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PRESENTATION

Operator

Good day, everyone and welcome to the Flagstar Bank fourth-quarter investor relations conference call. Today's call is being recorded. At this time, I would like to turn the conference over to Paul Borja. Please go ahead.

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

Thank you. Good morning, everyone. I would like to welcome you to our fourth-quarter 2012 earnings call. My name is Paul Borja, and I am the Chief Financial Officer of Flagstar Bank.

Before we begin our comments, I would like to remind you that the presentation today may contain forward-looking statements regarding both our financial condition and our financial results. These statements involve certain risks that may cause actual results in the future to be different from our current expectations. These factors include, among other things, changes in economic conditions, changes in interest rates, the outcome of pending litigation, competitive pressures within the financial services industry and legislative or regulatory requirements that may affect our businesses. For additional factors, we urge you to review the press release we issued last night, our SEC documents such as our most recent Form 10-K and Form 10-Q, as well as the legal disclaimer on page 2 of our earnings call slides that we have just posted on our investor relations page at Flagstar.com.

In addition, pursuant to the existing consent order, we are in the process of finalizing our capital plan and therefore, we will not be providing any guidance for the coming year at this time.

During the call, we may also discuss non-GAAP measures regarding our financial performance. A reconciliation of these measures to like GAAP measures is provided in the tables to our press release, which was issued last night, as well as in the appendix to our earnings call slides.

With that, I would like to now turn the call over to Mike Tierney, our Chief Executive Officer. Mike?

Mike Tierney - *Flagstar Bancorp, Inc. - President & CEO*

Thanks, Paul and good morning, everyone. Thank you for joining us and welcome to our fourth-quarter 2012 earnings call. We are refocusing our national Mortgage Banking business and our Michigan-based community bank model. We also remain dedicated to enhancing our culture of compliance. We are investing in our quality and risk management functions, as well as enhancing corporate governance so we can continue to generate sustainable profitability and deliver shareholder value.

With these priorities in mind, during the fourth quarter, we made several organizational changes that strengthened our corporatewide risk management and governance. First of all, our Mortgage Banking activities have been consolidated under one division, which Matt Kerin will lead. Second, the community banking activities, including commercial banking, personal financial services, bank operations and technology, are now operating under Sandro DiNello's oversight.

To help implement these organizational changes and further enhance our culture of compliance, we've made several additional personnel changes. First, we have hired a new Chief Risk Officer, Hugh Boyle, who will take over the position from Todd McGowan. Todd will be moving into a new and very important role as the Managing Director of Regulatory Affairs. We have also received OCC approval for John Lewis to serve as our Chairman. We expect to finalize his appointment shortly once we have received approval from the Federal Reserve.

I now would like to discuss some of the key themes and drivers of the fourth-quarter results. Matt Kerin, our Mortgage Banking President, will talk about the mortgage business. After Matt, Sandro DiNello, our Bank President, will provide an update of our community banking areas. Paul Borja will then take us through a more detailed financial review and finally, we will be available to answer your questions.

Please turn to slide 4. We are very happy to report fourth-quarter net income to common stockholders of $66.8 million, or $1.12 per diluted share, representing our third consecutive quarter of profitability. On an annualized basis, this represents a return on average assets of 1.8% and a return on average equity of 20.7%. For the full year of 2012, we earned net income to common stockholders of $223.7 million, or $3.74 per diluted share.

Looking at slide 5, you can see that the majority of our key performance metrics improved from the prior year. Our 2012 return on average assets was 1.5% and our 2012 return on average equity was 18.8%. We also increased our book value per common share to $18.97 at December 31, 2012, an increase of $4.17 per share or 28% from the prior year.

On slide 6, we have broken down select items from our balance sheet. As you can see, our total assets are approximately $800 million less than they were at the end of the third quarter. This decrease is due to a variety of factors, including lower mortgage loans held for sale as loan sales outpaced originations during the quarter, and a decline in commercial real estate loans originated prior to 2009.

Our fourth-quarter financial performance was anchored by continued strong performance from our Mortgage Banking business. Gain on loan sale income for the fourth quarter 2012 was $239 million with a margin of 153 basis points. Please note that this is different from our base production margin, which did not change materially from the third quarter to the fourth quarter. Matt Kerin will be speaking to the margin in a few minutes.

As you can see on slide 7, gain on loan sale income has outpaced credit costs in 2012 driving our strong financial performance. It represents the second highest level of gain on sale income for a quarter in the bank's history.

On slide 8, you will see that the net interest income and margin both increased slightly from the prior quarter as reductions in interest expense driven by our lower cost of deposits and improved mix of deposits outpaced the decline in interest income.

Turning to slide 9, our credit-related costs declined about 49% from the prior quarter, driven by a 75% linked-quarter decrease in provisions related to the representation and warranty reserve. We also continue to strengthen and derisk our balance sheet as reflected by a $201 million decline in the repurchase pipeline, increased reserves for pending and threatened litigation, a 100 basis point increase in Tier 1 capital and reductions in riskier asset classes amidst a flat level of nonperforming loans.

On slide 10, you'll see that our regulatory capital ratios increased significantly from prior levels with a Tier 1 capital ratio of 10.41% at December 31, 2012. In addition, we carried approximately $1 billion in cash and interest-earning deposits at quarter-end. We also added approximately $16 million in additional reserves for pending and threatened litigation bringing the total legal reserve, including amounts paid in anticipation of future settlements, to approximately $83 million.

As part of our continued efforts to reduce the concentration of mortgage servicing rights, we sold mortgage servicing rights related to $13.8 billion in underlying mortgage loans on a bulk sale basis during the fourth quarter. We will continue to look for opportunities to reduce the overall level of our mortgage servicing asset. We believe the market for mortgage servicing is becoming stronger as non-bank participants enter the market.

Turning to slide 11, you will find a summary of the agreement we made in the fourth quarter to sell $785 million in Northeast-based commercial loans for $779 million. We expect the transaction to be capital-accretive and that the majority of these assets will be transferred to CIT during the first quarter of 2013. As you can see, the transaction is expected to be capital-accretive by about 61 basis points and we believe this is an important step in derisking the balance sheet and strengthening the focus on our core markets. Although we intend to complete our exit from the New England commercial market, we remain very dedicated to the commercial banking market in Michigan.

Turning to slide 12, you see further details on our representation and warranty reserve. The total reserve would have increased by $2 million from the prior quarter after adjusting for an $11 million reclassification of reserves associated with loans insured by the MBIA Insurance Corporation. This reclassification of our reserves was done concurrently with the establishment of additional reserves related to the litigation filed by MBIA. Provisions related to the representation and warranty reserve decreased by approximately $100 million from the prior quarter, primarily driven by a decrease in net charge-offs of loan repurchases.

At December 31, 2012, the total repurchase pipeline decreased to $224 million as compared to $426 million at September 30, 2012 as we continued to work through the existing population of repurchase requests. New audit file requests increased by 12.7% from the prior quarter, which we believe is a reflection on the GSEs continuing their reviews as they transition to a new review process.

Turning to slide 13, our allowance for loan losses was unchanged from the prior quarter. At December 31, 2012, our ratio of allowance to nonperforming loans was 76%, the same as the third quarter, but increased from December 31, 2011's level of 65%.

On slide 14 and 15, you can see nonperforming loans in total were essentially unchanged from the prior quarter. Consumer nonperforming loans increased by approximately 13% from the prior quarter, but decreased by 19% from a year ago. The increase from the prior quarter was driven primarily by a $25 million increase in performing non-accrual TDRs as a result of the implementation of the OCC guidance on bankruptcies.

This is highlighted on slide 16, which shows a breakout of our three categories of TDRs. The remainder of the increase came from the repurchases of loans from the GSEs resulting from our continued successful efforts to reduce the loan repurchase pipeline.

Commercial nonperforming loans decreased by 29% from the prior quarter and 14% from the same period a year ago. These decreases are primarily driven by continued workouts and individual note sales within the portfolio.

On slide 17, net charge-offs on consumer loans increased from the prior quarter as we continue to work through nonperforming loans associated with our HFI residential first mortgage loan portfolio. A portion of the increase from the prior quarter was related to the implementation of the OCC guidance on bankruptcies I just mentioned.

One other item worth mentioning, on December 18, 2012, the US Treasury announced it was planning to conduct periodic individual auctions of its TARP-preferred stock for 53 of the remaining 218 institutions. Flagstar was included in those 53 institutions and once we have further information to share, we will do so.

Before I turn the call over to Matt, I want to take a moment and thank all of our employees for their hard work and dedication. Our sustained profitability and the achievements over the last year are truly amazing and they are a testament to the ongoing commitment of our team. With that, I would like to turn the presentation over to Matt Kerin for more detail on our Mortgage Banking operations.

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

Thanks, Mike. Good morning, everyone. As Mike mentioned, we continue to generate strong revenues from our Mortgage Banking operations. Mortgage Banking currently represents the majority of our overall revenues and consists of four primary drivers -- gain on loan sale income, interest income on residential first and second lien mortgages, income from loan fees, which is accounted for separately from the gain on sale component and income from servicing of mortgage loans.

During the fourth quarter 2012, we earned $235 million in gain on loan sale income with a margin of 153 basis points. This base margin has been consistent throughout the prior quarters. Net gain on loan sale income increased -- income decreased, pardon me, as compared to the prior quarter, but remains higher than historical levels as outlined on slide 18.

The change from last quarter's record levels is reflective of the decline in loan on gain on sale margin and a lower level of mortgage rate lock commitments. Reported gain on loan sale margin decreased by approximately 90 basis points in the prior quarter. This decline reflects a calculation for margin accounting purposes, which is determined using loan sales rather than loan locks as the denominator. As such, in a period of declining gain, but increasing loan sales as was the case during the fourth quarter, the gain on loan sale margin would be more compressed. This had a material impact during the fourth quarter.

The decline also reflects in part a change in mix and the increase in yields we experienced during the fourth quarter, roughly 18 basis points. And there were a number of other anomalies that impacted or items that impacted the quarterly results. We implemented the GFE increase for Fannie and we experienced that into our pricing. It took effect and it tempered some of the wider margins that had been available to us earlier in the year and there were other specified pooling opportunities that changed as a result of the mix. Overall, our gain on loan sale margins remain strong relative to historical perspective reflective of the strong consumer demand for the refinancing of residential mortgage.

Our residential rate lock commitments also declined towards the end of the quarter as you can see on slide 19. In part due to the increase in yields I mentioned previously and also due to normal cyclical mortgage origination patterns.

If you turn to slide 20, you'll see the residential mortgage originations increased from the prior quarter, which drove higher loan fees. As you can see from the slide, refinances continue to make up about 80% of the overall residential mortgage origination volume.

Please turn to slide 21. Net servicing revenue, which is the combination of net loan admin income, which includes the off-balance sheet hedges of the mortgage servicing rights and the gain on trading securities, in this case the on-balance sheet hedges of mortgage servicing rights. This amount increased by $13.7 million to $25 million for the fourth quarter. This increase from the prior quarter was primarily attributable to effective hedge positioning despite significant rate volatility intra-quarter.

I would now like to turn the presentation over to Sandro DiNello, the President of our bank.

Sandro DiNello - *Flagstar Bancorp, Inc. - EVP, President, Flagstar Bank & CAO*

Thanks, Matt. Good morning, everyone. As Mike mentioned, our net interest income and margin increased slightly from the prior quarter. These increases were driven by improvements in our funding costs, which more than offset a decline in the yield on interest earning assets.

As you will see on slide 22, our average cost of funds improved by 13 basis points from the prior quarter. This improvement was driven primarily by two factors. First, our mix of funding sources continue to improve as we reduce balances in wholesale brokered CDs and longer-term FHLB borrowings, both of which represent higher cost funding sources. The decreases in these balances were offset by an increase in lower cost deposits and by total assets.

Secondly, the average cost of our retail deposits fell by about 10 basis points versus the third quarter, driven by a decrease of 19 basis points in the average rate paid on retail certificates of deposits. This improvement continues an ongoing trend as the cost of our retail CDs fell 50 basis points compared to the fourth quarter of 2011.

Turning to slide 23, which represents point-in-time balances at quarter-end, you can see that total deposits decreased $1.2 billion from September 30 to December 31 tracking the overall decrease in total assets. This decrease was primarily attributable to a $1.2 billion reduction in principal and interest custodian accounts serviced for the GSEs. While these accounts were non-interest-bearing, their balances were also highly volatile and the reduction will help smooth out our deposit levels and facilitate easier balance sheet management.

On slide 24, you can see that we continue to add core deposits and improve the ratio of core deposits, which we define as checking, savings and money market accounts to retail deposits. We added approximately $400 million in core deposits during the quarter and have grown our core deposits by $670 million since the same period a year ago, increasing our percentage of core deposits from 45.9% at December 31, 2011 to 50.1% at December 31, 2012. The growth of core branch deposits will continue to represent a primary focus for us in 2013.

I would also like to add that I am very bullish about our prospects for growing our retail business here within Michigan. We are the largest bank headquartered in Michigan and are successfully leveraging that position. We have some very strong bankers in place and our product suite rivals that of any bank in our market. The exiting of our New England commercial line of business now allows us to focus all of our efforts right here in our home state of Michigan and our community banking team is very excited about that.

I will now turn it back to Paul Borja.

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

Thank you, Sandro and good morning again, everyone. As my colleagues have discussed and as we have mentioned in our recent public filings, we have refocused Flagstar's strategy to emphasize our national Mortgage Banking business and our Michigan-based community bank model. To execute on this strategy, we have materially changed the composition of our balance sheet and made significant organizational changes that strengthen our risk management and governance. We will continue to work closely with our regulators and our Board of Directors to achieve compliance with our consent order, including the submission of a three-year capital plan. As a result, and as I indicated earlier, we will not be providing guidance for 2013 at this time.

As mentioned, our net income for the fourth quarter was $66.8 million or $1.12 per share on a fully diluted basis. This is our third profitable quarter in a row. Our fourth-quarter earnings reflected a relatively flat net interest income after provision for loan losses, a decline in the gain on loan sales that was offset by the decline in the representation and warranty expense and resulted in an overall net increase in non-interest income and a relatively flat non-interest expense total.

With the (technical difficulty) quarter that was not repeated during the fourth quarter. We have in prior calls focused on three key areas of our operating results -- revenue generation, expense management and credit costs.

From a revenue generation perspective, our fourth-quarter results arose principally from Mortgage Banking revenue, including the second highest level of gain on loan sales in a single quarter in the bank's history and a steady level of net interest income even before the provision for loan losses.

With respect to net interest income, it increased slightly to $73.9 million from $73.1 million in the third quarter. At the same time, the bank's net interest margin increased 2.26% from 2.21% in the third quarter. On a companywide basis, the yield on our interest-earning assets declined by 10 basis points due to lower yields on our mortgage loans held for sale, which are short-term assets and thus more sensitive to interest rate movement. On our securities available for sale, reflecting the sale during the third quarter of our CMO securities and in our residential mortgage loans as higher rate loans refinanced.

The cost of our liabilities during the fourth quarter declined by 13 basis points. This decline resulted in large part from a 16 basis point decline in overall deposit costs of which a significant driver was the 10 basis point reduction in the cost of retail deposits that Sandro mentioned earlier covering demand deposits, savings accounts, money market accounts and retail certificates of deposit.

As a result, the decline in the yield we earned on our assets was more than offset by the decline in the cost of our funds resulting in an increase in the overall spread earned on our consolidated assets to 1.84% from 1.81% during the third quarter. The decline in yield reflects the overall low interest rate environment during the fourth quarter although there was significant intra-period volatility of these rates. For instance, the 10-year US Treasury rate was at 1.64% at the beginning of the fourth quarter and at 1.78% at the end of the quarter.

During the quarter, it rose as high as 1.86% and declined to as low as 1.58%. These historically lower yields facilitated continuation of the current refinancing environment. With higher-yielding residential mortgage loans that we hold for investment, refinancing to lower rates are paying off, in both cases reducing the yield we earn on those asset classes.

Also, the significant downward fluctuations both in the fourth quarter and the prior quarter resulted in a decline in the overall yield we were able to earn on the residential mortgage loans we originated during those periods and which we hold for sale for periods of 25 to 45 days.

The overall average balance of our interest-earning assets was relatively unchanged during the fourth quarter. An increase in the average balance of mortgage loans available for sale was offset by a decline in the average balance of higher-yielding investment securities available for sale following the sale of such securities during the third quarter.

There were also declines in the average balances of commercial real estate loans as they paid off or paid down and warehouse loans that we provide to correspondence and brokers for their origination of residential mortgage loans. With these and other declines in average balances and yields, the bank's interest income for the fourth quarter declined slightly to $115 million from $119 million during the third quarter.

At the same time, during the fourth quarter, we were able to continue to reduce our funding costs. We see opportunities for further reductions as we continue to execute on our strategy for a liability structure comprised substantially of retail deposit products.

For the fourth quarter, the average cost of our retail deposits declined to 82 basis points or 0.82% from 0.92% in the third quarter. We continue to see declines in the cost of our certificates of deposit with the lower rate structure of our retail certificates of deposit continuing to replace maturing higher cost retail CDs and wholesale CDs in our funding structure. During the fourth quarter, our overall funding expense declined to $41 million from $47 million in the third quarter and the cost of such funding decreased to 1.60% overall from 1.73% in the third quarter.

Turning to gain on loan sales, the bank's mortgage business during the fourth quarter generated $239 million in gain on loan sales as compared to $334 million during the third quarter. The fourth-quarter gain on loan sales was the second highest level of quarterly gain on loan sales in the bank's history.

During the fourth quarter, the bank continued to originate loans through refinancings of residential mortgage loans, including participation in the HARP 2 program and origination of FHA and VA loans. The gain on loan sales for the fourth quarter 2012 reflects a decline in overall lock volume as compared to the third quarter, but an increase in originations and an increase in sales.

Another driver of Mortgage Banking revenue is our net servicing revenue, which is a combination of income we earn from servicing the loans and the net effect of the hedges on the mortgage servicing rights on our balance sheet. During the fourth quarter, we've continued to earn income from our mortgaging servicing asset during a quarter in which, as we discussed earlier, there was significant interest rate volatility in the marketplace. In total, our net servicing revenue was $25 million for the fourth quarter, an increase from $11 million in the third quarter of 2012. This reflects the refinancing experienced during the fourth quarter, as well as the hedging challenges experienced during the third quarter with the volatile interest rate environment given the Federal Reserve's QE3 announcements and the European marketplace impact during the third quarter on the US Treasury market.

Overall, our mortgage servicing asset increased during the fourth quarter to $711 million from $687 million at the end of the third quarter. At December 31, 2012, the asset reflected approximately $77 billion of loans we are servicing for others, primarily the GSEs.

Non-interest expense, excluding asset resolution, was $216 million in the fourth quarter as compared to $221 million in the third quarter reflecting slightly higher compensation expense, higher commission expense due to the higher level of loan originations during the quarter, as well as a warrant expense, which reflects the increase during the quarter in our stock price. And this was offset by the absence during the fourth quarter of a prepayment fee that we made during the third quarter to the Federal Home Loan Bank of Indianapolis as we prepaid several advances.

Turning to our credit costs, loan loss provision expense declined slightly to $50 million for the fourth quarter as compared to $53 million for the third quarter. At the same time, we maintained a level of our reserve at $305 million as of December 31, 2012 even though the balance of our loans held for investment declined by approximately $1 billion from September 30 to December 31. This reflects our efforts during the fourth quarter to provide reserves for the potential redefaults of modified loans, also known as troubled debt restructurings or TDRs. We also work to provide further loss reserves against the balances of residential mortgage loans on our books that are currently performing, but which have interest rates that are expected to reset in the near future. We continue to review these areas and additional risk metrics as we monitor the level of our loan loss reserves.

Our representation and warranty expense for the fourth quarter declined as our charge-offs declined, although our reserve level actually increased when taking into account the reclassification of a portion of the reserve to the litigation reserve during the fourth quarter. For the fourth quarter, our reserves changed from $202 million at September 30, 2012 to $193 million at December 31 as we reclassified $11 million of the reserves to our litigation reserves in response to the MBIA litigation. That amount had initially been set aside in our representation and warranty reserve based on our expectation that we would resolve MBIA-related loan purchase demands on a loan by loan basis in a manner similar to the practice followed by the GSEs with us.

During the fourth quarter, we remediated loan purchase requests in our pipeline reducing the population of outstanding request loans by 47% as compared to the end of the third quarter. At the same time, however, we experienced an increase of almost 13% in requests from the GSEs for loan files to review for possible repurchase.

Finally, asset resolution expense increased to $21 million from $12 million in the third quarter. This increase reflects that there was a $7.8 million benefit we realized during the third quarter from the HUD-coordinated market option of our loans. With that, I will turn it back to Mike Tierney for questions and answers. Mike?

Mike Tierney - *Flagstar Bancorp, Inc. - President & CEO*

All right, thanks, Paul. Operator, we are going to open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Paul Miller, FBR.

Paul Miller - *FBR Capital Markets - Analyst*

Hey, thank you very much. Hey, guys, there is a lot of confusion out there and I think it is driving the stock price today on your gain on sale margins. Now I think the confusion -- it doesn't necessarily lie on the 153, but it is really going back to the gain on sale margins of last quarter. What exactly drove that 244 to be so high? And can you add some color to that? And then also can you add any color on what you're seeing right now? Are interest rate locks up today? It seems like December was an abnormally spike down.

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

Paul, it's Matt Kerin. How are you?

Paul Miller - *FBR Capital Markets - Analyst*

How are you doing?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

Great. Look, by way of background, as we all know, the industry benefited in the second and third quarter as mortgage yields had a pretty steady decline of 100 basis points or so. And we all had the opportunity to enjoy higher margins and pretty strong volumes.

In the fourth quarter, obviously yields increased roughly 18, 20 bps and that did have some impact on our overall margin. Some of the factors that impacted the fourth quarter, I think you saw that our lock volume was down and that was consciously done as we looked at where are originations and kind of focusing on where our production was coming from and some tweaking or just some pause, if you will, to assess and confirm and validate to our Board and others where our business and the type of business we were doing.

There were a number of other things that impacted the margins. In December in particular, we had the December Fannie GFE increase that took effect and that had a tempering influence on some of the wider margins that had been available prior to that GFE increase. Part of our origination development activities, we had benefited from some previous high balance pool transactions that had some spread widening impact in mid-November at the loans and the yields that impacted our execution in that space in December.

Overall, December was a little bit of a reduced supply of premium coupon spec pools that impacted some of our ability to get higher payouts on yields as they flattened out. We also had a different mix in our production volume. As you know, the FHA introduced their insurance premium increase and that took some folks out of the market and we are a big FHA player.

So there were just a number of things that impacted that overall execution premium that we had been contributing, as well as our own kind of predetermined pooling activities based on the originations that we were developing.

I do want to reiterate that our base production margin has remained steady and pretty strong over the course of time. Obviously, we were impacted by the --.

Paul Miller - *FBR Capital Markets - Analyst*

Can you go -- because I am not so sure that -- I mean I know you went through a lot of points, but I am not so sure most people followed any of it. And so I guess in layman terms, because we are not mortgage bankers out here, we follow stocks and we try to address the profitability of banks. And so what a lot of people are saying is this is a sure sign that the refi boom is over. It is a sure sign that there is a steep decline coming in gain on sale margins. So when you talk about your base production margin, can you talk about that and what exactly that is?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

Absolutely. Our base production margin is -- and I will try to make this as clean as I can. It is the average spread between our rate -- our point combination on our rate sheets and then the final price we attain from the expected loan sales proceeds at the time of funding. And then we obviously use our secondary capabilities to affect specified poolings that might provide higher payups for particular loan classes.

As you know, we are national lending, so we do have some high balance pools. I won't call them jumbo pools, others might, that we are able to have high balance specific pools that certainly at one point had narrower spreads than they did in mid-December, as they widened in mid-November. The December Fannie GFE increase -- basically that took effect in December and that had some tempering effect on the margins that we had been incurring.

Paul Miller - *FBR Capital Markets - Analyst*

But this base margin, getting to the core of the profitability of Flagstar, this base margin has remained relatively constant over the last couple quarters?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

Yes, I mean it was down modestly in December obviously as a result of yields moving, but, no, it has been very consistent. We were at about 145 for the year, I guess and probably slightly higher than that for the fourth quarter and slightly higher than that for the third quarter.

Paul Miller - *FBR Capital Markets - Analyst*

And what about -- I mean what about today, like in the first couple weeks of 2013? Is that base margin holding in there pretty solidly?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

Let me say this. Without making any forward-looking comments, I think that we have been consistently a pretty good indicator of where the market is and I would suggest that that is still true.

Paul Miller - *FBR Capital Markets - Analyst*

So if you are looking at -- if you are pulling up Bloomberg and you are seeing a primary, secondary market spread that is relatively flat, down slightly, that is a good indication of what is going on with your base margin?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

I would say we are pretty consistent with what you could look at what is going on in the industry and the markets specifically.

Paul Miller - *FBR Capital Markets - Analyst*

Okay. And then the other issue is what percentage of HARP did you guys do?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

That was an impact as well because our HARP volumes were down I think like a lot of folks. We were not a big servicer of refi opportunities, so we had an outsized share of that and like a lot of folks, I think we probably peaked at about 15%, which was an outside number for us when you think about our 2% servicer marketshare. And that has dropped off to probably south of 10%. I haven't looked at it in recent times because we have been kind of busy with year-end and a lot of the organizational changes, but that certainly had an impact from a margin perspective. That's part of the mix.

Paul Miller - *FBR Capital Markets - Analyst*

And then do you guys -- I don't know if you guys disclose this, some people do, but given your book, which is not relatively a new book, what do you think your book has an incentive to refi? I mean given where rates are today, what do you think is out there in the pipeline for production?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

Well, I think if you look at the industry forecast, they are all calling for a modestly down environment, but I think we are talking about $1.7 trillion market for 2012 and somewhere around $1.3 trillion. And if you really look out into the fourth quarter, they are still talking about a 60% refinance share.

So while we are focusing on the purchase market as an opportunity for the future, we are mindful of the fact that the refinance market is going to be a consistent piece of that. And obviously that is a big part of our production today.

Paul Miller - *FBR Capital Markets - Analyst*

But you guys talked about it at our conference that you guys want to be close to a 5% marketshare. So could you grow in a market that is declining? I mean we haven't seen any decline, so I know a lot of people are saying $1.3 trillion, but these same people said $700 billion last year and they were completely wrong. So I don't really follow the industry experts. But given the fact that you said you want to be a top five player, which gives you over 5%, would you be able to grow even if the market starts to shrink a little bit?

Mike Tierney - *Flagstar Bancorp, Inc. - President & CEO*

Hey, Paul, Mike Tierney, hey, when we were at your conference, we made some aspirational comments about where we wanted to be over the next five years, very long-term goal-oriented things. So I want to be sure that we have got that in the right context.

Paul Miller - *FBR Capital Markets - Analyst*

Okay.

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

And to your point, Paul, this is Matt, I mean our mantra and it will continue to be is to do business with good quality customers to develop good quality product and that is first and foremost for us. We believe we have a very strong distribution network and that we are well-positioned in the marketplace and we are going to manage our business appropriate to the capacity and controls that are in place here at the Company.

Paul Miller - *FBR Capital Markets - Analyst*

Okay, hey, guys, thank you very much.

Operator

Bose George, KBW.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Hey, guys, good morning. Just one follow-up on the gain on sale question. Was there much of a change in the mix in terms of channel? Like did you have a correspondent increase or anything there that was affecting the gain on sale margin?

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

Not significantly obviously. With Wells pulling out earlier in the year, our broker per share picked up a tad, but no, not particularly.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Okay, great. (multiple speakers). And then just in terms of the HARP percentage, you noted that it was down. Is that something that could come back up or is that probably going to continue to be a single-digit percentage number?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

Well, as you know, we weren't a participant in the Freddie (inaudible) refi plus program. That is something that we are looking at now that that has been fixed and we will continue to be an appropriate player in that marketplace. And I think it has been -- we have done a pretty admirable job of playing in that space given our relatively small servicing share.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Okay, great. And then just switching to a couple of other things. You guys sold some servicing, almost $14 billion. Was that mainly older more delinquent stuff or are you open to kind of selling older and newer servicing?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

Yes, I mean obviously we look at opportunities to sell servicing as appropriate to the Company both from a capital perspective and just from a concentration perspective. We have been a consistent seller of servicing in the near 3.5 years I have been here and I would expect that to continue if the opportunity presents itself.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Okay. And then just lastly on the rep and warranty, obviously came down pretty meaningfully this quarter. If all things being equal, if nothing changes, is that kind of a reasonable run rate for rep and warranty charges going forward?

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

Hi, this is Paul Borja. One of the things that we don't want to be doing is providing guidance for 2013. We believe that the reserve that we have established at the end of the year is appropriate and we provided the additional slides, the additional information in the earnings slides to provide you with the information, the information available. I believe it is slide 12.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Okay. Great, thanks a lot.

Operator

Sloan Bohlen, B-A-L-Y-A-S-N-Y.

Sloan Bohlen - *Balyasny - Analyst*

Hi, there, yes, Balyasny. Just a quick question on the rate lock impact on the margin. Is there a way to break that out just so -- I appreciate the comments on Paul's questions about the base margin, but is there a way to quantify the impact of the rate lock impact on the margin in the fourth quarter?

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

Hi, this is Paul Borja. Help me to understand the question just a little bit more if you could please.

Sloan Bohlen - *Balyasny - Analyst*

So of the 90 basis point margin decline, you said maybe kind of 18 basis points of it was due to maybe mix shift and then you also discussed a little bit about the change in the use of rate locks. Can you maybe discuss what that did to the margin to also kind of squeeze it a little bit?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

This is Matt Kerin. I think what we were saying is it's just kind of a dual combination impact to how this reads when you look at the margin. Part of it is the accounting treatment as we use the closings as the numerator, I mean as the denominator in the calculation as the [bullet] suggests gain on sale of locks.

In terms of the overall execution and the margin compression, it was a combination of rates, yields moving up in the month, change in mix because obviously different products have different margins associated with them. So those were really the two primary drivers and then some of it is special pooling and execution on the secondary side.

Sloan Bohlen - *Balyasny - Analyst*

Oh my god.

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

Sorry?

Sloan Bohlen - *Balyasny - Analyst*

Thank you, guys.

Operator

Jordan Hymowitz, Philadelphia Financial.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Thanks for taking my call, guys. A couple of things. You said that December was when Fannie Mae raised the GFE.

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

No, that is when it was put into effect with us.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

So if you look at December alone versus November and October, how much negative impact on gain on sale did just the GFE have in December?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

I haven't really looked at it specifically going by month to be honest with you.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

I mean but are we talking 20 basis points, are we talking 50? What is the sense of exactly the GFE in isolation what it would be because it was only in effect for one month and this time, it will be in effect all quarter?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

Well, I mean, no, it is a one-time adjustment. We will pick up some benefit from it. It has to do with how you price the GFE into your transaction.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

So but don't you pay 10 basis points higher on GFEs going forward?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

But that is reflected in our margin now. It is really -- what happened was before it actually because put into effect, you had [buyers] wider spreads available to you. And when the 10 basis points came in, that was an absolute narrowing of the hedge at the time.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

So in other words, the margin wasn't low in December because of the GFE?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

It was lower than we had experienced in the prior month because of the impact of the GFE increase, yes.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

But that is a one-time thing and going forward, January through March, would not be reflective of that lower rate because of the GFE by itself?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

Again, I am really not in a position to make any forward-looking comments.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

But it is a simple question. Does the GFE lower your gain on sale margin now that it has been raised or no?

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

This is Paul. I think what we were saying was that the GFE that took effect in December is being -- was factored into the pricing so that it doesn't have an adverse impact as it did in December.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Okay. So you are saying that the pricing is now being raised to make up for it?

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

Right.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

If the pricing was not raised to make up for it on an apples-to-apples basis, how much does the GFE impact the profitability?

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

That we would have to get to back to you on because of -- I think there is a couple things. One is we want to make sure that we get that kind of granularity you are asking for and second, we definitely want to find a way to provide it in an appropriate FD manner.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Okay. But it is 10 basis points by itself, right?

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

I believe that was the amount of the increase.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

And it is an average of about a four-year life?

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

I believe that in the industry it is about a four-year life, right.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Okay. And then what was the price you sold servicing for?

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

This is Paul Borja. When we sell servicing, which is part of our normal ops, what we normally do is we will provide information regarding the amount, the underlying UPB and we also provide any gain loss and we include within the more detailed 10-Q and 10-K I think a discussion within the income statement of the valuation changes, but we don't reveal specific prices.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Would it be fair to say you are more excited to sell servicing today because of the very high prices people are willing to pay for it?

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

If there are very high prices folks are willing to pay for it then we are always happy to look for that opportunity.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Okay, thank you.

Operator

Marc Steinberg, Dawson James Securities.

Marc Steinberg - *Dawson James Securities - Analyst*

Good morning. I have two quick questions for you. I know that you said that litigation reserves are now at about $83 million, an increase of $16 million for the quarter. Can you anticipate having to add more for litigation reserves and if yes, how much? And my second question is, and maybe I missed this. I heard you say you are not providing guidance for 2013 and I was wondering why.

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

This is Paul Borja. As to the second question, we said we are not providing guidance for 2013 at this time. We first want to finalize the capital plan that is described in the consent order, complete that process before we provide guidance to the Street.

As to the first of the questions, which is whether we intend to increase the litigation reserve, it is standard policy here and I think in a number of corporations not to comment on pending litigation or the accounting effects of that.

Marc Steinberg - *Dawson James Securities - Analyst*

Okay. Now I know that with regards to a short guarantee, there is supposed to be a decision sometime this month. Is that still on point?

Kevin Schutte - *Flagstar Bancorp, Inc. - Acting Deputy General Counsel*

This is [Kevin Schutte], the Acting Deputy General Counsel of litigation. We have received no indication from the court as to the timing of the opinion other than what Judge Rakoff said to us in open court on the last day of trial. So we are still operating off of those comments.

Marc Steinberg - *Dawson James Securities - Analyst*

Were those comments on the last day any different than what I have just asked? I mean did he say sometime toward the end of January or did I misinterpret?

Kevin Schutte - *Flagstar Bancorp, Inc. - Acting Deputy General Counsel*

No, sir. You got it right. It is late January. That is about all we know at this time.

Marc Steinberg - *Dawson James Securities - Analyst*

Okay, all right, thank you.

Operator

(Operator Instructions). [Andrew Lewis], Jersey Mike's.

Andrew Lewis - *Jersey Mike's - Analyst*

Hello, good morning. I just wanted to add my congratulations about another great earnings report. And my first question, I am not sure if it is kind of forward speculation or not, but I know Flagstar currently owns and operates 111 banking centers in Michigan, but they use to operate about 169 banking centers across the US, which is 58 more than now. And I was wondering if you are currently thinking of reexpanding throughout the Midwest and the rest of the US and if there is a timeline? And how many total locations are you guys looking to attain?

Sandro DiNello - *Flagstar Bancorp, Inc. - EVP, President, Flagstar Bank & CAO*

Hi, this is Sandro DiNello. With respect to bank branches, you are right on your numbers. We did sell or divest our sales of our Indiana and our Georgia banking centers about a year ago. But in keeping with the comments that we have been making relative to forward-looking statements, that is not something that I can comment on at this time.

Andrew Lewis - *Jersey Mike's - Analyst*

Is there some point where you will like in the next like next year or so or is there no like timeline at all?

Sandro DiNello - *Flagstar Bancorp, Inc. - EVP, President, Flagstar Bank & CAO*

Well, at this time, we are really just not going to comment on that.

Andrew Lewis - *Jersey Mike's - Analyst*

All right. My next question is I was just wondering in 2013 what is your guys' primary focus to keep profits continuing and basically to keep the bad loans down?

Mike Tierney - *Flagstar Bancorp, Inc. - President & CEO*

Well, our primary focus at the bank is to come into full compliance with our consent order. We want to improve our operations inside the bank and we want all of that to result in sustained profitability for the Company.

Andrew Lewis - *Jersey Mike's - Analyst*

Okay. And back to the -- about the selloff of -- what was the primary reason for the selloff of the 58 locations in Indiana and throughout the US? Like to regain capital or was it for another reason?

Sandro DiNello - *Flagstar Bancorp, Inc. - EVP, President, Flagstar Bank & CAO*

Yes, this is Sandro DiNello. Again, there were a number of different reasons that were strategic in connection with that. We made a decision that we wanted to focus on our Michigan operations as we have been talking about throughout the call today. So that was the primary driving reason is to be able to focus all of our efforts here in Michigan where we are the largest bank headquartered here and we think that that enhances our ability in the future to have an impact on improving the profitability of the banking part of the Company. And so at that point in both transactions, we felt that the economics made sense and as I said, we will be reevaluating further expansion as time goes forward.

Andrew Lewis - *Jersey Mike's - Analyst*

Was that large part to the profitability in the last few quarters due to the selloff or was that more for other reasons? Or do you think that was partly, maybe partly because of the selloff and obviously making good loans, etc.?

Sandro DiNello - *Flagstar Bancorp, Inc. - EVP, President, Flagstar Bank & CAO*

I am not sure I understand the question. Let me ask -- were you asking if the divestiture of those branches impacted the profitability of the bank over the last year?

Andrew Lewis - *Jersey Mike's - Analyst*

Yes, sir.

Sandro DiNello - *Flagstar Bancorp, Inc. - EVP, President, Flagstar Bank & CAO*

Well, we haven't provided specific information in terms of what portion of the profitability was specifically related to those sales. Certainly there was an impact on the operation relative to being able to reduce some operating expenses and such and as I said, to concentrate our efforts here in Michigan.

Andrew Lewis - *Jersey Mike's - Analyst*

Okay, all right, thank you so much. Have a good day.

Sandro DiNello - *Flagstar Bancorp, Inc. - EVP, President, Flagstar Bank & CAO*

You are welcome.

Operator

Dan Mazur, Harvest Capital.

Dan Mazur - *Harvest Capital - Analyst*

Good morning, thanks for taking my question. It looks like in just looking through the components of gain on sale, you took a $143 million loss related to the value of interest rate locks. Is that partly due to the GFE impact that you discussed earlier?

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

Hi, this is Paul Borja. No, the interest rate locks and the forward sales are hedges against the fair value of the portfolio itself. So you would generally expect to see, as you see in the prior quarters that are displayed as well, offsets between the two.

Dan Mazur - *Harvest Capital - Analyst*

Okay. And so it was a net more of a drag between the forward sales this quarter. So the GFE didn't impact the net of the forward sales and interest rate lock?

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

Right.

Dan Mazur - *Harvest Capital - Analyst*

Okay, but the catch-up on the GFE that you referenced earlier, was that on the interest rate lock for a go-forward basis or on a lookback basis?

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

It is going to be a go-forward basis.

Dan Mazur - *Harvest Capital - Analyst*

And where is that reflected? What part of the -- I mean I think you break out five or six parts of your gain on sale.

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

Why don't we do this? You ask a good question and generally what happens -- this is Paul Borja -- in our chart that we provide, we indicate the two key parts of the gain on loan sale value analysis from the accounting side. The top half is really the fair value analysis and the bottom half is really the operational effect of selling loans and the requirement to recognize different expenses as we do that.

What might make sense is for us to take a step back since this is an issue that has been raised now by two callers and look for a better way to display that within the presentation and then perhaps present it again publicly that way.

Dan Mazur - *Harvest Capital - Analyst*

Okay. And Paul, do you have an estimate when you will set the capital plan and after that, do you expect to provide more color on '13 or first quarter?

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

I think from the capital plan perspective, we are continuing to work on it. We will work with the Board of Directors and with our regulators and so we are not, at this point, prepared to provide a timeline. We will work within the construct of the consent order, but our expectation, our hope is that once we finalize that that we will be able to provide guidance to the public.

Dan Mazur - *Harvest Capital - Analyst*

Okay. And can you give just an estimate what the valuation allowance was at year-end and is there any way to kind of think about or what we should handicap on a go-forward basis or rule of thumb on discussion with auditors and when that might come back?

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

Sure. The valuation allowance you are referring to is a deferred tax asset valuation allowance?

Dan Mazur - *Harvest Capital - Analyst*

Yes, correct.

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

I believe it is about -- we will confirm this, but I believe it is about $285 million that from a reversal perspective generally we have seen as few as five or six quarters, as long as 12 quarters. It is a function of being able to demonstrate sustained profitability, as well as reliable forecasting. We know that in the last week to 10 days at least one or two banks have indicated they've fully reversed their deferred tax asset valuation allowance and placed the asset back on their books.

We have had three quarters of profitability and so we continue to watch it, but it might be preliminary for us to be engaging in these kind of discussions at this point with the auditors. But we do keep in close touch with our auditors and keep an eye on what the current industry trend is.

Dan Mazur - *Harvest Capital - Analyst*

Okay, thanks.

Operator

Bose George, KBW.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Hi, guys. Just had a quick question. Can you give us sort of a ballpark of the difference between gain on sale margin on HARP loans versus non-HARP loans?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP & President, Mortgage Banking Division*

I mean obviously the margin on the HARP loans historically has been higher than non-HARP production in large part I presume because [people] views on prepayment speed have an impact on their estimated value.

Bose George - *Keefe, Bruyette & Woods - Analyst*

And just going back to the gain on sale margin decline, I mean if there was one factor that you would highlight as being sort of the predominant driver of the decline, I mean is there one factor we can pin down? I mean would HARP be the biggest factor?

Paul Borja - *Flagstar Bancorp, Inc. - EVP & CFO*

Mix would be a (technical difficulty) factor, which would include the shift in HARP as well.

Bose George - *Keefe, Bruyette & Woods - Analyst*

Okay, great. Thanks.

Operator

With no further questions in the queue, I would like to turn the call back to Mike Tierney for any additional or closing remarks.

Mike Tierney - *Flagstar Bancorp, Inc. - President & CEO*

Well, I would like to thank you all for your time today and we look forward to talking to you again in another 90 days.

Operator

This does conclude today's conference. We thank you for your participation.