FLAGSTAR BANCORP INC
Form 10-Q
November 05, 2018
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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, 2018
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	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 1, 2018, 57,627,630 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	HOLA	Home Owners Loan Act
ALLL	Allowance for Loan & Lease Losses	Home equity	Second Mortgages, HELOANs, HELOCs
AOCI	Accumulated Other Comprehensive Income (Loss)	HTM	Held to Maturity
ASU	Accounting Standards Update	LIBOR	London Interbank Offered Rate
Basel III	Basel Committee on Banking Supervision Third Basel Accord	LHFI	Loans Held-for-Investment
C&I	Commercial and Industrial	LHFS	Loans Held-for-Sale
CDARS	Certificates of Deposit Account Registry Service	LTV	Loan-to-Value Ratio
CET1	Common Equity Tier 1	Loan Beta	The change in the annualized yield of our LHFI portfolio, compared to the change in the Federal Reserve discount rate
CFPB	Consumer Financial Protection Bureau	Management	Flagstar Bancorp's Management
CLTV	Combined Loan to Value Ratio	MBIA	MBIA Insurance Corporation
Common Stock	Common Shares	MBS	Mortgage-Backed Securities
CRE	Commercial Real Estate	MD&A	Management's Discussion and Analysis
DCB	Desert Community Bank	MSR	Mortgage Servicing Rights
Deposit Beta	The change in the annualized cost of our deposits, compared to the change in the Federal Reserve discount rate	N/A	Not Applicable
DFAST	Dodd-Frank Stress Test	NYSE	New York Stock Exchange
DOJ	United States Department of Justice	OCC	Office of the Comptroller of the Currency
DTA	Deferred Tax Asset	OTTI	Other-Than-Temporary-Impairment
EVE	Economic Value of Equity	QTL	Qualified Thrift Lending
Fannie Mae	Federal National Mortgage Association	REO	Real estate and other nonperforming assets, net
FASB	Financial Accounting Standards Board	RWA	Risk Weighted Assets
FDIC	Federal Deposit Insurance Corporation	SEC	Securities and Exchange Commission
FHA	Federal Housing Administration	SFR	Single Family Residence
FHLB	Federal Home Loan Bank	TARP Preferred	Troubled Asset Relief Program Fixed Rate Cumulative Perpetual Preferred Stock, Series C
FICO	Fair Isaac Corporation	TDR	Trouble Debt Restructuring
FRB	Federal Reserve Bank	UPB	Unpaid Principal Balance
Freddie Mac	Federal Home Loan Mortgage Corporation	U.S. Treasury	United States Department of Treasury
FTE	Full Time Equivalent Employees	VIE	Variable Interest Entities

GAAP	United States Generally Accepted Accounting Principles	XBRL	eXtensible Business Reporting Language

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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 2018, 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 Exhibit 99.1 to our June 1, 2018 Form 8-K Report.

Certain statements in this Form 10-Q, including but not limited to statements included within 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 34 of this Form 10-Q and Part I, Item 1A, Risk Factors of Flagstar Bancorp, Inc.'s 2017 Annual Report on Form 10-K for the year ended December 31, 2017. 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 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 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. We provide commercial and consumer banking services and we are the 5th largest bank mortgage originator and the 7th largest sub-servicer of mortgage loans nationwide. At September 30, 2018, we had 3,496 full-time equivalent employees. Our common stock is listed on the NYSE under the symbol "FBC."

We have a relationship-based business model which leverages our full-service Bank's capabilities with our national mortgage platform to create and build financial relationships with our customers. At September 30, 2018, we operated 108 full service banking branches that offer a full set of banking products to consumer, commercial, and government customers. Our banking footprint spans throughout Michigan and contiguous states as well as the high desert region of California.

In the first quarter of 2018, we closed the purchase of the mortgage loan warehouse business from Santander Bank, which added $499 million in outstanding warehouse loans and we completed the acquisition of eight Desert Community Bank branches in San Bernardino County, California, with $614 million in deposits and $59 million in loans.

In the second quarter 2018, we signed a definitive agreement to acquire 52 Wells Fargo branches in Indiana, Michigan, Wisconsin and Ohio. We expect to close this transaction at the beginning of December 2018.

We originate mortgages through a wholesale network of brokers and correspondents in all 50 states, and our own loan officers from 81 retail locations in 27 states and two call centers, which includes our direct-to-consumer lending team. Flagstar is also a leading national servicer of mortgage loans and provides complementary ancillary offerings including, MSR lending, servicing advance lending and recapture services. Servicing and subservicing of loans provides fee income and generates a stable long-term source of funding through custodial deposits.

Operating Segments

Our operations are conducted through our three operating segments: Community Banking, Mortgage Originations, and Mortgage Servicing. For additional information, please see MD&A - Operating Segments and Note 18 - Segment Information.

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

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
	(In millions and percentages)			
Selected Mortgage Statistics:				
Mortgage rate lock commitments (fallout-adjusted) (1)	$8,290	$8,898	$25,024	$23,896
Mortgage loans originated	9,199	9,572	26,125	24,659
Mortgage loans sold and securitized	8,423	8,924	24,930	22,397
Selected Ratios:				
Interest rate spread (2)	2.57 %	2.58 %	2.57 %	2.56 %
Net interest margin	2.93 %	2.78 %	2.85 %	2.74 %
Return on average assets	1.04 %	0.99 %	1.00 %	0.94 %
Return on average equity	12.80 %	11.10 %	12.10 %	10.23 %
Equity-to-assets ratio (average for the period)	8.13 %	8.95 %	8.23 %	9.16 %
Efficiency ratio	74.6 %	73.5 %	76.2 %	73.9 %
Effective tax provision rate	20.0 %	32.4 %	20.1 %	32.3 %
Average Balances:				
Average interest-earning assets	$16,786	$14,737	$16,050	$13,709
Average interest-paying liabilities	13,308	12,297	13,150	11,481
Average stockholders' equity	1,514	1,471	1,468	1,412

	September 30, 2018	December 31, 2017	September 30, 2017
	(In millions, except per share data and percentages)		
Selected Statistics:			
Book value per common share	$26.34	$ 24.40	$ 25.38
Tangible book value per share (3)	$25.13	$ 24.04	$ 25.01
Number of common shares outstanding	57,625,439	57,321,228	57,181,536
Common equity-to-assets ratio	8.12 %	8.27 %	8.60 %
Tangible common equity to assets ratio (3)	7.74 %	8.15 %	8.47 %
Capitalized value of mortgage servicing rights	1.43 %	1.16 %	1.15 %
Bancorp Tier 1 leverage (to adjusted avg. total assets) (4)	8.36 %	8.51 %	8.80 %
Bank Tier 1 leverage (to adjusted avg. total assets) (4)	8.77 %	9.04 %	9.38 %
Number of bank branches	108	99	99
Number of FTE employees	3,496	3,525	3,495

(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 previous historical experience and the impact of changes in interest rates.

(2) Interest rate spread is the difference between the annualized yield earned on average interest-earning assets for the period and the annualized rate of interest paid on average interest-bearing liabilities for the period.

(3) Excludes goodwill and intangibles of $70 million, $21 million, and $21 million at September 30, 2018, December 31, 2017, and September 30, 2017, respectively. See Non-GAAP Financial Measures for further information.

(4) The Basel III transitional phase-in rules were applicable to December 31, 2017 and September 30, 2017.

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Overview

The third quarter of 2018 resulted in net income of $48 million, or $0.83 per diluted share, up $8 million or $0.13 per diluted share compared to the third quarter of 2017. The increase in net income was primarily due to $21 million, or 20 percent, higher net interest income in the third quarter of 2018 compared to the same period a year ago, driven by growth in interest earning assets and net interest margin expansion.

Through the nine months ended September 30, 2018, consistent earnings performance demonstrated the strength of our Community Banking segment. When comparing the nine months ended September 30, 2018 to the same period in 2017, average commercial loans have increased $1.4 billion, or 42 percent, with broad based growth across all portfolios and average retail and government deposits have grown $955 million, or 13 percent. Additionally, the pending acquisition of 52 branches from Wells Fargo will provide us with over $2 billion of additional high quality, low cost deposits which we will use to fund balance sheet growth.

We continue to build the Mortgage Servicing segment, increasing the number of loans serviced 49 percent over the last 12 months and ending the third quarter of 2018 servicing nearly 620,000 accounts. We are positioned to continue to add scale to our servicing business which provides both stable deposits and a reliable source of fee income.

The mortgage market continued to be challenging through the third quarter 2018. Net gain on loan sales decreased $32 million, primarily driven by a 33 basis point decrease in net gain on loan sale margin in the three months ended September 30, 2018, compared to the same period in 2017. This loss was partially offset by stronger valuations and lower prepayments on our mortgage servicing assets, which improved $7 million.

Earnings Performance Highlights

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
	(Dollars in millions, except share data)					
Net interest income	$124	$103	$21	$345	$283	$62
Provision (benefit) for loan losses	(2)	2	(4)	(3)	4	(7)
Total noninterest income	107	130	(23)	341	346	(5)
Total noninterest expense	173	171	2	523	465	58
Provision for income taxes	12	20	(8)	33	52	(19)
Net income	$48	$40	$8	$133	$108	$25
Income per share						
Basic	$0.84	$0.71	$0.13	$2.32	$1.90	$0.42
Diluted	$0.83	$0.70	$0.13	$2.28	$1.86	$0.42

Comparison to Prior Year Quarter

- Net income increased $8 million, or $0.13 per diluted share, to $48 million, or $0.83 per diluted share.
- Net interest income increased $21 million, primarily driven by $2.0 billion higher average interest-earnings assets and a 15 basis point increase in net interest margin.
- Noninterest income decreased $23 million, primarily due to lower gains on loan sales, partially offset by higher returns on MSRs.
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Noninterest expense increased $2 million, primarily a result of organic growth and acquisitions, partially offset by a decrease in volume related expenses.

Comparison to Prior Year to Date

- Net income increased $25 million, or $0.42 per diluted share, to $133 million, or $2.28 per diluted share.
- Net interest income increased $62 million, primarily driven by 17 percent higher average interest-earning assets and net interest margin expansion of 11 basis points.
- The $7 million change in the provision for loan losses was driven by continued minimal net charge-offs and low levels of delinquencies.
- Noninterest expense increased $58 million, primarily resulting from growth initiatives and volume driven expenses.

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,					
	2018			2017		
	Average Balance	Interest	Annualized Yield/ Rate	Average Balance	Interest	Annualized Yield/ Rate
	(Dollars in millions)					
Interest-Earning Assets						
Loans held-for-sale	$4,393	$ 52	4.69 %	$4,476	$ 45	3.99 %
Loans held-for-investment						
Residential first mortgage	3,027	27	3.63 %	2,594	22	3.32 %
Home equity	695	9	5.12 %	486	6	5.11 %
Other	128	2	5.54 %	26	—	4.52 %
Total consumer loans	3,850	38	3.96 %	3,106	28	3.61 %
Commercial real estate	2,106	29	5.37 %	1,646	19	4.43 %
Commercial and industrial	1,330	18	5.28 %	1,073	13	4.77 %
Warehouse lending	1,586	21	5.10 %	978	12	4.82 %
Total commercial loans	5,022	68	5.26 %	3,697	44	4.63 %
Total loans held-for-investment (1)	8,872	106	4.70 %	6,803	72	4.16 %
Loans with government guarantees	292	3	4.20 %	264	3	4.58 %
Investment securities	3,100	21	2.81 %	3,101	20	2.58 %
Interest-earning deposits	129	1	2.38 %	93	—	1.23 %
Total interest-earning assets	16,786	183	4.32 %	14,737	140	3.77 %
Other assets	1,825			1,702		
Total assets	$18,611			$16,439		
Interest-Bearing Liabilities						
Retail deposits						
Demand deposits	$727	$ 3	1.62 %	$489	$ —	0.14 %
Savings deposits	3,229	7	0.90 %	3,838	7	0.76 %
Money market deposits	252	—	0.62 %	276	—	0.57 %
Certificates of deposit	2,150	10	1.78 %	1,182	4	1.19 %
Total retail deposits	6,358	20	1.27 %	5,785	11	0.78 %
Government deposits						
Demand deposits	283	1	0.59 %	250	—	0.43 %
Savings deposits	564	2	1.48 %	362	1	0.71 %
Certificates of deposit	327	1	1.52 %	329	1	0.89 %
Total government deposits	1,174	4	1.28 %	941	2	0.70 %
Wholesale deposits and other	537	3	2.03 %	35	—	1.49 %
Total interest-bearing deposits	8,069	27	1.32 %	6,761	13	0.78 %
Short-term Federal Home Loan Bank advances and other	3,465	18	2.10 %	3,809	11	1.17 %
Long-term Federal Home Loan Bank advances	1,280	7	2.11 %	1,234	6	1.99 %
Other long-term debt	494	7	5.62 %	493	7	5.09 %
Total interest-bearing liabilities	13,308	59	1.75 %	12,297	37	1.19 %
Noninterest-bearing deposits (2)	3,267			2,244		
Other liabilities	522			427		
Stockholders' equity	1,514			1,471		
Total liabilities and stockholders' equity	$18,611			$16,439		

Net interest income	$ 124		$ 103	
Interest rate spread (3)	2.57	%	2.58	%
Net interest margin (4)	2.93	%	2.78	%
Ratio of average interest-earning assets to interest-bearing liabilities	126.1	%	119.9	%

(1) Includes nonaccrual loans. For further information on nonaccrual loans, see Note 4 - Loans Held-for-Investment.
(2) Includes noninterest-bearing custodial 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.

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	Nine Months Ended September 30,							
	2018				2017			
	Average Balance	Interest	Annualized Yield/ Rate		Average Balance	Interest	Annualized Yield/ Rate	
	(Dollars in millions)							
Interest-Earning Assets								
Loans held-for-sale	$4,265	$ 142	4.44	%	$4,014	$ 119	3.96	%
Loans held-for-investment								
Residential first mortgage	2,893	76	3.52	%	2,497	62	3.34	%
Home equity	681	26	5.13	%	453	17	5.04	%
Other	71	3	5.37	%	26	1	4.52	%
Total consumer loans	3,645	105	3.86	%	2,976	80	3.61	%
Commercial real estate	2,026	79	5.12	%	1,482	47	4.15	%
Commercial and industrial	1,269	51	5.26	%	929	33	4.71	%
Warehouse lending	1,312	51	5.08	%	840	30	4.70	%
Total commercial loans	4,607	181	5.15	%	3,251	110	4.45	%
Total loans held-for-investment (1)	8,252	286	4.58	%	6,227	190	4.05	%
Loans with government guarantees	288	8	3.86	%	300	10	4.41	%
Investment securities	3,127	64	2.74	%	3,093	59	2.55	%
Interest-earning deposits	118	2	1.95	%	75	1	1.08	%
Total interest-earning assets	16,050	502	4.15	%	13,709	379	3.68	%
Other assets	1,784				1,697			
Total assets	$17,834				$15,406			
Interest-Bearing Liabilities								
Retail deposits								
Demand deposits	$660	$ 4	0.89	%	$502	$ 1	0.16	%
Savings deposits	3,376	21	0.85	%	3,899	22	0.76	%
Money market deposits	235	1	0.54	%	264	1	0.49	%
Certificates of deposit	1,927	24	1.64	%	1,116	9	1.12	%
Total retail deposits	6,198	50	1.09	%	5,781	33	0.76	%
Government deposits								
Demand deposits	256	1	0.54	%	228	1	0.41	%
Savings deposits	512	5	1.29	%	410	2	0.59	%
Certificates of deposit	369	4	1.34	%	314	1	0.73	%
Total government deposits	1,137	10	1.14	%	952	4	0.59	%
Wholesale deposits and other	325	5	1.99	%	16	—	1.21	%
Total interest-bearing deposits	7,660	65	1.13	%	6,749	37	0.74	%
Short-term Federal Home Loan Bank advances and other	3,713	50	1.81	%	3,028	23	1.01	%
Long-term Federal Home Loan Bank advances	1,283	21	2.15	%	1,211	17	1.92	%
Other long-term debt	494	21	5.53	%	493	19	5.06	%
Total interest-bearing liabilities	13,150	157	1.58	%	11,481	96	1.12	%
Noninterest-bearing deposits (2)	2,721				2,098			
Other liabilities	495				415			
Stockholders’ equity	1,468				1,412			
Total liabilities and stockholders' equity	$17,834				$15,406			
Net interest income		$ 345				$ 283		
Interest rate spread (3)			2.57	%			2.56	%
Net interest margin (4)			2.85	%			2.74	%
			122.1	%			119.4	%

Ratio of average interest-earning assets to interest-bearing liabilities

(1) Includes nonaccrual loans. For further information on nonaccrual loans, see Note 4 - Loans Held-for-Investment.
(2) Includes noninterest-bearing custodial 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, 2018 Versus 2017 Increase (Decrease) Due to:		
	Rate	Volume	Total
	(Dollars in millions)		
Interest-Earning Assets			
Loans held-for-sale	$8	$ (1)	$ 7
Loans held-for-investment			
Residential first mortgage	2	3	5
Home equity	—	3	3
Other	1	1	2
Total consumer loans	3	7	10
Commercial real estate	5	5	10
Commercial and industrial	2	3	5
Warehouse lending	1	8	9
Total commercial loans	8	16	24
Total loans held-for-investment	11	23	34
Investment securities	1	—	1
Interest-earning deposits and other	1	—	1
Total interest-earning assets	$21	$ 22	$ 43
Interest-Bearing Liabilities			
Interest-bearing deposits	$11	$ 3	$ 14
Short-term Federal Home Loan Bank advances and other	8	(1)	7
Long-term Federal Home Loan Bank advances	1	—	1
Total interest-bearing liabilities	20	2	22
Change in net interest income	$1	$ 20	$ 21

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	Nine Months Ended September 30, 2018 Versus 2017 Increase (Decrease) Due to:		
	Rate	Volume	Total
	(Dollars in millions)		
Interest-Earning Assets			
Loans held-for-sale	$15	$ 8	$23
Loans held-for-investment			
Residential first mortgage	4	10	14
Home equity	1	8	9
Other	—	2	2
Total consumer loans	5	20	25
Commercial real estate	15	17	32
Commercial and industrial	6	12	18
Warehouse lending	4	17	21
Total commercial loans	25	46	71
Total loans held-for-investment	30	66	96
Loans with government guarantees	(1)	(1)	(2)
Investment securities	5	—	5
Interest-earning deposits and other	1	—	1
Total interest-earning assets	$50	$ 73	$123
Interest-Bearing Liabilities			
Interest-bearing deposits	$22	$ 6	$28
Short-term Federal Home Loan Bank advances and other	22	5	27
Long-term Federal Home Loan Bank advances	3	1	4
Other long-term debt	2	—	2
Total interest-bearing liabilities	49	12	61
Change in net interest income	$1	$ 61	$62

Comparison to Prior Year Quarter

Net interest income increased $21 million, or 20 percent, for the three months ended September 30, 2018, compared to the same period in 2017. This increase was primarily driven by growth in average interest-earning assets, led by continued growth in the commercial loan portfolio.

Net interest margin for the three months ended September 30, 2018 was 2.93 percent, as compared to 2.78 percent for the three months ended September 30, 2017. The increase in net interest margin was primarily due to growth in our commercial loan portfolio, partially offset by higher average rates on deposits. Loans held-for-investment, driven by higher yielding commercial loans, saw a 54 basis point increase in average rates. This change in rates represents a loan beta of 54 percent, which is the change in the annualized yield of our LHFI portfolio, compared to the change in the Federal Reserve discount rate. Our deposit costs increased 36 basis points, representing a deposit beta of only 36 percent, primarily driven by holding a higher percentage of certificates of deposits, offset by lower cost deposits acquired from the DCB branch acquisition. The higher loan beta when compared to our deposit beta indicates that the yield on our LHFI portfolio is more responsive to changes in market rates than our deposit costs, driving a higher interest rate spread. In addition, average deposit growth of $2.3 billion allowed us to reduce higher cost FHLB borrowings, further benefiting margin expansion.

Average interest-earning assets increased $2.0 billion for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, primarily due to an increase in both commercial and consumer LHFI average balances. The commercial loan portfolio increased $1.3 billion from broad based growth in warehouse, commercial real estate and C&I loans driven by organic growth and the acquisition of the Santander warehouse business from the first quarter of 2018. Additionally, we experienced growth of $744 million in our consumer loan portfolio as we continued to portfolio mortgage loan production and grow our indirect lending business.

Average interest-bearing liabilities increased $1.0 billion for the three months ended September 30, 2018, compared to the three months ended September 30, 2017. This increase was primarily due to the DCB branch acquisition as well as organic growth in retail certificates of deposit partially offset by a decline in retail savings deposits. Additionally, we experienced an increase in wholesale deposits to bridge funding needs to December when these funds will be replaced with lower cost, more stable branch deposits from the Wells Fargo acquisition. As a result of deposit growth, average short term FHLB borrowings were reduced $344 million.

Comparison to Prior Year to Date

Net interest income increased $62 million, or 22 percent, for the nine months ended September 30, 2018, compared to the same period in 2017. This increase was primarily driven by growth in average interest-earnings assets, led by continued growth in the commercial loan portfolio.

Our net interest margin for the nine months ended September 30, 2018 was 2.85 percent, as compared to 2.74 percent for the nine months ended September 30, 2017. Margin expansion was primarily a driven by a 53 basis point increase in yields on our LHFI portfolios, which outweighed a 27 basis point increase in average costs of deposits. The increase in deposit costs was driven by a shift in mix to longer duration certificates of deposits, partially offset by the low cost deposits acquired from the DCB branch acquisition.

Average interest-earning assets increased $2.3 billion for the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, primarily due to broad based growth in the commercial loan portfolio of $1.4 billion, partially driven by the Santander warehouse business acquisition, and increases in residential mortgage loans and HELOCs of $669 million.

Average interest-bearing liabilities increased $1.7 billion for the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017. Interest-bearing deposits increased $911 million, primarily driven by the DCB branch acquisition along with higher retail and wholesale deposits. Additionally, to fund balance sheet growth, average short term FHLB advances increased $685 million.

Provision for Loan Losses

The provision for loan losses was a benefit of $2 million and $3 million for the three and nine months ended September 30, 2018, respectively, compared to a provision of $2 million and $4 million for the three and nine months ended September 30, 2017, respectively. The improvement in the provision reflects our continued strong credit quality with continued low levels of charge-offs, offset by growth of the portfolio in areas we believe to pose lower levels of credit risk.

For further information on the provision for loan losses see MD&A - Credit Quality.

Noninterest Income

The following tables provide information on our noninterest income along with other mortgage metrics:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
	(Dollars in millions)					
Net gain on loan sales	$43	$75	$ (32)	$166	$189	$ (23)
Loan fees and charges	23	23	—	67	58	9
Deposit fees and charges	5	5	—	15	14	1
Loan administration income	5	5	—	15	16	(1)
Net return on mortgage servicing rights	13	6	7	26	26	—

Other noninterest income	18	16	2	52	43	9
Total noninterest income	$107	$130	$ (23)	$341	$346	$ (5)

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	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
	(Dollars in millions)					
Mortgage rate lock commitments (fallout-adjusted) (1)	$8,290	$8,898	$(608)	$25,024	$23,896	$1,128
Net margin on mortgage rate lock commitments (fallout-adjusted) (1)(2)	0.51 %	0.84 %	(0.33)%	0.66 %	0.79 %	(0.13)%
Mortgage loans sold and securitized	8,423	8,924	(501)	24,930	22,397	2,533

(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 impact of changes in interest rates.
(2) Gain on loan sale volume is based on net gain on loan sales to fallout-adjusted mortgage rate lock commitments.

Comparison to Prior Year Quarter

Total noninterest income decreased $23 million during the three months ended September 30, 2018, compared to the same period in 2017.

Net gain on loan sales decreased $32 million during the three months ended September 30, 2018, compared to the three months ended September 30, 2017, primarily due to a 33 basis point decrease in net gain on loan sale margin and $608 million decrease in fallout-adjusted rate lock volume. The mortgage market has seen a decrease in production and continued over capacity during the third quarter of 2018 compared to the same quarter a year ago. The decrease in gain on sale margin was primarily due to secondary margin compression and a shift in the channel mix toward lower margin, but lower cost delegated correspondent channel.

Net return on MSRs, including the impact of hedges, increased $7 million during the three months ended September 30, 2018, compared to the three months ended September 30, 2017. The increase was primarily due to higher net return from the MSR asset resulting from lower prepayments and stronger valuations, along with a higher average MSR balance.

Other noninterest income increased $2 million during the three months ended September 30, 2018, compared to the three months ended September 30, 2017. The increase was primarily due to higher FHLB stock dividend income attributable to an increase in FHLB stock holdings and higher rental income driven by growth within the equipment finance operating lease portfolio.

Comparison to Prior Year to Date

Total noninterest income decreased $5 million during the nine months ended September 30, 2018, compared to the same period in 2017.

Net gain on loan sales decreased $23 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, primarily due to a 13 basis point decrease in net gain on loan sale margin driven by secondary margin compression and a mix shift toward the lower margin, but lower cost delegated correspondent channel, partially offset by securitizations. Margin compression was partially offset by a 5 percent increase in fallout-adjusted rate locks, boosted by our 2017 mortgage acquisitions.

Loan fees and charges increased $9 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, primarily due to an increase in mortgage loan closings, boosted by our 2017 mortgage acquisitions, and shift in the channel mix from third party originations to retail channels.

Other noninterest income increased $9 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017. The increase was primarily due to higher FHLB stock dividend income attributable to an increase in FHLB stock holdings and a supplemental dividend from the FHLB received in the first quarter of 2018, higher rental income driven by growth within the equipment finance operating lease portfolio, and higher investment and insurance income.

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Noninterest Expense

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
	(Dollars in millions)					
Compensation and benefits	$76	$76	$ —	$236	$219	$ 17
Occupancy and equipment	31	28	3	91	75	16
Commissions	21	23	(2)	64	49	15
Federal insurance premiums	6	5	1	18	12	6
Loan processing expense	14	15	(1)	43	41	2
Legal and professional expense	7	7	—	19	22	(3)
Other noninterest expense	18	17	1	52	47	5
Total noninterest expense	$173	$171	$ 2	$523	$465	$ 58
Efficiency ratio	74.6 %	73.5 %	1.1 %	76.2 %	73.9 %	2.3 %
Average number of FTE	3,570	3,500	70	3,617	3,233	384

Comparison to Prior Year Quarter

Noninterest expense increased $2 million during the three months ended September 30, 2018, compared to the three months ended September 30, 2017.

Occupancy and equipment increased $3 million during the three months ended September 30, 2018, compared to the three months ended September 30, 2017. The increase was primarily due to a higher average depreciable asset base resulting from technology upgrades and software.

Commissions decreased $2 million and loan processing expense decreased $1 million, during the three months ended September 30, 2018, compared to the three months ended September 30, 2017, primarily due to a decrease in loan originations.

Comparison to Prior Year to Date

Noninterest expense increased $58 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017.

Compensation and benefits increased $17 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, primarily due to 12 percent higher average FTE, driven by acquisitions and growth in our overall business, partially offset by cost reduction initiatives and lower incentive compensation.

Occupancy and equipment increased $16 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017. The increase was primarily due to a higher average depreciable asset base and an increase in vendor services supporting business growth.

Commissions increased $15 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017. The increase is primarily due to the acquisition of Opes in May of 2017, which has increased our retail mortgage originations versus our predominately third party origination model, and $1.4 billion higher loan originations in the nine months ended September 30, 2018, compared to the nine months ended

September 30, 2017.

FDIC insurance premiums increased $6 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, primarily due to growth in our total assets.

Other noninterest expense increased $5 million during the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, primarily due to advertising expense to raise brand awareness.

Provision for Income Taxes

Our provision for income taxes for the three and nine months ended September 30, 2018 was $12 million and $33 million, respectively, compared to a provision of $20 million and $52 million for the three and nine months ended September 30, 2017, respectively. These decreases are primarily due to the reduction in the statutory corporate tax rate from 35 percent to 21 percent as a result of the Tax Cuts and Jobs Act.

Our effective tax provision rate for the three and nine months ended September 30, 2018 was 20.0 percent and 20.1 percent, respectively, compared to 32.4 percent and 32.3 percent for the three and nine months ended September 30, 2017, respectively. Our effective tax provision rate differs from the combined federal and state statutory tax rate primarily due to non-taxable bank owned life insurance and other tax-exempt earnings, partially offset by nondeductible expenses.

Operating Segments

Our operations are conducted through three operating segments: Community Banking, Mortgage Originations, and Mortgage Servicing. The Other segment includes the remaining reported activities. The operating segments have been determined based on the products and services offered and reflect the manner in which financial information is currently evaluated by management. Each of the operating segments is complementary to each other and because of the interrelationships of the segments, the information presented is not indicative of how the segments would perform if they operated as independent entities.

For detail on each segment's objectives, strategies, and priorities, please read this section in conjunction with Note 18 - Segment Information.

Community Banking

Our Community Banking segment services commercial, governmental and consumer customers in our banking footprint which spans throughout Michigan and contiguous states as well as the high desert region of California. We also serve home builders, correspondents, and commercial customers on a national basis. The Community Banking segment originates loans, and provides deposit and fee based services to consumer, business, and mortgage lending customers.

Our commercial customers are from a diversified range of industries including financial, insurance, service, manufacturing, and distribution. We offer financial products to these customers for use in their normal business operations and financing of working capital needs, capital investments, and equipment purchases and leases. Additionally, our commercial real estate business supports income producing real estate and home builders. The Community Bank also offers warehouse lines of credit to other mortgage lenders.

Our Community Banking segment has seen continued growth, both organically and through strategic acquisitions, and our transformation into a commercial bank continues to be a key component in our overall business model. Our commercial loan portfolio has grown 25 percent in the last twelve months, to $5.0 billion, at September 30, 2018, boosted by the Santander warehouse business acquisition. Additionally, the DCB branch acquisition expanded our banking footprint and drove an increase in deposits in the Community Banking segment. Average deposits, for the nine month ended September 30, 2018, have increased to $8.6 billion, compared to $7.4 billion, for the same period in 2017.

In the second quarter 2018, we signed a definitive agreement to acquire 52 Wells Fargo branches in Indiana, Michigan, Wisconsin and Ohio. These branches will provide us with over $2 billion of high-quality, low-cost deposits, allowing for balance sheet growth and further expansion of our banking footprint. We estimate post-closing deposit run-off of approximately 17 percent and anticipate fourth quarter 2018 integration costs to be approximately $10 million. The acquisition is expected to be moderately accretive to 2019 earnings per share with a payback period of less than five years. We expect to close this transaction at the beginning of December 2018.

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Community Banking	Three Months Ended September 30, 2018	2017	Change	Nine Months Ended September 30, 2018	2017	Change
	(Dollars in millions)					
Summary of Operations						
Net interest income	$81	$63	$18	$231	$171	$60
Provision benefit for loan losses	(1)	(1)	—	(2)	(3)	1
Net interest income after (provision) benefit for loan losses	80	62	18	229	168	61
Net gain (loss) on loan sales	(3)	(4)	1	(10)	(7)	(3)
Other noninterest income	10	8	2	27	22	5
Total noninterest income	7	4	3	17	15	2
Compensation and benefits	(17)	(15)	(2)	(51)	(46)	(5)
Other noninterest expense and directly allocated overhead	(27)	(25)	(2)	(81)	(67)	(14)
Total noninterest expense	(44)	(40)	(4)	(132)	(113)	(19)
Income before indirect overhead allocations and income taxes	43	26	17	114	70	44
Overhead allocations	(9)	(10)	1	(29)	(30)	1
Provision for income taxes	7	6	1	18	14	4
Net income	$27	$10	$17	$67	$26	$41
Key Metrics						
Efficiency Ratio	51.2%	59.7%	(8.5)%	53.5 %	60.8 %	(7.3)%
Return on average assets	1.2 %	0.6 %	0.6 %	1.1 %	0.6 %	0.5 %
Average number of FTE employees	846	725	121	811	705	106

Comparison to Prior Year Quarter

The Community Banking segment reported net income of $27 million for the three months ended September 30, 2018, compared to $10 million for the three months ended September 30, 2017. The $17 million increase in net income was primarily due to an $18 million increase in net interest income driven by higher average commercial loans. Average commercial loans increased $1.3 billion for the three months ended September 30, 2018 compared to the three months ended September 30, 2017, due to organic growth and our 2018 acquisitions of Desert Community Bank branches and the Santander warehouse business. This increase was partially offset by a $4 million increase in noninterest expense primarily due to higher compensation and benefits driven by an increase in FTE to support growth initiatives and an increase in FDIC premiums primarily due to higher total assets.

Comparison to Prior Year to Date

The Community Banking segment reported net income of $67 million for the nine months ended September 30, 2018, compared to $26 million for the nine months ended September 30, 2017. The $41 million increase in net income was primarily due to a $60 million increase in net interest income driven by average commercial loan growth of $1.4 billion for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017. This average commercial loan growth was due to organic growth and our 2018 acquisitions of Desert Community Bank branches and the Santander warehouse business. The increase in net interest income was partially offset by a $19 million increase in noninterest expense driven by growth initiatives, which include higher compensation and benefits, commissions, occupancy and equipment expense, along with an increase in community reinvestment programs and FDIC premiums primarily due to higher total assets.

Mortgage Originations

We are a leading national originator of residential first mortgages. Our Mortgage Origination segment originates and acquires one-to-four family residential mortgage loans primarily to sell or in some instances to hold in our LHFI portfolio in the Community Banking segment. We utilize diversified channels to originate or acquire mortgage loans including more than 1,100 correspondent partners, more than 800 broker relationships and we operate 81 retail lending locations.

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Mortgage Originations	Three Months Ended September 30, 2018	2017	Change	Nine Months Ended September 30, 2018	2017	Change
	(Dollars in millions)					
Summary of Operations						
Net interest income	$36	$34	$2	$100	$96	$4
Provision for loan losses	—	(1)	1	(1)	(3)	2
Net interest income after provision benefit for loan losses	36	33	3	99	93	6
Net gain on loan sales	46	79	(33)	176	196	(20)
Other noninterest income	30	27	3	76	77	(1)
Total noninterest income	76	106	(30)	252	273	(21)
Compensation and benefits	(26)	(28)	2	(83)	(72)	(11)
Other noninterest expense and directly allocated overhead	(41)	(49)	8	(129)	(114)	(15)
Total noninterest expense	(67)	(77)	10	(212)	(186)	(26)
Income before indirect overhead allocations and income taxes	45	62	(17)	139	180	(41)
Overhead allocation	(16)	(15)	(1)	(51)	(46)	(5)
Provision for income taxes	6	16	(10)	18	47	(29)
Net income	$23	$31	$(8)	$70	$87	$(17)
Key Metrics						
Efficiency Ratio	59.1%	55.0%	4.1%	60.1%	50.4%	9.7%
Return on average assets	1.6%	2.2%	(0.6)%	1.7%	2.2%	(0.5)%
Mortgage rate lock commitments (fallout-adjusted) (1)	$8,290	$8,898	$(608)	$25,024	$23,896	$1,128
Average number of FTE employees	1,464	1,618	(154)	1,575	1,381	194

(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 impact of changes in interest rates.

Comparison to Prior Year Quarter

The Mortgage Originations segment reported net income of $23 million for the three months ended September 30, 2018, compared to $31 million for the three months ended September 30, 2017. The decrease in net income, was primarily due to a $33 million lower net gain on loan sales driven by a 33 basis point decrease in net gain on loan sale margin and $608 million lower fallout adjusted locks. Secondary margin compression and a mix shift toward lower margin, but lower cost delegated correspondent channel, drove margin compression. The decrease in net interest income was partially offset by a $10 million decrease in noninterest expense due to lower volume related expenses and a decrease in compensation and benefits resulting from lower headcount, in addition to a $7 million increase in net return on MSRs primarily driven by lower prepayments and stronger valuations, along with a higher average UPB MSR balance.

Comparison to Prior Year to Date

The Mortgage Originations segment reported net income of $70 million for the nine months ended September 30, 2018, compared to $87 million for the nine months ended September 30, 2017. The decrease was primarily due to $20 million decrease in net gain on loan sales driven by a 13 basis point decrease in net gain on loan sale margins, partially offset by $1.1 billion higher fallout adjusted locks driven by 2017 acquisitions. The increase in mortgage volumes drove a $13 million increase in commission expense and a partially offsetting $2 million favorable impact on loan fees and charges. Additionally, an increase in headcount, primarily driven by acquisitions, resulted in $11 million higher compensation and benefits.

Mortgage Servicing

The Mortgage Servicing segment services loans, in which we hold the MSR asset, and subservices mortgage loans for others through a scalable servicing platform on a fee for service basis. We may also collect ancillary fees and earn income through the use of noninterest bearing escrows. The loans we service generate custodial deposits which provide a stable funding source. Revenue for those serviced and subserviced loans is earned on a contractual fee basis, with the fees varying based on our responsibilities and the delinquency status of the underlying loans. The Mortgage Servicing segment also services residential mortgages for our LHFI portfolio in the Community Banking segment and our own MSR portfolio in the Mortgage Originations segment for which it earns intersegment revenue.

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Mortgage Servicing	Three Months Ended September 30, 2018	2017	Change	Nine Months Ended September 30, 2018	2017	Change
	(Dollars in millions)					
Summary of Operations						
Net interest income (1)	$2	$4	$(2)	$5	$9	$(4)
Provision for loan losses	—	—	—	—	—	—
Net interest income after provision for loan losses	2	4	(2)	5	9	(4)
Total noninterest income	24	14	10	65	47	18
Compensation and benefits	(4)	(4)	—	(13)	(12)	(1)
Other noninterest expense and directly allocated overhead	(18)	(13)	(5)	(49)	(45)	(4)
Total noninterest expense	(22)	(17)	(5)	(62)	(57)	(5)
Income (loss) before indirect overhead allocations and income taxes	4	1	3	8	(1)	9
Overhead allocations	(5)	(6)	1	(15)	(17)	2
Provision (benefit) for income taxes	—	(1)	1	(2)	(6)	4
Net income (loss)	$(1)	$(4)	$3	$(5)	$(12)	$7
Key Metrics						
Efficiency Ratio	86.9%	94.4%	(7.5)%	88.6%	101.8%	(13.2)%
Return on average assets	(14.5)%	(53.3)%	38.8%	(24.5)%	(44.4)%	19.9%
Average number of residential loans serviced	591,769	401,792	189,977	515,292	397,558	117,734
Average number of FTE employees	238	197	41	221	197	24

(1) Includes intersegment interest earned, net of interest paid on custodial deposits.

The following table presents residential loans serviced and the number of accounts associated with those loans.

	September 30, 2018		December 31, 2017	
	Unpaid Principal Balance (1)	Number of accounts	Unpaid Principal Balance (1)	Number of accounts
	(Dollars in millions)			
Residential loan servicing				
Subserviced for others (2)	$106,297	494,950	$65,864	309,814
Serviced for others	21,835	88,410	25,073	103,137
Serviced for own loan portfolio (3)	8,033	35,185	7,013	29,493
Total residential loans serviced	$136,165	618,545	$97,950	442,444

(1) UPB, net of write downs, does not include premiums or discounts.

(2) Includes temporary short-term subservicing performed as a result of sales of servicing-released MSRs. Includes repossessed assets.

(3) Includes LHFI (residential first mortgage and home equity), LHFS (residential first mortgage), loans with government guarantees (residential first mortgage), and repossessed assets.

Comparison to Prior Year Quarter

The Mortgage Servicing segment reported net loss of $1 million for the three months ended September 30, 2018, compared to a net loss of $4 million for the three months ended September 30, 2017. The increase in net income was primarily due to an increase in loans serviced which drove higher volume related income, including a $6 million increase in loan administration income and a $3 million increase in ancillary fees, partially offset by higher volume related noninterest expense.

Comparison to Prior Year to Date

The Mortgage Servicing segment reported a net loss of $5 million for the nine months ended September 30, 2018, compared to a net loss of $12 million for the nine months ended September 30, 2017. The increase in net income was primarily due to an increase in the number of loans serviced which drove higher volume related income, including a $10 million increase in loan administration income and an $8 million increase in ancillary fees. This increase was partially offset by higher volume related costs driving an increase in noninterest expense.

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Other

The Other segment includes the treasury functions, which include, the impact of interest rate risk management, balance sheet funding activities and the administration of the investment securities portfolios, as well as other expenses of a corporate nature, including corporate staff, risk management, and legal expenses. In addition, the Other segment includes revenue and expenses not directly assigned or allocated to the Community Banking, Mortgage Originations or Mortgage Servicing segments.

Other	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change	2018	2017	Change
	(Dollars in millions)					
Summary of Operations						
Net interest income (1)	$5	$ 2	$ 3	$9	$ 7	$ 2
(Provision) benefit for loan losses	3	—	3	6	2	4
Net interest income after (provision) benefit for loan losses	8	2	6	15	9	6
Net gain (loss) on loan sales	—	—	—	—	—	—
Other noninterest income (1)	—	6	(6)	7	11	(4)
Total noninterest income	—	6	(6)	7	11	(4)
Compensation and benefits	(29)	(29)	—	(89)	(89)	—
Other noninterest expense and directly allocated overhead (1)	(11)	(8)	(3)	(28)	(20)	(8)
Total noninterest expense	(40)	(37)	(3)	(117)	(109)	(8)
Income (loss) before indirect overhead allocations and income taxes	(32)	(29)	(3)	(95)	(89)	(6)
Overhead allocations	30	31	(1)	95	93	2
Provision (benefit) for income taxes	(1)	(1)	—	(1)	(3)	2
Net income (loss)	$(1)	$ 3	$ (4)	$1	$ 7	$ (6)
Key Metrics						
Average number of FTE employees	1,022	960	62	1,010	950	60

(1) Includes offsetting adjustments made to reclassify income and expenses relating to operating leases and custodial deposits for subservicing clients.

Comparison to Prior Year Quarter

The Other segment reported net loss of $1 million, for the three months ended September 30, 2018, compared to net income of $3 million for the three months ended September 30, 2017. This decrease was primarily due to a $3 million increase in noninterest expense to support growth. Higher custodial deposit expense, included in an inter-segment reclassification adjustment, resulted in an increase in net interest income and decrease in noninterest income. Additionally, the benefit for loan losses was $3 million for the three months ended September 30, 2018, compared to zero for the same period in 2017.

Comparison to Prior Year to Date

The Other segment reported net income of $1 million for the nine months ended September 30, 2018, compared to net income of $7 million for the nine months ended September 30, 2017. This decrease was primarily due to an $8 million increase in noninterest expense to support growth. The $4 million decrease in noninterest income primarily resulted from higher custodial deposit expense, partially offset by an increase in dividend income on FHLB stock and a FHLB stock supplemental dividend which we received in the first quarter 2018. Additionally, the benefit for loan losses increased $4 million in the nine months ended September 30, 2018, compared to the same period in 2017.

RISK MANAGEMENT

Certain risks are inherent in our business and include, but are not limited to, credit, regulatory compliance, legal, reputation, liquidity, market, operational, and strategic. We continuously invest 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 unexpected loss arising from these risks.

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, 2017. Some of the more significant processes used to manage and control credit, market, liquidity and operational risks are described in the following paragraphs.

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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, and enter into financial derivative contracts, all of which have related credit risk.

We maintain credit limits, in compliance with regulatory requirements. Under the Home Owners Loan Act ("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 the Tier 2 capital. This limit was $263 million as of September 30, 2018.

We maintain a more conservative maximum internal Bank limit than required by HOLA, of $100 million (commitment level) to any one borrower/obligor relationship, with the exception of warehouse borrower/obligor relationships, which have a higher internal Bank limit of $125 million as all advances are fully collateralized by residential mortgage loans. We have a tracking and reporting process to monitor lending concentration levels and all credit exposures to a single borrower that exceed $50 million must be approved by the Board of Directors.

Loans held-for-investment

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

	September 30, 2018	December 31, 2017	Change
	(Dollars in millions)		
Consumer loans			
Residential first mortgage	$3,085	$ 2,754	$ 331
Home equity (1)	704	664	40
Other	150	25	125
Total consumer loans	3,939	3,443	496
Commercial loans			
Commercial real estate	2,160	1,932	228
Commercial and industrial	1,317	1,196	121
Warehouse lending	1,550	1,142	408
Total commercial loans	5,027	4,270	757
Total loans held-for-investment	$8,966	$ 7,713	$ 1,253

(1) Includes second mortgages and HELOC/HELOAN loans.

Loans held-for-investment increased $1.3 billion from December 31, 2017 to September 30, 2018. This increase was due to growth in our Community Banking segment, combined with the acquisitions of Santander Bank's warehouse lending business and Desert Community Bank branches which occurred during the first quarter of 2018.

As we continue to strengthen our Community Banking segment by growing interest earning assets, our commercial loan portfolio has grown $757 million, or 18 percent, from December 31, 2017 to September 30, 2018, led by a $408 million increase in our warehouse loans, primarily due to our Santander warehouse business acquisition. In addition, our consumer loan portfolio has increased $496 million, or 14 percent, from December 31, 2017 to September 30, 2018, led by a $331 million and $125 million increase in residential first mortgage loans and other consumer loans, respectively.

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.

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

	September 30, 2018	December 31, 2017
	(Dollars in millions)	
Estimated LTVs (1)		
Less than 80% and refreshed FICO scores (2):		
Equal to or greater than 660	$2,538	$ 2,441
Less than 660	75	73
80% and greater and refreshed FICO scores (2):		
Equal to or greater than 660	397	168
Less than 660	31	12
U.S. government guaranteed	44	60
Total	$3,085	$ 2,754
Geographic region		
California	$1,286	$ 1,127
Michigan	312	275
Washington	207	169
Texas	200	182
Florida	198	201
Illinois	103	101
New York	77	62
Arizona	75	76
Colorado	73	69
Maryland	59	65
Others	495	427
Total	$3,085	$ 2,754

(1) LTVs reflect UPB at the date reported, as a percentage of property values as appraised at loan origination.
(2) FICO scores are updated at least on a quarterly basis or more frequently, if available.

The following table presents our total residential first mortgage LHFI as of September 30, 2018, by year of origination:

	2018	2017	2016	2015	2014 and Prior	Total
	(Dollars in millions)					
Residential first mortgage loans	$639	$790	$592	$676	$388	$3,085
Percent of total	20.7 %	25.6 %	19.2 %	21.9 %	12.6 %	100.0 %

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 credit quality and loan profitability. Our debt-to-income ratio on HELOANS 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. Second mortgage loans/HELOANS are fixed rate loans and are available with terms up to 20 years. HELOC loans are variable-rate loans that contain a 10-year draw period followed by a 20-year amortizing period. At September 30, 2018, we had $146 million first lien HELOCs and HELOANs included in residential first mortgage loans and $693 million second lien HELOCs and HELOANs included in home equity.

Commercial real estate loans. The commercial real estate portfolio contains loans collateralized by diversified property types which are primarily income producing in the normal course of business. The majority of our retail exposure is to high-quality, single tenant locations, including many drug stores, with limited exposure to big box retail centers. This portfolio also includes owner occupied real estate loans and secured home builder loans. 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. At September 30, 2018, our average LTV and average debt service coverage for our CRE portfolio was 54 percent and 2.00 times, respectively. Our CRE loans earn interest at a variable rate.

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Our national home builder finance program has helped grow our balance sheet, increase commercial deposits and generate incremental revenue through our retail purchase mortgage channel. Through this program, we finance and have active relationships with homebuilders nationwide. At September 30, 2018, loans committed to home builders totaled $1.2 billion, of which $741 million UPB was drawn or used. Of that, $141 million UPB is unsecured which is included in our C&I portfolio and $600 million UPB is collateralized and included in either the single family residence or land-residential categories of our CRE portfolio.

The following table presents our total CRE LHFI by collateral location and collateral type:

	Michigan	Texas	Colorado	Florida	California	Other	Total	% by collateral type
	(Dollars in millions)							
September 30, 2018								
Single family residence (1)	$20	$91	$ 127	$97	$ 44	$76	$455	21.1 %
Owner occupied	239	4	—	6	27	56	332	15.4 %
Retail (2)	185	2	6	1	7	120	321	14.9 %
Multi family	102	35	17	32	7	92	285	13.2 %
Office	177	—	—	3	16	20	216	10.0 %
Land - Residential (3)	5	43	36	25	31	39	179	8.3 %
Hotel/motel	105	17	—	—	3	31	156	7.2 %
Senior Living facility	13	—	—	—	—	64	77	3.6 %
Industrial	41	—	—	—	—	33	74	3.4 %
All other (4)	26	3	1	11	2	22	65	2.9 %
Total	$913	$195	$ 187	$175	$ 137	$553	$2,160	100.0 %
Percent by state	42.3 %	9.0 %	8.7 %	8.1 %	6.3 %	25.6 %	100.0 %	

(1) Includes home builder loans secured by SFR 1-4 properties whether under construction or completed.
(2) Includes multipurpose retail space, neighborhood centers, strip centers and single-use retail space.
(3) Includes development and unimproved vacant land and home builder loans secured by land.
(4) All other primarily includes: parking garage, non-profit, mini-storage facilities, data centers, movie theater, etc.

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 times. Most of our C&I loans earn interest at a variable rate.

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

	Michigan	Texas	California	Connecticut	Virginia	Other	Total	% by industry
	(Dollars in millions)							
September 30, 2018								
Services	$119	$17	$ 46	$ 44	$ —	$74	$300	22.8 %
Financial & Insurance	15	—	—	6	72	185	278	21.1 %
Manufacturing	82	13	4	—	—	116	215	16.3 %
Homebuilder	—	75	20	—	—	46	141	10.7 %
Distribution	87	—	19	—	—	—	106	8.0 %
Healthcare	2	10	9	—	—	79	100	7.6 %
Government & Education	28	—	4	24	—	24	80	6.1 %
Rental & Leasing	49	—	—	—	—	30	79	6.0 %

Servicing Advances	—	—	—	—	—	9	9	0.7 %
Commodities	4	—	—	—	—	5	9	0.7 %
Total	$386	$115	$ 102	$ 74	$ 72	$568	$1,317	100.0 %
Percent by state	29.3 %	8.7 %	7.7 %	5.5 %	5.5 %	43.1 %	100.0 %	

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.

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The following table presents our warehouse advance amount of loans sold to the Bank:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars in millions)			
UPB of warehouse loans sold to the bank	$2,269	$2,927	$6,938	$8,039
Loans sold to the bank as a percentage of advances	24 %	36 %	27 %	39 %

Underlying mortgage loans are predominantly originated using the Agencies' underwriting standards. The guideline for debt to tangible net worth is 15 to 1. We have a national platform with relationship managers across the country. The aggregate committed amount of adjustable-rate warehouse lines of credit granted to other mortgage lenders at September 30, 2018 was $4.0 billion, of which $1.6 billion was outstanding, compared to $2.8 billion at December 31, 2017, of which $1.1 billion was outstanding. This increase is primarily due to our acquisition of the warehouse business from Santander Bank.

Credit Quality

Trends in certain credit quality characteristics remain very strong and are a result of our focus on effectively managing credit risk. 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, 2018	December 31, 2017
	(Dollars in millions)	
LHFI		
Consumer loans		
Residential first mortgage	$11	$ 12
Home equity	1	1
Total nonperforming LHFI	12	13
TDRs		
Consumer loans		
Residential first mortgage	9	12
Home equity	4	4
Total nonperforming TDRs	13	16
Total nonperforming LHFI and TDRs (1)	25	29
Real estate and other nonperforming assets, net	7	8

LHFS	10	9
Total nonperforming assets	$42	$ 46
Nonperforming assets to total assets (2)	0.17%	0.22 %
Nonperforming LHFI and TDRs to LHFI	0.28%	0.38 %
Nonperforming assets to LHFI and repossessed assets (2)	0.35%	0.48 %

(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.

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At September 30, 2018, we had $42 million of nonperforming assets compared to $46 million of nonperforming assets at December 31, 2017. The consistent, low levels of nonperforming loans reflect our focus on growing our loan portfolios with strong credit quality loans.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars in millions)			
Beginning balance	$ 27			