# Memo from Management

April 6, 2020

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**All Loan Officers and Branch personnel,**

First, we want to thank you for being patient and understanding during the Covid-19 Pandemic. Our bank owners and management team have been working throughout the last two weeks to find ways to keep our sales people originating, while still navigating safely through the numerous challenges presented in the current market in order to protect the bank, it's owners, and all of our wonderful employees for the future.

As many of you know, the main challenge we are facing is the value of servicing that our investor partners have paid to us for loans in the past. Over the last three weeks, we have seen some of those amounts be reduced by over 300-400 basis points (or 3-4 points), and other products/parameters no longer even being offered. Unfortunately, many of our branches have been built around the premise of "smaller volume" and "higher margin" in the past. Some of our branches would fit the "middle ground", and a few of our branches would fit a "higher volume" and "lower margin" model. Unfortunately, even the "higher volume" and "lower margin" model (though better in a time like this) will be impacted as well if we do not see a stabilization in the markets soon. In the below steps we will outline what this means to you and how as a team we will navigate this market **WITH THE GOAL** to offer a viable rate sheet as of 4/13/2020.

Our management team does NOT want to wait until next week. However, based on conversations we have had with many "in the know" industry relationships we feel it prudent. We have been advised to wait and see if the Federal Reserve / Treasury department will step up and help our investors with their cash flow issues derived from the forbearance being offered to homeowners. If that help comes, we believe the premiums will improve but not completely bring back servicing values to pre Covid-19 levels. To that end, any good management team should "plan for the worst", but "hope for the best". We know that over the last two weeks you have not been able to originate new loans, therefore after this week we can no longer "hope", but instead put a plan in place to make us stronger and better in the future. We owe that to all of you, our staff and our ownership who all of us are proud to work for!

Below is our vision and background for each step to get us back originating.

**First step – Getting a sense of "what are the loans worth"?**

Normally our lock desk (secondary department) bases our daily rate sheet from the "best efforts" price an investor would give us. For those of you that do not know, that means to our "best effort" as a company we commit to sell a loan to our investor by a set lock date, but there is no penalty to FSB if we did not deliver it. Unfortunately, if we quoted our rates off this scenario like we have in the past the rate sheet will continue to look like it does and that would not allow you to originate loans (too ugly). This is the current reason the rate sheet looks as bad as it does right now.

Therefore, we must set the rates based on a "bid price". A bid price is an amount that investors normally compete for to buy our loans in bulk. Unfortunately, since the change in premiums FSB has only sold one "bulk pool". We put out our pool bids every Tuesday, and we will do so again this week. Once we see what our loans can be sold for, this will give us a second bid to compare and feel comfortable knowing what a 680+ Government and conventional loan is worth in premium. In addition, we are hopeful that we will still have enough bidders on 660+ Government and conventional loans.

**Second Step – Creating a lock policy to mitigate risk**

While we see what our bids come in this week, we can be ahead of the game as to a lock policy that we have ran by our secondary experts in order to protect all of us from the "most volatile market conditions since the great depression." Unfortunately, our bank has already lost a great deal of income from the market movement. We cannot allow this to happen further, nor can any lender. Therefore, the below lock policy will seem strange, but our hedge manager advised last week that the below lock policy will be the "norm" for all companies until the Pandemic comes to an end if the lender is prudent and the markets remain volatile.

**Government Loan Lock Policy (FHA/VA/USDA)**

1) Our rate sheet will have an aggressive 15-day price, all other lock durations will be unattainable.
2) Loan must be disclosed on a float at .75 in rate higher than the rate sheet "best 15-day coupon".
3) Loan can only be locked once the loan reaches the "initial CD request" stage.
4) At this time, your processor will request you lock each loan but not before the Initial CD Request stage
5) Unfortunately, NO exceptions will be granted. You must get to your MSA or pass on loan level pricing adjustments to your borrowers.

**Conventional Loan Lock Policy**

1) Before ANY conventional lock is performed, it is the LO or Branch Manager's job to confirm that the borrower(s) are currently employed and to the best of their knowledge will continue to be employed. It is CRUCIAL that when locking up front moving forward that the loan is closable. We are trusting our LO's/Branch managers in this regard, but if we see loans in the next 15 days where this has not been followed then the LO will only be able to lock at time of initial CD.

2) Our rate sheet will have an aggressive 15-day price, all other lock durations will be attainable, but there will be ***significant*** difference in pricing.
3) Loan must be disclosed on a float at .50 in rate higher than the rate sheet "best 15-day coupon", if you are choosing to float your loan.
4) Unfortunately, NO exceptions will be granted. You must get to your MSA or pass on loan level pricing adjustments to your borrowers.

**Third Step – Possible Branch Redevelopment for surviving Covid-19**

As previously mentioned, many of our branches have been built around the premise of "smaller volume" and "higher margin" in the past. In the pre Covid-19 market this was a great business model for our "rural markets" in particular. Unfortunately, this model will be impacted significantly by at least 2 to 3 points per loan in the future if the market does not change. In addition, the rules are stacked against us due to ATR/QM rules. Paraphrased, you cannot charge enough points to get to your MSA's. Though many of you can "sell ice cream to an Eskimo" and finance discount points in the past, most of you will not be able to do so on 680+ (660 maybe) loans in the future when all of your competition is going to want the same loans. This is a VERY important statement for all branch managers and LO's to consider. Therefore, our third step is to meet with all our branches one at a time to go over the logical affects of this Covid-19 market we are in and may continue to be in moving forward. Branches that have had a "smaller volume" and "higher margin" model in the past may have to migrate to another to survive. We believe when the chips are down, you all comprise a great sales force. Our management team will help you navigate through this tough time and "figure this out" together! To this end, both Thursday and Friday we will be meeting with each branch so we can do the following for all your locations. If you have a pipeline call scheduled for Thursday this week, we will use that time for this meeting. All branches, your sales manager will be in touch to set up these meetings.

1) Go over any questions on our lock policy
2) Establish new MSA's, etc. based on:
   A) Premium information based on our bids this week
   B) Current overhead at the branch level per loan
   C) Compensation plans at the branch level per loan
   D) Direct loan fee charges to borrowers at the branch level
   E) Discuss potential volume in this strange market

**Fourth Step – Future Redevelopment for FSB as a whole**

Lastly, it is important for all of our staff to know that the ownership and management of this division have looked at the most recent occurrences in the market and have a plan for the future to compete and eventually come out of this stronger for it. Paraphrased, we all "must learn from these events". We want every branch to know that if they embrace and acknowledge the fact that "smaller volume" and "higher margin" are now a risk to their branch potentially in the future, we as a management team also need to help our branches in the future "meet in the middle". Our bank needs to give you tools to first survive, and then build. To that end we are taking the following steps:

1) We will have our application in to become a direct seller to GNMA by the end of next week. We believe the full approval will take about 4 months.
2) We are engaging in setting up relationships with smaller GNMA sellers incase our larger investors cannot weather the storm of servicing liquidity issues.
3) We are engaging on setting up with a sub-servicer to help us get the GNMA approval quicker.
4) We are going to grow our "servicing retained" platform in the future on conventional government loans due to the removal of Basil Three requirements which limited us in the past.

**Summary**

We know this caught all of us off guard as a company, division, and nation. Our goal is to try and save all our branches, personnel, and relationships. We will need all your help to do it, but we can do it together.