge-offs.

Delinquencies

The following table sets forth our performing LHFI which are past due 30-89 days:

	September 30, 2017	December 31, 2016
	(Dollars in millions)	
Performing loans past due 30-89:		
Consumer loans		
Residential first mortgage	$ 3	$ 6
Home equity	2	3
Other	—	1
Total performing loans past due 30-89 days	$ 5	$ 10

Early stage delinquencies remained low with the 30 to 89 days past due loans decreasing to $5 million at September 30, 2017, compared to $10 million at December 31, 2016. There were no past due commercial loans at September 30, 2017 and December 31, 2016.

Troubled debt restructurings (held-for-investment)

Troubled debt restructurings ("TDRs") are modified loans in which a borrower demonstrates financial difficulties and for which a concession has been granted as a result. Nonperforming TDRs are included in nonaccrual loans. TDRs remain in nonperforming status until a borrower has made at least six consecutive months of payments under the modified terms. Performing TDRs are excluded from nonaccrual loans because it is reasonably assured that all contractual principal and interest due under the restructured terms will be collected.

The following table sets forth a summary of TDRs by performing status:

	September 30, 2017	December 31, 2016
	(Dollars in millions)	
Performing TDRs		
Residential first mortgage	$ 20	$ 22
Home equity	26	45
Total performing TDRs	46	67
Nonperforming TDRs	4	8
Nonperforming TDRs at inception but performing for less than six months	11	10
Total nonperforming TDRs	15	18
Total TDRs (1)	$ 61	$ 85

(1) The ALLL on consumer TDR loans totaled $12 million and $9 million at September 30, 2017 and December 31, 2016.

At September 30, 2017 our total TDR loans decreased $24 million compared to December 31, 2016 primarily due to the sale of nonperforming loans and lower delinquency rates during the nine months ended September 30, 2017. Of our total TDR loans, 75.5 percent were in performing status at September 30, 2017.

For further information, see Note 4 - Loans Held-for-Investment.

Allowance for Loan Losses

The ALLL represents management's estimate of probable losses that are inherent in our LHFI portfolio but which have not yet been realized. For further information, see Note 4 - Loans Held-for-Investment.

The ALLL as a percentage of LHFI decreased to 2.0 percent as of September 30, 2017 from 2.4 percent as of December 31, 2016. This decrease is attributable to the continued low levels of delinquencies and net charge-offs in our portfolio. Additionally, our loan growth has been in high credit quality assets across both our consumer and commercial portfolios. At September 30, 2017, our allowance as a percent of our consumer loan portfolio was 2.3 percent and our allowance as percent of our commercial loan portfolio was 1.7 percent.

The percentage of ALLL to LHFI and loans with government guarantees (excluding fair value loans), decreased to 1.9 percent as of September 30, 2017 from 2.2 percent as of December 31, 2016.

The following tables set forth certain information regarding the allocation of our ALLL to each loan category:

	September 30, 2017			
	Loans Held-for-Investment	Percent of Portfolio	Allowance Amount	Allowance as a Percent of Loan Portfolio
	(Dollars in millions)			
Consumer loans				
Residential first mortgage	$2,656	36.9 %	$ 52	2.0 %
Home equity	492	6.8 %	20	4.1 %
Other	26	0.4 %	1	3.8 %
Total consumer loans	3,174	44.1 %	73	2.3 %
Commercial loans				
Commercial real estate	1,760	24.5 %	42	2.4 %
Commercial and industrial	1,097	15.3 %	19	1.7 %
Warehouse lending	1,159	16.1 %	6	0.5 %
Total commercial loans	4,016	55.9 %	67	1.7 %
Total consumer and commercial loans (1)	$7,190	100.0 %	$ 140	1.9 %

(1) Excludes loans carried under the fair value option.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(Dollars in millions)			
Beginning balance	$140	$150	$142	$187
Provision (benefit) for loan losses (1)	2	—	4	(16)
Charge-offs				
Consumer loans				
Residential first mortgage	(1)	(7)	(6)	(26)
Home equity	(2)	(1)	(3)	(4