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PRESENTATION

Operator

Good morning. My name is Melissa, and I will be your conference operator today. At this time, I would like to welcome everyone to the Flagstar Bank First Quarter Investor Relations Conference Call. (Operator instructions)

Mr. Paul Borja, Chief Financial Officer, you may begin your Conference.

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

Thank you.

Good morning. I'd like to welcome you to our First Quarter 2011 Earnings Call. My name is Paul Borja, and I'm the Chief Financial Officer of Flagstar Bank.

Before we begin our comments, let me remind you about a few things -- that this presentation does contain some forward-looking statements regarding both our financial condition and our financial results, and that 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, competitive pressures within the financial services industry, and legislative or regulatory requirement that may affect our businesses. For additional factors, we urge you to please review our press release and SEC documents, as well as the legal disclaimer on page two of our slides that we posted on our Investor Relations website for this speech.

I'd like to now turn the call over to Joseph Campanelli, our Chairman and Chief Executive Officer.

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

Thank you, Paul, and good morning, everyone. I would also like to welcome you to our First Quarter 2011 Earnings Call.

I'll begin today by updating you on our first quarter financial results and discussing the key items that drove those results. I will also spend some time discussing the progress we've made in our transformation to a more diversified super-community bank model. This progress is very important but not fully reflected in our financial results this quarter.

Paul will then discuss the financials in greater detail. And then I will update and review our key business drivers for 2011. Finally, Paul and I, along with the rest of my executive management team, will be available to answer questions you may have.

Last night, we reported a first quarter net loss to common shareholders of approximately $32 million, as compared to $192 million loss in fourth quarter of 2010 and an $82 million loss in the first quarter of 2010. Our quarterly loss was an improvement from prior quarters, and we believe we remain on track in meeting our primary goals and targets. We continue to identify ways to conduct our business better, faster and cheaper. Productivity gains have funded our investment in new products, enhanced our customer experience and supported investments in risk management.

The improvement in the first quarter was driven primarily by a decline in our credit-related expenses. Our three biggest credit costs -- provision for loan losses, asset resolution expenses and secondary marketing reserve provision -- have now decreased in total for four consecutive& quarters. We continue to maintain a prudent level of reserves, and we believe we are starting to see the light at the end of the tunnel.

Many of our key asset quality metrics continue to trend in a positive direction. Nonperforming assets in total decreased on a linked-quarter basis both in absolute value and as a percentage of total assets. Regardless, we continued to maintain a healthy allowance with our reserve-to-nonperforming loan coverage ratio at 74% at March 31st, 2011.

At the same time, we remain committed to continuing to de-risk the balance sheet through opportunistic sale of assets. During the first quarter, we sold $80.3 million nonperforming residential first mortgage loans, which represents the vast majority of the loans which were moved to our available for-sale portfolio on our balance sheet. The $80.3 million in nonperforming loans were essentially sold at the carrying value, so there's no material effect on our P&L.

Given our strong capital, liquidity and reserve levels, we believe we are in a good position to selectively pursue other opportunities to accelerate the de-risking of our balance sheet by selling legacy asset at or near the carrying value. Aggressive write-downs, prudent oversight and improving marketing conditions have put us in a position for continued improvement in our asset quality.

During the quarter, we also increased our capital ratios. We ended the first quarter with a Tier 1 ratio of 9.87 and total risk-based capital ratio of 20.51%. Our first quarter equity-to-asset ratio was 9.5%. The improvement in credit cost was offset by two key items -- first, the decline in net interest margin; and second, lower mortgage banking revenues.

In the first quarter, the Bank had a net interest margin of 1.68%, down 19% from the prior-quarter level of 2.08%. The decrease in margin had a negative impact of approximately $10 million on our bottom-line P&L. The decrease in net interest margin was driven by a reduction in average loan balances in both our available-for-sale and warehouse portfolios, consistent with the slowdown in the mortgage banking business and an increased short-term liquidity position [which] provides for the funding for new asset generation.

Like most banks, we also lost margin as a result of the phenomenon analysts are calling the curse of cash. Our liquidity position increased by 80% from its fourth quarter level as we're holding excess cash for investment in new assets we are in the process of generating. That cash is only earning a marginal interest rate which in turn temporarily deteriorates our net interest margin. However, we believe that the reduction in net interest margin this quarter is a timing issue, and we're still on track to meet our year-end target.

As is the case with the prudent build-out of any new business line, there's a period of time before you begin to realize the benefits of your investment. We are well along the way in generating attractive earning assets. Over the past 18 months, we have made significant investments in our infrastructure and personnel build-out. We have recently begun to prudently originate quality interest-earning assets, including commercial and small business loans, which will be invested on our balance sheet. I'm optimistic that the results of these efforts will be demonstrated over the coming quarters as we begin to see a meaningful and positive impact on our net interest margin and other fee income.

We are transitioning to a full-service super-community bank, and we're off to an excellent start. During the first quarter, we announced that Steve Issa and Mike Tierney had joined Flagstar's leadership team. Steve was appointed to the position of Executive Vice President, Managing Director, Commercial Banking and will oversee Commercial Banking division and serve as a market president for the New England division. Mike was appointed to the position of Executive Vice President and Managing Director of Retail Banking and will oversee the Retail Banking division and serve as our market president for the Midwest region.

We're excited that we're able to attract such great banking talent to our team. Steve brings over 30 years experience in understanding the needs of small and medium-sized businesses and possesses a keen knowledge of how to grow specialty lending lines of business. He also brings a network of long-established relationships to Flagstar. Mike is also a seasoned commercial banker as well, with over 30 years experience in Michigan and Midwest markets. Both are highly regarded in the banking industry and in the communities they serve.

To date, we have strategically positioned leadership teams in key markets in Michigan and New England. We will continue to build our commercial strategy over the next year as we continue to hire experienced relationship managers, each of whom brings with them relationships with established clients in centers of influence.

As of today, we recruited over 30 professionals involved in commercial lending, credit and operations. Our commercial and mortgage lending teams are working together to elevate market awareness for the Flagstar brand. This teamwork enhances the customer experience and allows us to more effectively cross-sell multiple products and services.

We remain very focused and committed to building out an exceptionalist management function. We recognize the growing level of regulations in a more challenging and volatile economic environment. We have made significant investment in people, process and systems to identify, monitor and manage risk. We all know that lending money is the easy part. The harder part, on occasion, [be] getting it back.

Prior to rolling out our commercial strategy, we spent a great deal of time and energy on building a solid credit infrastructure and culture. During the quarter, we were excited to announce that we've recruited Dan Landers as our Chief Credit Risk Officer. Dan brings exceptional leadership and discipline, with over 30 years of operational, credit and management experience. Dan, along with Steve and Mike, have set the foundation for a very successful and profitable operation.

Over the past several months, we have built an active and robust pipeline of commercial prospects. The majority of these potential relationships are businesses that our relationship managers have dealt with in the past and are well known to management. Given that familiarity, we expect to close majority of the pipeline and anticipate increasing our loan balances significantly over the course of the year. We expect to generate sufficient deposit balances and fee income from these customers as well.

We are also developing an actively managed and appropriately sized investment portfolio, which will further improve our net interest margin. Our current liquidity portfolio earns approximately 25 basis points and, we believe, is an opportunity to enhance our investment returns with an acceptable asset and liability framework, while building a diverse and high-quality investment portfolio.

We continue to see a decline in our overall cost of funds, as we've focused on replacing maturing high-cost wholesale and retail certificates of deposit with low-cost core deposits. For the first quarter of 2011, our cost deposits was 1.63%, a quarter-over-quarter improvement of approximately 9% and a year-over-year improvement of 29%. As part of this strategy for reducing our overall cost of funds, total core deposits increased by 10% on a linked-quarter basis. The increase was attributable to a 24% increase in government core and a 7% increase in retail core from the prior quarter. At March 31st, 2011, our ratio of core to total deposits increased to 36.3%, up from the prior-quarter level of 32.1%.

We attribute our ability to grow core deposits to a culture built around exceptional customer service. For the second consecutive year, J.D. Power and Associates has ranked Flagstar Bank highest in customer satisfaction in the North Central region, which includes Michigan, Indiana, Ohio, Kentucky and West Virginia. The J.D. Powers survey measures retail customer satisfaction based on account activities, account information, banking facilities, fees, problem resolution and product offerings. Our overall score of 802 in 2011 ranked 37 points above the national average. Receiving this award in consecutive years illustrates how our retail associates take care of our customers and bodes well for our continued transformation to a super-community bank.

Turning to the mortgage business -- we experienced a decline in mortgage banking revenues, a result which is reflective of lower origination volumes industry-wide. For the quarter, total banking -- mortgage banking revenues, including interest income on mortgage loans and securities, gain on sale income, loan fee income and income from our mortgage servicing rights portfolio was down 18% from the fourth quarter. The decline in mortgage banking revenues for the quarter is consistent with what we are seeing throughout the industry. But we're optimistic that volumes will increase in the second and third quarters as a result of increased purchase business, which has been seen repeatedly over the years. Our [marl is] also scalable to capitalize on increased refinance activity when present.

More specifically, gain on loan sale income for the quarter declined by 35% from the prior quarter, driven by decreased rate lock commitments. Gain on sale margin was 86 basis points in the first quarter, relatively flat from the prior-quarter level of 89 basis points.

First quarter mortgage originations decreased to $4.9 billion, which reflects the typical seasonality of declining purchase business and is consistent with industry mortgage origination trends. As a result, we experienced lower loan fee income. The decline in gain on sale income and loan fee income was partially offset by an increase in income from mortgage servicing. We continue to enjoy strong returns on this asset, driven in part by the steepness of the yield curve and the effect of hedge performance.

While mortgage banking revenues were down this quarter, the housing finance industry is still arguably one of the most important industries to the US economy. Mortgage banking continues to provide significant non-interest income to us, and we are committed to remaining a major player in the industry. Whether the sector stays with a strong focus on Fannie or Freddie, a move towards the private sector; we feel we are well positioned to maintain overall market share given our strength in distribution and high-quality originations.

We will also actively work with private sector participants to evaluate their product and process requirements. Our strong third-party origination control process and systems make us a desirable partner in the creation of high-quality loans that are attractive to investors in this newly developing sector.

As I'm sure you are aware, enforcement orders were recently issued against a number of residential mortgage servicers throughout the country. Fortunately, Flagstar was not one of them. However, we are closely analyzing the orders and assessing the extent, if any, that our current servicing practices might warrant modification. And we are treating the standards set forth in the orders as best practices in the industry. As such, we are voluntarily adjusting as appropriate.

With respect to certain issues such as servicing level requirements, the orders are vague, and we will need to continue to monitor developments closely and refine as necessary. We anticipate but have not yet quantified that there will be some additional expenses associated with the servicing business. But at the same time, we believe that our efforts over the last year have resulted in many of these costs having already been embedded in our process. We remain comfortable with both our expense projections and our MSR evaluation.

In addition, we believe that the higher bar for servicing standards will pose significant barriers to entry and will further improve our competitive position as a leader in the residential mortgage origination and servicing industry. With heightened scrutiny being placed on servicing, we continue to monitor and look for ways to lower our MSR-to-Tier 1 ratio and are observing increased interest in the secondary market for servicing, and are confident with the valuation of our servicing asset.

Another area we're seeing industry pressure relates to overdraft fees. In that regard, Flagstar has been an early adopter of the best practices guidelines issued by our primary regulator. As such, we've already taken steps in the execution of these best practices, which has resulted in reduced fee income. At this time, we do not believe there's a significant risk for further material declines in overdraft fees. This assessment is, of course, subject to any new regulatory guidance that may become applicable.

I'd like to turn things over now to Paul Borja, who will take us through the financial results, before we discuss the drivers and open it up for questions.

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

Thank you, Joe.

For the quarter ended March 31st, 2011, we had a net loss of $31.7 million. This was a decline from the net loss in the fourth quarter 2010 of $192.1 million. It was also a decline from the net loss in the first quarter of 2010 of $81.9 million. Joe has discussed the key reasons for our performance for the quarter. I'll discuss the particular P&L and balance sheet items affected.

Our net interest income decreased to $39.8 million for the first quarter 2011, as compared to $54.4 million for the fourth quarter of 2010. This reflects the reduction in the average balance of interest-earning assets during Q1 of 2011 to $9.7 billion from $10.8 billion during Q4 2010. The overall yield on the interest-earning assets also declined by 32 basis points, as the mix of assets changed from higher-yielding available-for-sale loans and warehouse loans to lower-yielding cash deposits.

At the same time, deposit costs declined by 15 basis points to 1.63%, as Joe pointed out, from 1.78% during Q4 2010. And the level of interest-bearing liabilities declined by $500 million. Overall borrowing costs declined by 4 basis points.

With these changes, the Bank's net interest margin declined in Q1 2011, to 1.68% from 2.08% in Q4 2010, but was still higher than the net interest margin for Q1 2010 of 1.42% and for the 2010 year overall of 1.64%.

Our provision expense continued to decline, even after taking into account the provision expense in Q4 2010 that was associated with the sale of residential nonperforming loans during that fourth quarter.

We continued to add to the loan loss allowance with provision expense, but at a reduced rate based on improved overall loan performance. At the same time, our loan charge-offs exceeded our provision. As a result, our loan loss allowance declined slightly, by $3 million, to $271 million at the end of Q1 2011.

However, our ratio of the loan loss allowance to our loans held for investment increased at March 31st, 2011, to 4.7% from 4.4% at the end of 2010. Also, we still had a good coverage ratio. That is the ratio of the allowance to our nonperforming loans of approximately 74% as compared to 47% at March 31st of last year.

Our non-interest income declined for the quarter, as loan fees and a net gain on loan sales declined, offset in part by an increase in our net loan administration revenue. Our loan fees and charges decreased to $16.1 million in Q1 of 2011 versus $28.6 million in Q4 of 2010. This reflects a decrease in originations or loan closings to $4.9 billion in Q1 of 2011 from $9.2 billion in Q4 of 2010.

Our net loan administration revenue is the loan administration income from our servicing portfolio, plus the effects of our hedging of that MSR portfolio. The on-balance sheet hedge results are reflected under gain-loss on trading securities, and we combine them with the loan administration income to reach the net loan administration revenue number. Overall, this increased to $39.3 million during Q1 2011, as opposed to $28.1 million in Q4 2010. The mortgage servicing rights asset which gives rise to this income continues to provide an above-average return while maintaining our exposure well within acceptable risk tolerances.

Our net gain on loan sales decreased to $50.2 million in Q1 2011 versus $76.9 million in Q4 2010. This decline reflects several items -- a decrease in interest rate locks to $5.5 billion in Q1 2011 from $8.9 billion in Q4 2010, a decrease in residential mortgage loan sales to $5.8 billion in Q1 2011 versus $8.6 billion in Q4 2010, and a slight decrease in the margin on loan sale to 86 basis points during Q1 2011 from 89 basis points in Q4 2010.

Our non-interest expense declined during Q1 2011 to $134.5 million, as compared to $150.8 million during Q4 2010. Some key reasons for the decrease -- our compensation expense declined, which includes benefits and commissions, decreased to $63.3 million versus $66 million in Q4 2010. This decline reflects a decrease in the commissions that we've paid as a result of decreased loan production, which is partially offset by some compensation to build out new commercial banking business.

Our asset resolution expense declined to $25.3 million in Q1 2011 versus $30 million in Q4 of 2010, and this decline reflects some reduced provisions that we keep for possible losses on foreclosed property. Also, under warrant expense, we actually had income of $800,000 in Q1 of 2011 versus an expense of $7.9 million in Q4 2010. This decrease in the value of the warrants is based on the decrease in first quarter stock price, and therefore a reversal of the charges we took during Q4 for the stock increase in price.

On our balance sheet, our assets decreased to $13 billion at March 31st, 2011, from $13.6 billion at the end of 2010. The key changes in our asset mix are -- an increase in the interest-earning deposits of $772 million, a decrease in our loans available for sale of $976 million, and a decline in our held-for-investment loans of $541 million. Our liabilities decreased, which reflects a decrease in deposits of $249 million and also a decrease in our FHLV advances -- primarily short-term advances -- of $325 million from the end of 2010 to the end of Q1 2011.

At this time, I'll turn this over to Joe for a discussion of our drivers for the year.

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

Thanks, Paul.

On page 17 of the presentation, we provide our outlook for 2011 for each of our key drivers. With respect to asset size -- for 2011, we are revising our range for target asset size from $14.3 billion and $15.5 billion down to $13.8 billion to [$14.8 billion] (corrected by company after the call). We view this reduction in target size largely as a timing issue, as we believe that we have reached the inflection point of shrinking the balance sheet and are poised for growth. We have excess liquidity, ample capital, and a product set and market position that we believe well positions us. But we want to make sure to grow assets prudently and resist temptation to leverage our capital for short-term gains.

As to where we'll fall within the forecasted range -- it's going to be largely a function of refinance activity in residential mortgage business, as that drives both the outstanding balance on our AFS portfolio as well as draws on our warehouse business.

With respect to -- we are reiterating our forecast of $21 billion to $25 billion of residential mortgage originations. Our first quarter production of $4.9 billion is slightly below that range on a run rate basis. But as we enter the buying season, we believe that volume will pick up. And our expertise [and] proportionally large market position with FHA originations position us well to capitalize more purchase business in upcoming months.

We observed a similar trend in 2010 and were also aided by increased refinance activity in second half of the year. Should that happen again, we'll be able to hit the higher end or even exceed our forecast, as we did in 2010. We still intend to sell the vast majority of our conforming production in 2011. Therefore loan sales in 2011 are also forecasted in a range of $21 billion to $25 billion.

We reiterate our margin -- our 2011 estimate for margin on the origination in sale of loans between 85 basis points and 115 basis points. We are pleased with our margin of 86 basis points in the first quarter, despite a sizeable reduction in volume as well as pricing pressure from market competitors. As with origination volume, we'd expect to hit the higher end of the range if refinance activity picks up as it did in 2010. But based on current volumes and locks, we believe that we will be in the lower end of the range.

On the net interest margin, we are reiterating our range for bank net interest margin for 2011 of 200 to 260 basis points, notwithstanding the first quarter NIM of 168. The drag on NIM that we are experiencing is primarily due to the excess liquidity that we are holding. And we believe that we will be able to prudently deploy these funds as we close commercial loans in upcoming quarters.

In addition, we expect mortgage volume and related warehouse volume to increase, and as such see the positive trends in NIM that we saw in 2010 returning for the remainder of 2011. In order to achieve the higher end of our range, we would likely need to see an increase in mortgage originations along the lines of what occurred in 2010 to drive AFS volume as well as warehouse draws.

We are reiterating our estimate of provision expense for 2011 of between $85 million to $120 million. Credit trends continued to improve, notwithstanding the increase of residential NPAs that we observed and expected in the first quarter. That increase resulted largely from the natural migration of 30- and 60-day delinquent loans that were not included in our NPA sale in the fourth quarter, the lack of 60-day-plus loans that would migrate to OREO or that would otherwise be reversed in normal course [or since reverse] migration. Overall, we are encouraged by the size of reduction in 30-day delinquencies in residential portfolio.

On the commercial side, we continue to actively manage the legacy portfolio, and our level of NPAs continues to decline. We've had a number of discussions with potential buyers of our nonperforming commercial loans. And those discussions [have] given further credence to our belief that the portfolio's appropriately marked. We'd expect to hit the lower end of our range for provision if these credit trends continue and expect that the upper end would only occur if loan growth is better than currently forecasted.

With that said, let me turn it back over to Paul, who will lead our question-and-answer session.

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

Thank you, Joe.

At this time, if there are any questions, we'd be happy to take them.

QUESTIONS AND ANSWERS

Operator

(Operator instructions) Bose George, KBW.

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

I had a couple of questions.

Actually, first on the mortgage side -- your gain on sale margin held up very well. But your volumes were down, looks like, probably more than the industry. So I was wondering if that indicated -- are you backing away from some lower-margin business, or can we read anything into that?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP*

This is Matt Kerin. To answer your question -- I think we're relatively in line with most of the industry. We are, obviously, not a price leader in the marketplace. And we've continued to look to our distribution network to maximize the production that we can get through that. I think there was also, similar to last year, a lot of the same lack of activity in certain portions of the early part of the year that have kind of picked up pretty dramatically as the quarter progressed.

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

Great.

Just switching to wrap in warranty -- I assume you can't comment on the Assured Guaranty lawsuit. But I was wondering if there are other wrapped second-lien deals that we should think about. And then, just on the other side -- you guys hold securities as well, private-label Alt A securities. Are there any potential recoveries on any of those? Are any of those wrapped?

Matt Roslin - *Flagstar Bancorp, Inc. - Chief Administrative Officer, Chief Legal Officer and EVP*

Bose, this is Matt Roslin. The only other securitizations, non-agency securitizations, that we did were fixed-rate second transactions that are wrapped by MBIA. And in that regard, if you look at our 10-K disclosure on loss contingencies, there are similar issues there. But we're pretty comfortable with where we're at.

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

Thanks.

And then, just one last thing -- where did the DTA stand at the end of the quarter?

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

This is Paul Borja. The DTA at the end of Q1 was 349, which is an increase from the end of Q4 2010.

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

Okay. And is there actually any restriction on -- when that reverses, on how does it -- on the utilization, does that have to be utilized -- is there any limit to how much can be utilized in any given year? Or is that something that can be reversed once it's profitable, and utilized fully at that point?

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

There's actually two aspects there. One is the valuation allowance, which can be reversed once we hit that profitability inflection point. The second is the actual utilization of net operating losses, which is covered by a 20-year term. I believe we're only two years into a 20-year term for some of them. There was a restriction on a portion of the NOLs we had at January 2009 -- infusion of investment. Back in January 2009, we had a change in control. But the rest of the NOLs are not affected.

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

Is that a pretty small part of the NOL?

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

It's less than half of the NOLs. We'll have a schedule. We normally have a schedule that we publish, and we'll put one out later on that will show the breakdown between the two.

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

Great. Thanks a lot.

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

Thanks, Bose.

Operator

Terry McEvoy, Oppenheimer.

Terry McEvoy - *Oppenheimer & Co. - Analyst*

I just wanted to talk a little bit about that excess liquidity, the cash and interest-bearing deposits up $800 million. And it sounds like you want to move a good percentage of that into commercial loans. And I know you talked a lot about the initiatives. But could you just run through -- over the near term, geographically speaking -- where you expect to see that growth? And do you think that $800 million is something that will be put into loans over the next three quarters or by the end of this year?

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

Terry, without getting down to specific numbers by MSA in geography -- our goal is to grow diversified portfolio throughout New England and the Midwest, along with the absorption on the warehouse lending. [Aside] you saw a pretty significant dip in the warehouse outstanding. So a combination of return-to-normal levels on warehouse lending, via the penetration of our market presence throughout the Northeast. With our team that we have in place today, we feel that our pipeline in our forecast will absorb that excess liquidity, [and it's] a good source of funding.

Terry McEvoy - *Oppenheimer & Co. - Analyst*

And could you just talk about commercial loan performance -- I'm sure it's somewhere in the slide deck -- and whether you have an appetite to grow that portfolio?

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

Yes, we really have looked at it two different ways. One, we see [that] while the industry has not experienced a rapid recovery, it's consistent with the economic environment in loans we made, et cetera. We believe bringing in seasoned, experienced people that maintain very strong relationships -- and our positioning is to provide a host of credit and noncredit products that's competitive with the large banks but delivered on a very personalized relationship basis. We see a lot of that taking traction in the form of our pipeline in our anticipated closures. So that's well within what our expectations were.

As far as a legacy portfolio -- there's a couple of hundred million dollars in that portfolio that's within our footprint that we have access to cross-sell. And [Martin] and his team has already begun relationship reach-out, looking for other opportunities to do business with that client base. And the balance is really just -- will be run off as it matures. So it really is to run off the legacy portfolio and really drive the relationship-driven component.

If you're familiar with the Company back when our portfolio was put in place [has] been very much of a loan strategy. What we're talking about in the super-community bank model is really building relationships with companies that we know and understand and that we can provide a variety of products and services. So many of these people we've dealt with over the last decade or two.

Terry McEvoy - *Oppenheimer & Co. - Analyst*

Helpful.

And then, just the last question -- as I look at your deposit cost, is there room to go much lower -- total retail deposits [135] -- still sitting on a fair amount of higher-costing CDs -- the rate there, 1.84%. [Though] I did admittedly log onto your presentation today, I see you've got a SMART Saving account at 1.25%, which is above where your current savings and money market deposits are yielding right now. So can you bring those deposit costs lower to help that margin, getting closer to your guidance for the full year?

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

Yes, we believe we can, especially building on the core retail and commercial customer. Mike, why don't you add a little color to that, if you could?

Mike Tierney - *Flagstar Bancorp, Inc. - EVP and Managing Director, Retail Banking*

Sure. Because of our liquidity position, we are -- we've really lowered our new rates on CDs, so we can afford a little runoff there. And the SMART Savings account that you saw -- that's a 90-day upfront promo rate, and then it drops to 80 basis points. So we're comfortable that we'll continue to see declines in the cost of the retail deposits and that we'll continue with our favorable mix trends. Our core percentage continues to move up.

Terry McEvoy - *Oppenheimer & Co. - Analyst*

Thanks a lot. Appreciate it.

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

Thanks, Terry.

Operator

Paul Miller, FBR.

Paul Miller - *FBR Capital Markets & Co. - Analyst*

Yes. Can you talk about a little bit of your activity you've gotten so far in April, as some of these warehouse lines, utilization rates -- going up? And have you seen a higher production level so far in the spring buying season?

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

I think when we looked at the quarter -- Matt Kerin just mentioned that the beginning of the year, given the weather and the environment, was not -- it was as cold inside as it was outside, I think. Fortunately, towards the end of the quarter, we saw the pickup that continues to build momentum, as we'd expect.

Unidentified Company Representative

I think we do have strong momentum. And we actually looked at some targeted programs and used some pricing changes and variances as we became more competitive in the marketplace, when we saw the opportunity to kind of continue to grasp share. I think that related to the whole -- you see a number of the firms looking at their MSR and doing some write-downs, that's putting us in a more favorable pricing position in the marketplace. And that's offering some opportunity, and we think that should continue, given where our MSRS is [marked].

Paul Miller - *FBR Capital Markets & Co. - Analyst*

Okay.

And then, the other issue, I believe -- if you addressed it, I missed it -- on the TDRs that you guys talked about selling about six months ago, are you guys still actively trying to sell your TDRs? I think it was like $400 million.

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

We're looking at the opportunity and looking at what our cumulative loss rates would be versus what market conditions are like. In certain markets, we've seen a lot of activity, especially around commercial real estate, coming up. We haven't seen a similar pickup in the TDR market. So we continue to evaluate what our shareholder return is on a hold basis versus sale basis.

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

And Paul, this is Paul. These are still interest-earning assets. So we've had -- we take that into account as well, as compared to the nonperforming loans that we sold back in November.

Paul Miller - *FBR Capital Markets & Co. - Analyst*

And on the TDR behavior -- how's the re-default rate of these -- or do they ever go into -- I know some people define TDRs in many different ways. Some of them -- they never go in default, some they default. They re-perform, and then there's a performance measure afterwards. Can you talk about that a little bit on these TDRs?

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

Yes. In order to be considered [performing is] a 12-month payment period. They have tests they have to meet. And to your point -- the challenge in the industry is that not all TDRs are created equal. So while there's an umbrella of designation and certainly different characteristics within each organization. So we don't consider one to be performing [till] 12 successful payments.

Unidentified Company Representative

Right. And to Joe's point, as you look at our TDR performance, there are certain, clearly, sizeable buckets that perform very well from a re-default perspective. And while I don't have empirical data here to support that, I can tell you that I look at our default rates, and I believe what other industry players are suggesting are their re-default rates. And ours perform very favorably to that.

I think to echo Paul's sentiment that -- if you looked at the fact that these are performing pretty well and are good yielding assets, given our excess liquidity at the moment, as we continue to look at our TDR strategy and assess opportunities to manage that portfolio appropriately through a number of different disciplines, we have a lot of latitude and flexibility at times to if we want to pull the trigger or not.

Paul Miller - *FBR Capital Markets & Co. - Analyst*

I don't want to put words in your mouth, but are you leaning towards more sense holding onto these TDRs now, versus selling them, like you said, in the past?

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

This is Paul. I think what we were saying in the past is there were four potential asset categories that we thought would be helpful in de-risking the balance sheet. One of the key ones was the residential NPL side, which we executed both in November and February to complete that, except for, I think, a slight bit that was left over. We were also looking at other opportunities, as Joe mentioned in course of the speech, including some of the commercial opportunities.

Overall, though, our focus is to increase the revenue. And to sort of echo Matt Kerin's comments -- we're looking at interest-earning assets. This is a good interest-earning asset. We do see it as a TDR. For classification purposes, I believe, under S&L, it's considered not a good asset. But it certainly contributes currently to our net interest income and our net interest margin.

So we're going to look at that carefully, but we're also sensitive to the fact that if you dispose of an asset and receive cash, you can reinvest it in another interest-earning asset. As we mentioned with respect to the interest-earning deposits, we're currently looking at a 25-basis point return. So we certainly want to make sure we maximize our return on interest-earning assets.

Paul Miller - *FBR Capital Markets & Co. - Analyst*

Is there a different risk weighting for these TDRs? Is it additional capital hit?

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

Believe it is. At the same time, I believe our risk-weighted capital at the end of 3/31/2011 was 20.5%, I believe.

Unidentified Company Representative

Correct.

Paul Miller - *FBR Capital Markets & Co. - Analyst*

Okay.

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

So risk-based capital's not an issue at this point with us.

Unidentified Company Representative

(Inaudible)

Paul Miller - *FBR Capital Markets & Co. - Analyst*

Okay.

Getting back to your NIM -- your NIM has been lumpy, it's bounced around. And that's where I was asking about what the activity has been so far toward the end of the quarter, relatively speaking, in April. But I think I'm going to get a lot of questions today, like -- can they back up to that 200 basis points? So, can you just add a little bit more color? Are you going to buy securities if you don't get commercial real estate loans, or get some more commercial loans? How can we get comfortable that you will get back above 200 basis points on that NIM?

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

Yes. [It is] one of the issues. Eighteen months ago, we talked about the benefits of a more diversified revenue stream, and being highly concentrated [in] volatility of the mortgage market, which ties to the FAS and the warehouse lending components that really drive the earning asset side of the equation.

So we've made a lot of good success on the liability side, with lowering our deposit costs we just talked about. Mike and [Sonjo] and the team are really looking at ways to drive more traffic to our branches, grow our deposits. We also talked about the restructuring of the FHLV advances -- bring down the cost on that side of the house.

On the asset side -- we're not panicking and trying to make security trades [in order to suddenly] manufacture a NIM. When you look at the spreads that are available in general small business lending and middle-market specialty lending, everyone's got their own range. But if you look at any common index, you're looking at 300- to 400-basis point spreads in those businesses.

We're cognizant of the fact that you really want to build a good foundation before you start putting on loans. That's why we spent the last 18 months bringing in Todd McGowan and a bunch of other people, including Dan Landers; and really putting in a new commercial and operating system in AFS. We've written every policy procedure, developed noncredit products in Marshall Soura's world, really to go from a building stage now through an implementation stage.

So as I said earlier, lending money's easy. If somebody wants to get out there, you can buy market share for [either compromising] underwriting and pricing. We've taken the steps to make sure that we're building relationships. And we're in the process and comfortable with the pipeline we've built of customers and credits that we know and understand and are confident in rolling out. Therefore we don't feel the immediate pressure to go out and start putting on securities and taking any undue risk in duration, and some of the other things that now you may be seeing out in the marketplace.

So yes, there's opportunities to be a little more prudent and aggressive on the security portfolio, [seeing] that we're pretty much [overnight] liquidity of 25 basis points. But we're certainly not looking to replace that with a security yielding 300 because of the duration issue [may come with it].

Unidentified Company Representative

Yes, I think to follow up on Joe's point -- when you take a look at the excess liquidity, we'd expect over the course of the year for that decline at some point. But [with some] (inaudible), the mix of that liquidity to be comprised in part of securities that we carefully select to ensure that we've got the duration down and we're comfortable with the risk.

But the majority of the growth you're going to see is going to transition over to the held-for-investment side, as we continue to grow the commercial, the C&I and the warehouse lending side. So we expect that to be funded by a slight increase in deposits, but certainly looking at short-term FHLV advance, depending upon the price index.

So we see the (inaudible) held for investment, as well as [redeployment] from the liquid cash into higher-yielding security that is higher than 25 basis points. That is together creating a mix that allows us to reach our target.

Matt Kerin - *Flagstar Bancorp, Inc. - EVP*

This is Matt Kerin. I would also add that there's a number of initiatives underway on the warehouse front that will continue to build back our balances with our existing customers and our new customers in the marketplace, that we have kind of throttled back in the fourth quarter, given the high level of activity with our existing customers. We wanted to make sure we had ample balance sheet capacity to support their origination needs, especially when it came to the Flagstar --

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

Yes.

Matt Kerin - *Flagstar Bancorp, Inc. - EVP*

-- [origination] channel.

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

We're not going to be tempted by trading credit risk from the past, the interest rate risk for the future, because of a quarter challenge. We're sensitive to it; it's a little bit frustrating. But it's the operating environment we're in. And we'll manage our way through this in a prudent fashion that we've laid out over the last 12 months.

Paul Miller - *FBR Capital Markets & Co. - Analyst*

Thank you, gentlemen.

Unidentified Company Representative

Thanks, Paul.

Operator

(Operator instructions) Ben Hockenberg, Venor Capital.

Ben Hockenberg - *Venor Capital - Analyst*

I was hoping -- and just to kind of reiterate Paul's question, you kind of restated your guidance on NIM. But in the quarter, obviously you were below the low end of that guidance. Could you kind of provide a bridge to how, over the next three quarters, you can bring that number up, to get even to somewhere within the middle of that range?

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

I think with respect to the bridge -- this is Paul, and Joe's going to have a comment afterwards -- with respect to the bridge -- if you take a look at our March 31 balance sheet, and look at the high level of liquid assets, you take a look at available-for-sale loans, the held-for-investment loans -- what you'd expect to see by the end of the year should be a reduction in the amount of liquid assets, with the liquid assets earning more than 25 basis points because of the redeployment of part of that into securities. You would expect to see a significant portion of the liquidity go into the growth of the held-for-investment portfolio, including C&I loans, and especially warehouse loans and commercial loans, especially lending. And you expect that to be funded by low-cost core deposits and funded by low-cost short-term FHLV advances.

Those taken together, we believe, will allow us to reach the target by the end of the year.

Ben Hockenberg - *Venor Capital - Analyst*

Great. And what should we be thinking about as kind of a target asset yield that those liquid assets can be redeployed into?

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

With respect to the securities, I think we're looking at -- to Joe's point -- you want to be careful and prudent in a low-interest environment. But we've talked -- we've looked at ranges for that -- a run of 1% with respect to some of the assets that we're bringing onboard. I believe we spoke earlier, back in November, and also beginning of the year -- we talked in the range of 4% to 5%.

And as far as the deposit side -- I think you take a look at our low-cost deposits. With respect to the overall deposit costs, what you'd expect to see during the course of the year is that to go down, as higher-cost wholesale deposits roll off, and as we continue to replace them with core deposits.

Ben Hockenberg - *Venor Capital - Analyst*

Great. And one final question, if I may -- now that you've brought on a good team of underwriting professionals, can you give us some sense of what your loan backlog is, just so we can kind of think about the magnitude of the C&I and other products that we could see roll on throughout the year?

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

Yes. I don't think we've publicly disclosed any of our pipeline numbers. But there are -- consistent with other conversations we have -- growing things well into the hundreds of billions -- hundreds of millions. (Inaudible). And they're the typical types of credits that you would expect to see in small business and middle-market, and especially warehouse lending and others. So it's a pretty diversified portfolio, consistent numbers with what you would expect at any commercial bank when you look at [per-RM] backlogs and pipelines.

Ben Hockenberg - *Venor Capital - Analyst*

Great. Thanks for taking my questions.

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

Thanks, Ben.

Operator

Herb Wamholt, individual investor.

Herb Wamholt - *- Analyst*

The questions I have are based around TARP. When I look through all your financial reports, I see TARP located nowhere. What is the amount you owe TARP? Where are these funds located? And do you have that money to pay back? And how's that going to impact you for the business financials?

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

Sure. This is Paul Borja. The TARP investment was made by the purchase by the U.S. Treasury of preferred stock for the holding company. So what you'll see on the balance sheet is common stock and preferred stock. The preferred stock is the TARP stock. The total amount we purchased -- or that was purchased from us was $267 million back on January 30th, 2009. It accrues at 5% per year; that's the dividend rate. And afterwards, it goes to a 9% rate.

Our current overall plan is for us to return to profitability, to be able to secure the reversal of the valuation allowance associated with the deferred tax assets. And that'll be used as replacement capital so that we can repay the TARP. So part of the overall plan is to repay the TARP once we return to profitability.

Herb Wamholt - - *Analyst*

If you don't return to profitability in this year, then you'd pay the higher rate when you do? In other words, 2012 you return to profitability, but the cost of TARP now goes from 4%, 5% to 6% or 7%.

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

The costs will go from 5% to 9% after five years. So at January 30th, 2014, the rate will change to 14%.

Unidentified Company Representative

9% --

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

9%, I'm sorry. So we certainly want to make sure we do it before then.

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

Yes, but the priorities right now are doing just what you mentioned -- returning to profitability, executing the strategy we laid out roughly 18 months ago. And I think today it's a little premature to talk about TARP repayment. But clearly, with the deferred tax asset allowance and other sources, the ability to repay TARP is there. And we've been paying our dividend and plan to pay the dividend as agreed until we retire the entire security.

Herb Wamholt - - *Analyst*

Thank you.

Operator

Michael Moskoff, MRM Capital.

Michael Moskoff - *MRM Capital - Analyst*

Can you guys just talk about the lawsuit regarding Assured Guaranty, the $100 million (inaudible) that was announced a few weeks back, I believe?

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

Matt, why don't you -- obviously, because it's pending litigation, we have limited our comments. We believe our financial disclosures in our 10-K speak to it clearly. And other than [some of the] editorial comment, I probably should not respond in like kind.

Matt, why don't you respond, as an attorney?

Matt Roslin - *Flagstar Bancorp, Inc. - Chief Administrative Officer, Chief Legal Officer and EVP*

Yes. As disclosed in our 10-K, the Loss Contingency section -- we have had these growth in warranty demands. We've [embedded] them. We believe we've got appropriate defenses to the action, and we intend to defend it.

Michael Moskoff - *MRM Capital - Analyst*

Thank you.

Operator

Bob [Hoboken], investor.

Bob Hoboken - *- Analyst*

Hi. My name is Bob Hoboken; I'm an individual investor. And I was wondering -- I see the loans -- the nonperforming loans, the individual loans rather than commercial -- have increased. What state is the problem in? And do you see that leveling off pretty soon?

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

Yes, I'll turn it over to Matt Kerin in one moment.

Bob, part of it is the fact that we sold off, at the end of 2010, the beginning of 2011, a bulk sale of roughly $474 million, and then $80 million that really chopped off the loans that were delinquent or OREO. A percentage of those loans normally would have been -- what I call reverse migration -- would have returned to performing through various negotiations and repayments. And what you see now is just a runoff of migration of the balance of the portfolio in the over-90-day bucket migrating to nonaccrual. So we expect those to level off, especially when you look at the level of current loans and the level -- the 30- and 60-day delinquency buckets are actually dropping nicely.

Bob Hoboken - *- Analyst*

All right.

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

(Inaudible), you want to add some more color?

Unidentified Company Representative

Yes. I think, a couple things. One, from a geographic dispersion, I think it's pretty representative of what has been going on nationally. And not to be cavalier, but it's a function of the fact that we're a national lender. So where we originated in states like California, Florida and Michigan in particular -- which is our home state, obviously -- you'll see the portfolio reflect the trends that have been undergone in that marketplace.

So reiterate what our CEO has said -- overall, I think the trends are fairly stable, from a migration perspective. And if you go back 12 months and look at the trend lines and the roll rates, the 0-to-30, 30-to-60 and 60-to-90 buckets were all pretty favorable.

Obviously, there's been a slight uptick in the 90-plus. And I would suggest it's largely a function of three things. First and foremost is we sold $500 million worth of NPLs, which reduces what I would call the eligible pool or population of loans that would otherwise migrate to REO or otherwise be resolved through short-sale (inaudible) or charge-off. So when you have standing-steady and slightly declining inflows, with no outflows, you're going to have a buildup in the NPL category, which I would suggest to you is what's occurring in the fourth quarter and in the first quarter.

I think there's also been an impact that we brought back a substantial portfolio of our loans that were serviced by others for a couple of years. And since we made the announcement to them to do that in December, there's been a modest uptick in the delinquency status of those loans. And I think also, you're going to see an impact of the relative seasonality that occurs in a delinquent portfolio through the first quarter. So those are really kind of my key guidance on those factors.

Bob Hoboken - - *Analyst*

Well, thank you very much.

The other question I have is in regard to profitability. When do you think you're going to return to profitability?

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

As soon as reasonable. We haven't put -- the goal, really, is to reposition the Company through the course of 2011 to be on a profitable run rate. And we haven't put out guidance on when, but more specifically how, and how are we executing quarter-over-quarter. But a combination of growing good earning assets, improving our net interest margin, funding that growth through redeployment of its current liquidity and growing our core deposit base, and seeing a steady reduction in credit costs, all bring the elements in line to provide a long-term return of profitability, and not taking any short-term steps, whether it's investing in securities or leveraging the balance sheet. So it's really been a pragmatic approach to build a strategy, put the plans in place and the controls in place. And now we're in the offensive mode of executing it.

So not to be [shorthand], but we're doing it in a very thoughtful process that is sustainable.

Bob Hoboken - - *Analyst*

All right.

The other question is -- do you foresee any more need to raise capital, either through bond issuance or stock issuance?

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

[I'll tell you,] when you look at it, we have Tier 1 capital in excess of 9.8%; risk-adjusted capital of over 20%. We also have significant liquidity at the holding company. We have no short-term pressures clearly on capital. And once we return to profitability, have a very sizeable deferred tax asset allowance reserve that is significant, even once -- if and when a decision is made to repay TARP, or whenever that timeline is, we still have excess capital there.

So our focus now is on investing it wisely and generating the shareholder returns that will bring us back to profitability.

Bob Hoboken - - *Analyst*

Gentlemen, thank you very much for taking my questions. I appreciate it. Keep up the good work.

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

Thanks.

Operator

There are no further questions at this time. I turn the call back over to the presenters for any closing remarks.

Joseph Campanelli - *Flagstar Bancorp, Inc. - Chairman and CEO*

Thank you all for joining us this morning. And we look forward to following up on our second quarter call, when I hope there's much better weather for everyone.

Thank you. Have a great day.

Operator

This concludes today's Conference Call. You may now disconnect.
