FLAGSTAR BANCORP INC
Form 10-Q
May 08, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2008

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

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)

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 ninety days. Yes þ No o.

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o	Smaller reporting company o

(Do not check if a smaller reporting company)

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

As of May 1, 2008, 60,335,101 shares of the registrant s common stock, $0.01 par value, were issued and outstanding.

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FORWARD-LOOKING STATEMENTS

This report contains certain forward-looking statements with respect to the financial condition, results of operations, plans, objectives, future performance and business of Flagstar Bancorp, Inc. (Flagstar or the Company) and these statements are subject to risk and uncertainty. Forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, include those using words or phrases such as believes, expects, anticipates, plans, trend, objective, continue, remain, pattern or similar expressions or future or conditiona as will, would, should, could, might, can, may or similar expressions.

There are a number of important factors that could cause future results to differ materially from historical performance and these forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed under the heading Risk Factors in Part I, Item 1A of the Company s Annual Report on Form 10-K for the year ended December 31, 2007 and Part II, Item 1A of this Company s Quarterly Report on Form 10-Q, including: (1) general business, economic and political conditions may significantly affect our earnings; (2) if we cannot effectively manage the impact of the volatility of interest rates, our earnings could be adversely affected; (3) the value of our mortgage servicing rights could decline with reduction in interest rates; (4) gains on mortgage servicing rights may be difficult to realize due to disruption in the capital markets; (5) we use estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation; (6) current and further deterioration in the housing and commercial real estate markets may lead to increased loss severities and further worsening of delinquencies and non-performing assets in our loan portfolios. Consequently, our allowance for loan losses may not be adequate to cover actual losses, and we may be required to materially increase our reserves; (7) our secondary market reserve for losses could be insufficient; (8) our home lending profitability could be significantly reduced if we are not able to resell mortgages; (9) our commercial real estate and commercial business loan portfolios carry heightened credit risk; (10) we have substantial risks in connection with securitizations and loan sales; (11) our ability to borrow funds and raise capital could be limited, which could adversely affect our earnings; (12) we may be required to raise capital at terms that are materially adverse to our stockholders; (13) our holding company is dependent on the Bank for funding of obligations and dividends; (14) we may not be able to replace key members of senior management or attract and retain qualified relationship managers in the future; (15) the network and computer systems on which we depend could fail or experience a security breach; (16) our business is highly regulated; (17) our business has volatile earnings because it operates based on a multi-year cycle; (18) our loans are geographically concentrated in only a few states; (19) a larger percentage or our loans are collateralized by real estate, and an adverse change in the real estate market may result in losses and adversely affect our portfolio; (20) a significant part of our business strategy involves adding new branch locations, and our failure to grow may adversely affect our business, prospects, and results of operations and financial condition; (21) we are subject to heightened regulatory scrutiny with respect to bank secrecy and anti-money laundering statutes and regulations; and (22) certain hedging strategies that we use to manage our investment in mortgage servicing rights may be ineffective to offset any adverse changes in the fair value of these assets due to changes in interest rate; and (23) we depend on our institutional counterparties to provide services that are critical to our business. If one or more of our institutional counterparties defaults on its obligations to us or becomes insolvent, it could materially adversely affect our earnings, liquidity, capital position and financial condition.

The Company does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

The unaudited condensed consolidated financial statements of the Company are as follows:

Consolidated Statements of Financial Condition — March 31, 2008 (unaudited) and December 31, 2007.

Unaudited Consolidated Statements of Operations — For the three months ended March 31, 2008 and 2007.

Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss) — For the three months ended March 31, 2008 (unaudited) and for the year ended December 31, 2007.

Unaudited Consolidated Statements of Cash Flows — For the three months ended March 31, 2008 and 2007.

Unaudited Notes to Consolidated Financial Statements.
Statement Regarding Computation of Net Earnings Per Share
Section 302 Certification of Chief Executive Officer
Section 302 Certification of Chief Financial Officer
Section 906 Certification, as Furnished by the Chief Executive Officer
Section 906 Certification, as Furnished by the Chief Financial Officer

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Flagstar Bancorp, Inc.
Consolidated Statements of Financial Condition
(In thousands, except for share data)

	At March 31, 2008	At December 31, 2007
	(Unaudited)	
Assets		
Cash and cash items	$ 138,351	$ 129,992
Interest-bearing deposits	209,358	210,177
Cash and cash equivalents	347,709	340,169
Securities classified as trading	36,308	13,703
Securities classified as available for sale	2,364,007	1,308,608
Mortgage-backed securities held to maturity (fair value $1.3 billion at December 31, 2007)		1,255,431
Other investments	28,402	26,813
Loans available for sale	3,137,410	3,511,310
Loans held for investment	8,574,024	8,134,397
Less: allowance for loan losses	(121,400)	(104,000)
Loans held for investment, net	8,452,624	8,030,397
Total interest-earning assets	14,228,109	14,356,439
Accrued interest receivable	55,806	57,888
Repossessed assets, net	136,490	109,274
Federal Home Loan Bank stock	348,944	348,944
Premises and equipment, net	242,545	237,652
Mortgage servicing rights at fair value	486,584	
Mortgage servicing rights, net	11,291	413,986
Other assets	275,192	138,561
Total assets	$ 15,923,312	$ 15,792,736
Liabilities and Stockholders Equity Liabilities		
Deposits	$ 8,427,804	$ 8,236,744
Federal Home Loan Bank advances	6,207,000	6,301,000
Security repurchase agreements	108,000	108,000
Long term debt	248,685	248,685
Total interest-bearing liabilities	14,991,489	14,894,429
Accrued interest payable	40,248	47,070
Secondary market reserve	27,400	27,600
Other liabilities	160,521	130,659
Total liabilities	15,219,658	15,099,758
Commitments and Contingencies		
Stockholders Equity		

Common stock $.01 par value, 150,000,000 shares authorized; 63,667,079 and 63,656,979 shares issued, and 60,325,344 and 60,270,624 shares outstanding, at March 31, 2008, and December 31, 2007, respectively	637	637
Additional paid in capital	63,775	64,350
Accumulated other comprehensive loss	(18,611)	(11,495)
Retained earnings	698,983	681,165
Treasury stock, at cost, 3,341,735 shares at March 31, 2008, and 3,386,355 at December 31, 2007	(41,130)	(41,679)
Total stockholders equity	703,654	692,978
Total liabilities and stockholders equity	$ 15,923,312	$ 15,792,736

The accompanying notes are an integral part of these consolidated financial statements.

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Flagstar Bancorp, Inc.
Consolidated Statements of Operations
(In thousands, except per share data)

	For the Three Months Ended March 31, 2008	2007
	(Unaudited)	
Interest Income		
Loans	$ 176,294	$ 187,252
Mortgage-backed securities	15,576	14,617
Securities available for sale	15,591	13,598
Interest-bearing deposits	2,768	3,501
Other	624	1,602
Total interest income	210,853	220,570
Interest Expense		
Deposits	84,050	85,026
FHLB advances	64,558	67,852
Security repurchase agreements	3,155	12,393
Other	4,292	2,448
Total interest expense	156,055	167,719
Net interest income	54,798	52,851
Provision for loan losses	34,262	8,293
Net interest income after provision for loan losses	20,536	44,558
Non-Interest Income		
Loan fees and charges	884	1,229
Deposit fees and charges	6,031	4,978
Loan administration	(17,046)	2,183
Net gain on loan sales	63,425	25,154
Net gain on sales of mortgage servicing rights	287	115
Net gain on sales of securities available for sale		729
Loss on trading securities	(9,482)	
Other fees and charges	8,575	5,078
Total non-interest income	52,674	39,466
Non-Interest Expense		
Compensation and benefits	53,993	39,492
Occupancy and equipment	19,821	16,768
Communication	1,785	1,074
Other taxes	891	(573)
General and administrative	12,678	15,084

Total non-interest expense		89,168		71,845
(Loss) earnings before federal income taxes		(15,958)		12,179
(Benefit) provision for federal income taxes		(5,359)		4,420
Net (Loss) Earnings	$	(10,599)	$	7,759
(Loss) earnings per share				
Basic	$	(0.18)	$	0.12
Diluted	$	(0.17)	$	0.12

The accompanying notes are an integral part of these consolidated financial statements.

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Flagstar Bancorp, Inc.
Consolidated Statements of Stockholders Equity and Comprehensive Income (Loss)
(In thousands, except per share data)

	Common Stock	Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Total Stockholders Equity
Balance at January 1, 2007	$ 636	$ 63,223	$ 5,182	$ 743,193	$	$ 812,234
Net loss				(39,225)		(39,225)
Reclassification of gain on swap extinguishment			(101)			(101)
Change in net unrealized loss on swaps used in cash flow hedges			(3,957)			(3,957)
Change in net unrealized loss on securities available for sale			(12,619)			(12,619)
Total comprehensive loss						(55,902)
Adjustment to initially apply FIN 48				(1,428)		(1,428)
Stock options exercised	1	69				70
Stock-based compensation		1,083				1,083
Tax effect from stock-based compensation		(25)				(25)
Purchase of treasury stock					(41,705)	(41,705)
Issuance of treasury stock					26	26
Dividends paid ($0.35 per share)				(21,375)		(21,375)
Balance at December 31, 2007	637	64,350	(11,495)	681,165	(41,679)	692,978
(Unaudited)						
Net loss				(10,599)		(10,599)
Reclassification of gain on dedesignation of swaps used in cash flow hedges			(236)			(236)
Change in net unrealized loss on securities available for sale			(6,880)			(6,880)

Total comprehensive loss						(17,715)
Cumulative effect adjustment due to change of accounting for residential mortgage servicing rights				28,417		28,417
Restricted stock issued		(549)			549	
Stock options exercised		42				42
Stock-based compensation		130				130
Tax effect from stock-based compensation		(198)				(198)
Balance at March 31, 2008	$ 637	$ 63,775	$ (18,611)	$ 698,983	$ (41,130)	$ 703,654

The accompanying notes are an integral part of these consolidated financial statements.

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Flagstar Bancorp, Inc.
Consolidated Statements of Cash Flows
(In thousands)

	For the Three Months Ended March 31,	
	2008	**2007**
	(Unaudited)	
Operating Activities		
Net (loss) earnings	$ (10,599)	$ 7,759
Adjustments to net (loss) earnings to net cash used in operating activities		
Provision for loan losses	34,262	8,293
Depreciation and amortization	6,434	21,449
Decrease in valuation allowance in mortgage servicing rights	(119)	(448)
Loss on fair value of residential mortgage servicing rights, net of hedging gains	46,961	
Stock-based compensation expense	130	374
Loss on interest rate swaps	1,611	
Net gain on the sale of assets	(370)	(878)
Net gain on loan sales	(63,425)	(25,154)
Net gain on sales of mortgage servicing rights	(287)	(115)
Net gain on securities classified as available for sale		(729)
Unrealized loss on trading securities	9,482	
Proceeds from sales of loans available for sale	6,271,453	4,714,831
Origination and repurchase of mortgage loans available for sale, net of principal repayments	(6,489,510)	(5,380,030)
Decrease in accrued interest receivable	2,082	2,446
(Increase) decrease in other assets	(123,830)	12,817
(Decrease) increase in accrued interest payable	(6,822)	2,295
Net tax effect for stock grants issued	198	59
(Decrease) increase in federal income taxes payable	(14,592)	6,204
Decrease in payable for securities purchased		(249,694)
Increase (decrease) in other liabilities	10,244	(5,628)
Net cash used in operating activities	(326,697)	(886,149)
Investing Activities		
Net change in other investments	(1,589)	262
Repayment of mortgage-backed securities held to maturity	90,846	92,238
Proceeds from sale of investment securities available for sale		171,441
Repayment (purchase) of investment securities available for sale	26,157	(218,023)
Proceeds from sales of portfolio loans		620,866
Origination of portfolio loans, net of principal repayments	100,244	310,154
Purchase of Federal Home Loan Bank stock		(51,457)
Proceeds from the disposition of repossessed assets	18,990	26,255
Acquisitions of premises and equipment, net of proceeds	(9,815)	(8,102)
Proceeds from the sale of mortgage servicing rights		116
Net cash provided by investing activities	224,833	943,750

Financing Activities		
Net increase in deposit accounts	191,060	351,894
Net decrease in security repurchase agreements		(365,380)
Net (decrease) increase in Federal Home Loan Bank advances	(94,000)	197,000
Net receipt of payments of loans serviced for others	5,213	8,170
Net receipt of escrow payments	7,287	6,335
Proceeds from the exercise of stock options	42	(87)
Net tax effect of stock grants issued	(198)	(59)
Dividends paid to stockholders		(6,321)
Purchase of treasury stock		(16,466)
Net cash provided by financing activities	109,404	175,086
Net increase in cash and cash equivalents	7,540	232,687
Beginning cash and cash equivalents	340,169	277,236
Ending cash and cash equivalents	$ 347,709	$ 509,923

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	For the Three Months Ended March 31,	
	2008	2007
	(Unaudited)	
Supplemental disclosure of cash flow information:		
Loans held for investment transferred to repossessed assets	$ 62,699	$ 26,720
Total interest payments made on deposits and other borrowings	$ 162,876	$ 166,303
Federal income taxes paid	$	$
Reclassification of mortgage loans originated for portfolio to mortgage loans available for sale	$	$ 693,283
Reclassification of mortgage loans originated available for sale then transferred to portfolio loans	$ 592,874	$ 125,721
Mortgage servicing rights resulting from sale or securitization of loans	$ 100,752	$ 68,034
Reclassification of mortgage backed securities held to maturity to securities available for sale	$ 1,163,681	$ 315,344

The accompanying notes are an integral part of these consolidated financial statements.

Flagstar Bancorp, Inc.
Notes to Consolidated Financial Statements
(Unaudited)

Note 1. Nature of Business

Flagstar Bancorp, Inc. (Flagstar or the Company), is the holding company for Flagstar Bank, FSB (the Bank), a federally chartered stock savings bank founded in 1987. With $15.9 billion in assets at March 31, 2008, Flagstar is the largest financial institution headquartered in Michigan.

The Company s principal business is obtaining funds in the form of deposits and wholesale borrowings and investing those funds in single-family mortgages and other types of loans. Its primary lending activity is the acquisition or origination of single-family mortgage loans. The Company also originates consumer loans, commercial real estate loans, and non-real estate commercial loans and it services a significant volume of residential mortgage loans for others.

The Company sells or securitizes most of the mortgage loans that it originates and generally retains the right to service the mortgage loans that it sells. These mortgage-servicing rights (MSRs) have occasionally been sold by the Company in transactions separate from the sale of the underlying mortgages. The Company may also retain a portion of its loan production on its statement of financial condition as loans held for investment in order to enhance the Company s leverage ability and receive the interest spread between earning assets and paying liabilities.

The Bank is a member of the Federal Home Loan Bank System (FHLB) and is subject to regulation, examination and supervision by the Office of Thrift Supervision (OTS) and the Federal Deposit Insurance Corporation (FDIC). The Bank s deposits are insured by the FDIC through the Deposit Insurance Fund (DIF).

Note 2. Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of the Company and its consolidated subsidiaries. All significant intercompany balances and transactions have been eliminated. In accordance with current accounting principles, the Company s trust subsidiaries are not consolidated. In addition, certain prior period amounts have been reclassified to conform to the current period presentation.

The unaudited consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles for interim information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X as promulgated by the Securities and Exchange Commission. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America (U.S. GAAP) for complete financial statements. The accompanying interim financial statements are unaudited; however, in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for the three month period ended March 31, 2008, are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. For further information, you should refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007. The Form 10-K can be found on the Company s Investor Relations web page, at **www.flagstar.com**, and on the website of the Securities and Exchange Commission, at **www.sec.gov**.

Note 3. Recent Accounting Developments

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) 157, *Fair Value Measurements.* SFAS 157 defines the term fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP, and expands disclosures about fair value measurements. SFAS 157 clarifies that the exchange price is the price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. SFAS 157 emphasizes that fair value is a market-based measurement and not an entity-specific measurement. It also establishes a hierarchy used in such measurement and expands the required disclosures of assets and liabilities measured at fair value. The Company adopted SFAS 157 as of January 1, 2008. See Note 4, Fair Value Accounting for further information.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities.* SFAS 159 permits entities to choose to measure financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The decision to elect the fair value option may be applied instrument by instrument, is irrevocable and must be applied to the entire instrument and not to specified risks, specific cash flows or portions of that instrument. An entity is restricted in choosing the dates to elect the fair value option for an eligible item. The Company adopted SFAS 159 effective January 1, 2008. See Note 4, Fair Value Accounting for further information.

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In November 2007, the FASB issued SFAS 160 *Non-controlling Interest in Consolidated Financial Statements an amendment to ARB No. 51.* SFAS 160 changes the way consolidated net earnings are presented. The new standard requires consolidated net earnings to be reported at amounts attributable to both the parent and the non-controlling interest on the face of the consolidated statement of earnings. The adoption of this statement will result in more transparent reporting of the net earnings attributable to non-controlling interests. The statement establishes a single method of accounting for changes in a parent s ownership interest in a subsidiary which does not result in deconsolidation. The statement also requires that a parent recognize a gain or loss in net earnings when a subsidiary is deconsolidated. The adoption of SFAS 160 is effective for the Company on January 1, 2009. Management does not expect that the adoption of this statement will have a material impact on the Company s consolidated financial condition, results of operation or liquidity.

In November 2007, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin 109 (SAB 109). SAB 109 expresses the views of the SEC regarding the written loan commitments that are accounted for at fair value through earnings under generally accepted accounting principles. SAB 109 supersedes SAB 105 and expresses the current view of the staff that, consistent with the guidance in SFAS 156 *Accounting for Servicing of Financial Assets* and SFAS 159 *The Fair Value Option for Financial Assets and Financial Liabilities*, the expected net future cash flows related to the associated servicing of the loans should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. The adoption of SAB 109 is effective on a prospective basis for the Company s derivative loan commitments issued or modified on or after January 1, 2008. The effect of this change resulted in an increase in the Company s gain on loan sales by approximately $12 million during the three month period ended March 31, 2008.

In December 2007, the SEC issued Staff Accounting Bulletin 110 (SAB 110). SAB 110 expresses the views of the SEC regarding the use of a simplified method in developing an estimate of the expected term of plain vanilla share options as discussed in SAB 107 and issued under SFAS 123 (revised 2004), *Share-Based Payment.* The SEC indicated in SAB 107 that it would accept a company s decision to use the simplified method, regardless of whether the company had sufficient information to make more refined estimates of expected term. Under SAB 107, the SEC had believed detailed information about employee exercise behavior would be readily available and therefore would not expect companies to use the simplified method for share option grants after December 31, 2007. SAB 110 states that the SEC will continue to accept, under certain circumstances, the use of the simplified method beyond December 31, 2007. The Company does not utilize the simplified method, and therefore management does not expect that this pronouncement will have an impact on the Company s consolidated financial condition, results of operation or liquidity.

In March 2008, the FASB issued SFAS 161 *Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133.* SFAS 161 requires enhanced disclosures about an entity s derivative and hedging activities and thereby improves on the transparency of financial reporting. In adopting SFAS 161, entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial positions, financial performance and cash flows. Because this pronouncement affects only disclosures, this pronouncement will not have an impact on the Company s consolidated financial condition, results of operation or liquidity. The adoption of SFAS 161 is effective for fiscal years beginning after November 15, 2008, with early adoption permitted. The Company does not expect to elect early adoption of SFAS 161.

Note 4. Fair Value Accounting

On January 1, 2008, the Company adopted SFAS 157, *Fair Value Measurements* and SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities.* SFAS 157 establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 was issued to establish a uniform definition of fair value. The definition of fair value under SFAS 157 is market-based as opposed to company-specific and includes the following:

Defines fair value as the price that would be received to sell an asset or paid to transfer a liability, in either case through an orderly transaction between market participants at a measurement date, and establishes a framework for measuring fair value;

Establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date;

Nullifies the guidance in EITF 02-3, which required the deferral of profit at inception of a transaction involving a derivative financial instrument in the absence of observable data supporting the valuation technique;

Eliminates large position discounts for financial instruments quoted in active markets and requires consideration of the company s creditworthiness when valuing liabilities; and

Expands disclosures about instruments that are measured at fair value.

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