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PRESENTATION

Operator

Good day, and welcome to the Flagstar Bank Second Quarter 2020 Earnings Call. Today's conference is being recorded.

At this time, I'd like to turn the call over to Ken Schellenberg. Please go ahead, sir.

Kenneth Schellenberg - *Flagstar Bancorp, Inc. - VP of IR*

Thank you, and good morning. Welcome to the Flagstar Second Quarter 2020 Earnings Call. Before we begin, I would like to mention that our second quarter earnings release and presentation are available on our website at flagstar.com. I would also like to remind you that any forward-looking statements made during today's call are subject to risks and uncertainties. Factors that could materially change our current forward-looking assumptions are described on Slide 2 of today's presentation in our press release and in our 2019 Form 10-K and subsequent reports on file with the SEC. We are also discussing GAAP and non-GAAP financial measures, which are described in our earnings release and in the presentation we made available for this earnings call. You should refer to these documents as part of this call.

With that, I'd like to now turn the call over to Sandro DiNello, our President and Chief Executive Officer.

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

Thanks, Ken, and good morning to everyone listening in. I hope all of you and your loved ones have been able to stay safe and healthy. I'm joined this morning by Jim Ciroli, our Chief Financial Officer; Lee Smith, our Chief Operating Officer; and Steve Figliuolo, our Chief Risk Officer. We're going to start the call by providing a high-level view of our performance for the quarter. Then I'll turn the call over to Jim for details on our financial results. Lee will then follow with a review of our business segments and strategic initiatives, and then we'll open the line for your questions.

Well, it was an absolutely fantastic quarter for Flagstar. In my opinion, the best in the company's history. Not only did we report outstanding earnings far exceeding anyone's estimates but we continue to build a fortress balance sheet. We've talked a number of times about how our results are validating the earnings power of the business model we built starting in 2013. There have been quarters when mortgage results fell off, when banking returns a lag, when interest rates soared and when it slumped, and still, we produced strong returns quarter after quarter.

The knock-on Flagstar by many has been our mortgage business. It's too much of our revenue. It has regulatory risk. It's too volatile. I think we've laid those concerns to rest. Not that long ago, when the mortgage business was challenging, as challenging as it has ever been, and the rest of the company carried us. Now we're in a recession and the mortgage business is off the charts. But that's not the most important story of the quarter. The most important story is the expansion of our net interest margin. Yes, expansion. How did we do it?

First and foremost, the yield on our warehouse portfolio held up well relative to the decrease in benchmark rates quarter-over-quarter. Thanks to [floor] rates that protected a yield that was enhanced by significant growth in income from [draw fees]. In fact, the yield on our warehouse portfolio increased from 3.78% in May to 4.01% in June, and our overall net interest margin increased from 2.84% in May to 2.88% in June.

We've also been diligent in establishing floor rates in many of our other commercial loans. What began as an extra layer of protection we acted to put into our term sheets has paid off well. Not only have our margin improved, but we've also grown net interest income by seizing the opportunity in the warehouse business. That's reflected in the outstanding growth we enjoyed in the quarter, ending with over $5 billion in outstanding warehouse balances for the first time. And it's a trend that's continued into July as our average balances thus far this month are above $5.1 billion.

So despite taking a very conservative stance on lending in all other commercial categories, we succeeded in growing low risk, high-return assets, and in turn, net interest income. As a reminder, the entire commercial portfolio at Flagstar is less than $5 billion net of warehouse loans. And total credit losses in our warehouse portfolio have been less than $5 million over the last 12 years. But we have grown net interest income this quarter without increasing credit risk.

The other important story from the quarter is the aggressive way we managed deposit costs and the makeup of our wholesale funding. Deposit costs dropped dramatically in the second quarter. And because we carry a large amount of wholesale funding, where costs are tied to LIBOR, those costs dropped in tandem with Fed action. Importantly, we think our margin will remain resilient. We also saw nice growth in banking deposits of about $650 million for the quarter.

On to mortgage. What can I say. Over $300 million in gain on sale revenue, just $30 million less than all of last year, pretty amazing. And that run rate is continuing as we are already over $100 million in gain on sale revenue thus far in July. And then quietly, the servicing business just keeps plugging along, supporting our mortgage business, providing efficient funding and adding fee income.

Finally, let me address credit. So far, so good. Everything is holding up. But I know that until we get to the other side of this virus, the credit story remains to be told. I've been a stickler about having a conservative credit allowance in my tenure as CEO and I have no intention of wavering on that, especially now.

You saw that we added $100 million to the ACL for the second quarter and improved our coverage ratio significantly. This has nothing to do with any specific concerns we have with our book. But given current economic projections, I think we are comfortably where we need to be. My guess, though, is that economic forecasts are likely to deteriorate. And if they do, it may require greater reserves. As always, we are hoping for the best, but we're prepared for the worst. And I believe we will be able to add reserves as appropriate, should economic forecast dictate without dipping into or raising capital.

In closing, I think we're in a very good place. A very stable interest margin, outstanding noninterest income generation and a fortress balance sheet.

Let me now turn it over to Jim.

James K. Ciroli - *Flagstar Bancorp, Inc. - Executive VP & CFO*

Thanks, Sandro. Turning to Slide 6. Net income this quarter was $116 million, $2.03 per share. This performance compared to the $46 million or $0.80 per share last quarter. The increase on a linked-quarter basis is largely due to stronger mortgage results and a nice increase in net interest income, the result of higher earning assets and growth in the net interest margin, only partially offset by $102 million credit provision this quarter. We had adjusted net income of $41 million or $0.71 per share last -- in the same quarter last year.

Digging deeper into this quarter's performance, our pretax pre-provision earnings were $250 million this quarter compared to $70 million last quarter. Net interest income increased $20 million or 14%. Average earning assets grew $2.5 billion. Net interest margin increased by 7 basis points, excluding the 2 basis point impact of lower-yielding PPP loans. This performance was primarily driven by the strength of our warehouse business that has rate floors in place to protect from margin compression due to lower rates and our strong core deposits, which benefited from higher custodial balances and also from maturities of higher cost CDs and expiration of promotional rates on savings.

We will view these numbers further on the next slide. Mortgage revenues were $295 million, an increase of $199 million compared to the prior quarter. During the quarter, we saw gain on margins increase significantly as primary secondary spreads remained wide and we worked to manage capacity. Asset quality remains strong. Net charge-offs were only 11 basis points, and nonperforming loans were relatively flat to the prior quarter.

Despite all of this and reflecting our views on the uncertainties within the economy, our allowance for credit losses, or ACL, which include the reserve for unfunded loan commitments were $250 million at quarter end, up from $152 million at the end of the first quarter.

We'll provide more details when we get to the asset quality slide and take a deeper dive into CECL. Capital also remained solid. All capital ratios remained above the stress buffers that we've established based on our DFAST models. Total risk-based capital was 11.3%. At June 30, our CET1 ratio was 9.1%, and our Tier 1 leverage ratio was 7.8%. We'll go into more details on capital later.

So let's turn to Slide 7 and dive deeper into the income statement. Net interest income increased $20 million to $168 million this quarter, up 14% from last quarter, primarily driven by warehouse loan growth and the impact of lower interest rates on borrowing costs, especially core deposits, partially offset by lower yields on earning assets. Earning assets grew 12% led by warehouse lending and loans held for sale. Deposit costs came down 33 basis points, while average deposit balances increased $1.9 billion, led by a $1.4 billion increase in custodial deposits and retail deposit growth of $0.4 billion. We'll dive deeper into net interest income and our interest rate risk position on the next slide.

Noninterest income increased $221 million to $378 million due to higher mortgage revenues. Our gain on sale revenue of $303 million represented an increase of $213 million, fall-out adjusted locks increased 24% to $13.8 billion, and the gain on sale margin increased to 219 basis points. We saw extraordinary levels of gain on sale margin throughout the quarter and manage our volume levels to fit our fulfillment capacity.

The purchase market returned later in the quarter and demand continues to be strong. We also recognized a loss of $8 million on our MSR. The result of model changes that we believe are congruent with the economic forecast we use for CECL and higher prepayments. The MSR market is beginning to come back as shown with the smaller MSR sales that we executed in July.

Loan admin income improved $9 million due to a decline in the LIBOR-based credit that we provide to our sub-servicing customers for the custodial deposits that they control. Noninterest expense was $296 million, up $61 million from the prior quarter, primarily reflecting a $53 million increase in mortgage volume-driven expenses, largely commissioned and loan processing expense as mortgage loan closings increased 41%.

Overall, mortgage expenses as a percentage of closings were consistent with the prior 3 quarters. Expenses also increased due to higher incentive compensation costs. Lee will provide more color on expenses later.

Slide 8, which we added last quarter, provides details on our interest rate risk position at the end of the quarter. There's a lot of information on this slide, and we added it last time to support our confidence in holding the net interest margin stable. It's shows that we are still positioned well. While the majority of loans have variable rates, many of those have rate floors, which provide us protection from lower rates. Consequently, the yields on our loan portfolio held up rather well this past quarter, and we expect them to hold up well for the future, too. On the deposit side of the balance sheet, we benefited from the full quarter impact of the pricing changes we made in March when the Fed dropped short-term rates. Additionally, as we observed last quarter, deposits continued to repricing at a new curve environment, which provided support for our net interest margin.

I'd also mention that approximately 85% of our custodial deposits, those controlled by our subservice and clients, naturally priced down as those rates are based on LIBOR.

In summary, we believe the deposit rates will continue to be a tailwind for the remainder of the year. Also, (inaudible) interest rate positioning that our mortgage business gives us, we've locked-in future funding rates at these lower levels. To do this, we've executed interest rate swaps and entered into long-term FHLB advances to lock in lower rate funding, laddering those out between 3 and 7 years. We've now executed $1.7 billion of this strategy, securing long-term funding at an average cost of 57 basis points, well below our cost of funds.

While it's difficult to predict where rates might be in the future, we feel that our interest rate risk position is in a good place. We feel that we can protect our net interest income and net interest margin in this rate environment and believe that our NIM should be relatively flat excluding the impact of higher levels of loans with government guarantees. More on that in a minute.

We've sold our portfolio of PPP loans and net sales should close by tomorrow. As in the first quarter, we finished the quarter with a stronger net interest margin and the net interest margin will be averaged during the quarter. June NIM was 2.91%, excluding the impact of the lower-yielding PPP loans. We do expect that loans with government guarantees will increase. To help explain this, we've added Slide 40 to the appendix, which provides more details.

In summary, where we own an MSR for Ginnie Mae loans, we have the option to repurchase those loans after the loans have gone 3 months without a payment, due either to delinquency or (inaudible). At June 30, we had $1.1 billion of such loans and we have not yet repurchased for which the accounting rules made us reconsolidate under the balance sheet with an offset to other liabilities. These assets had a yield of 1.97% last quarter, and so their weak consolidation will likely reduce our net interest margin but not reduce our net interest income.

At June 30, we had Ginnie Mae MSRs covering $15 billion of principal. Of that amount, 20% or a total of $3 billion was in forbearance and $1.1 billion of that amount had not had payment for 3 months, making those loans eligible to repurchase. As I said before, we have not yet repurchased the loans. We do not believe there is significant downside to holding loans, either by buying them or through this accounting gross up.

If we were to repurchase these loans, we can pledge them to the FHLB and they're 20% risk weighted asset. Further, if we do repurchase the loans, we could resell those loans at a later date, which is attractive for us, and they remain government guaranteed.

Let's now turn to Slide 9, which highlights our average balance sheet this quarter. Average earning assets increased $2.5 million from last quarter. This resulted from a $1.5 billion increase in warehouse loans and a $0.4 billion increase in loans held for sale. PPP loans, which are included in C&I loans, averaged $0.3 billion for the quarter. Average deposits increased $1.9 billion from last quarter. Custodial deposits drove $1.4 billion of this increase. We also saw growth of $0.3 billion in noninterest-bearing retail deposits, a 21% increase from last quarter.

We continue to have a strong liquidity position driven by the strength of our deposit base and access to multiple sources of liquidity, both on balance sheet with a high-quality securities portfolio and our balance sheet with our undrawn FHLB facilities. At June 30, we had ready liquidity of $6 billion, not including the ample access we have to borrow the Fed discount window.

Finally, we continued to demonstrate significant capital generation capabilities with growth in our tangible book value per share of $31.74, up $2.22 from March 31 and $5.58 from 1 year ago, a 21% increase.

So let's now turn to asset quality on Slide 10. Credit quality in the loan portfolio remained strong. Early stage delinquencies continue to be relatively low, only $15 million of total loans were over 30 days delinquent and still accruing as of June 30, down from $26 million from March 31. Our allowance for credit losses covered 1.7% of total HFI loans. This coverage reflects 35% of the HFI loans being warehouse loans, so excluding warehouse loans from the denominator, given their relatively clean credit loss history and considering that substantially all of these loans are collateralized with agency and Government Act residential mortgage loans, our coverage ratio would now stand at 2.6%.

As required by CECL, this level of ACL coverage considers our economic forecast over the next 2 years and lifetime losses on the portfolio.

On Slide 11, we can see that we ended the quarter with $250 million of allowances for credit losses, consisting of $229 million of allowance for loan loss and $21 million in the reserve unfunded loan commitments, which is included in other liabilities.

In total, our allowances for credit losses at quarter end increased by 64% over what we reported at the end of the first quarter 2020. In our adoption of CECL, we use 3 different economic forecasts for the next few years, which then reverted to a long-term average over a linear period. These forecasts included an average projection, an adverse projection that reflected severe economic distress, which [related] to 30%.

However, at March 31, we used only the baseline forecast due to the significant amount of uncertainty in the economy at that time, and judgmentally added $4 million of reserves to that base forecast at March 31. This quarter, we returned to using 3 different moves forecasts over the next 2 years, an S1 growth forecast weighted at 30%, their baseline forecast rated at 40% and their S3 adverse forecast rated at 30%, all of the forecasts is in the June release. The resulting composite forecast for Q2 is worse than what we assumed in Q1. Unemployment ends the year at 10% and recovers only slightly in 2021. GDP recovers only slightly by the end of the year from current levels and doesn't get back to the pre-COVID level until mid-2022. HPI drops about 2% from early 2020 through 2021. The worsening of our economic forecast increased the ACL by $31 million on March 31. In addition to this increase, we judgmentally increased qualitative reserves by $39 million, primarily in our CRE and C&I portfolios, guided by this seasonal allowance model output using the Moody's adverse scenarios to provide coverage for industries and customers that we believe could be more exposed to the stressful conditions in our forecast.

Finally, we reviewed our loans and deferral status. And while we do not have any nonperforming loans in these categories at this time, we proactively downgraded 170 million OMs to watch status during the quarter. These downgrades and other credit changes increased the output from our CECL model by $24 million. We've provided a portfolio-by-portfolio breakdown with the resulting ACL coverage ratios in our appendix.

On Slide 12, we've updated our exposure to those industries that we believe are more likely to be the most impacted by COVID. In total, we have $1 billion of outstanding loans in this category, representing less than 7% of our total loan portfolio. In our commercial and industrial loan portfolio, these balances totaled $0.3 billion. You can see that the exposure here is relatively low, especially as the early use portfolios total only $63 million, we have no oil and gas exposure.

In our commercial real estate portfolio, we have $0.7 billion outstanding in the areas most likely to be impacted by COVID, including CRE loans secured with hotels, retail properties and senior housing. Of the loans in this category, our average LTV is 56%, and our average debt service coverage ratio was 1.6x. We've taken a deeper dive into our portfolio this past quarter and reexamine borrower strength and liquidity. Importantly, we didn't identify any loans that we believe will default.

While we believe that we will have losses, we continue to see strong borrower support across the portfolio. We feel relatively good about our credit risk in this portfolio as we are starting from a position of strength from our carefulness about who we lend to, to the disciplined underwriting of those credits in the pre-COVID LTVs and debt service coverage ratios in the CRE portfolio. While we know this will be a challenging time for many of our customers, we believe that we have a low level of exposure to those industries most impacted by COVID as a result of our well-diversified loan portfolio and the discipline and experience -- the team of experienced bankers that we have.

Turning to Slide 13. Our capital ratios remained solid and nicely above our stress buffers. Total risk-based capital was 11.3% on June 30, up 14 basis points. Our CET1 ratio of 9.1% was relatively unchanged. As expected, our Tier 1 leverage ratio of 7.8% decreased 33 basis points this quarter as it's based on average assets. It's interesting to see that between [1% and 12%] on a warehouse loan portfolio, we have approximately 750 basis points of total risk-based capital and 450 basis points of Tier 1 leverage capital dedicated to these 2 asset categories that have very low-risk content. If you add the $1.1 billion of unpurchased loans with revenue guaranteed and we've had to reconsolidate, we have over 770 basis points of total risk-based capital dedicated to low-risk portfolios.

In warehouse lending, which has 100% risk weight, we had under $5 million of losses cumulatively over the last 12 years. I'd remind you that we also hold the collateral for those loans while they are on our lines, and that collateral consisted almost entirely of agency and government-backed residential mortgage loans. Loans held for sale also had very little risk content, this portfolio was carried at fair value.

In summary, we believe that we are operating at strong capital levels given our low-risk balance sheet composition.

I will now turn to Lee for more insight into each of our businesses.

Lee Matthew Smith - *Flagstar Bancorp, Inc. - Executive VP & COO of Flagstar Bank*

Thanks, Jim, and good morning, everyone. We're extremely pleased with our net income of $2.03 per diluted share for the second quarter, which increased tangible book value to $31.74. More importantly, we've strengthened our balance sheet by increasing our ACL reserve to $250 million or 2.6% of loans held for investment, excluding warehouse loans. We've deliberately designed our business model to be balanced between interest income and fee income revenues and have businesses that are countercyclical, such as mortgage originations and warehouse lending. So we're able to generate strong earnings in any interest rate environment.

This diversified model has delivered record earnings this quarter, bolstered our capital and created the liquidity we need to fund our balance sheet growth. Given this low rate environment looks as though it will persist for some time, we believe we will continue to generate strong earnings, increase book value and deliver exceptional results for our shareholders.

On our last call, I mentioned how I couldn't have been more proud of how we've responded as an organization to the COVID-19 pandemic, and that continues to be the case. Our 3 main priorities have been ensuring the health and safety of our employees, continued best-in-class service to our customers and giving them easy access toward Care Act and stimulus programs, protecting the bank's position given the uncertainty COVID-19 has created. The vast majority of our employees continue to work from home and our productivity levels have been unaffected. We've actually seen increased productivity in certain areas, and we continue to serve our customers and partners with the same exceptional standards they've come to expect from us.

For those employees working from Flagstar facilities, we're ensuring comprehensive distancing standards, cleaning regimens and that the necessary personal protective equipment is available in order our employees feel safe at all times. 157 of our 160 bank branches have now reopened utilizing a comprehensive safety plan to protect our employees and customers. We took over 3,000 applications for the Paycheck Protection Program and have worked with borrowers requesting forbearance relief on their mortgages or deferral relief on their consumer or commercial loans. We're facilitating the main street lending program and continue to work with the many nonprofit organizations we support in our communities to ensure our customers and partners have access to all stimulus programs being offered by the federal government, states and agencies.

Finally, we've protected the bank by tightening the credit box around certain mortgage and warehouse lending products being thoughtful and considered around new lending opportunities, an increase in our ACL reserves significantly in the last 2 quarters, given the uncertainty COVID-19 has created.

There were several other notable developments during the quarter, which included net interest margin increased 5 bps to 2.86%, a result of reduced deposit and borrowing costs given the lower interest rate environment. The Paycheck Protection loans actually reduced our net interest margin by 2 bps during the quarter, otherwise, it would have been a 7 bps increase quarter-over-quarter, and we closed tomorrow on the sale of all of our Paycheck Protection loans to a third party. Average loans held for investment increased $1.8 billion or 15% and primarily a result of an increase in warehouse lending balances.

Deposits increased $1.9 billion or 12%, predominantly due to custodial deposits given the higher payoffs but we also saw an increase in demand deposits, a result of reduced spending because of the shutdowns and stimulus programs paying out during the quarter. Mortgage banking revenues increased an incredible $199 million or 207% as we continue to take advantage of the strong refinance market. 69% of our revenues in the second quarter were from noninterest or fee income businesses, with over $300 million being generated through gain on sale revenues from our mortgage origination business.

Our subservicing business decreased slightly in terms of loan serviced or subserviced, a result of higher payoffs given the low interest rate environment, but we were able to replace most of that runoff through new originations, another strength of our business model. We ended the core of servicing or subservicing approximately 1,042,000 loans, which generates consistent noninterest fee income and deposits for the bank.

We couldn't be more pleased with our record second quarter from an earnings point of view, which wouldn't be possible without our fantastic employees, team-oriented approach and carefully designed business model.

I will now outline some of the key operating metrics from each of our major business segments during the second quarter.

Please turn to Slide 16. Quarterly operating highlights for the Community Banking segment include: average commercial and industrial and commercial real estate loans increased $491 million or 11%, with the growth being driven predominantly by Paycheck Protection loans. We continue to be thoughtful in terms of new facilities and believe our strong credit policies and diversified portfolio will be a strength as the fallout from this pandemic becomes more apparent.

Average consumer loans held for investment decreased $193 million or 4%, a result of increased payoffs in our first lien mortgage portfolio. And we ended the quarter with approximately $4.6 billion of consumer loans on our balance sheet, with 81% being residential first lien mortgages and HELOCS. Through June 30, approximately 2,400 deferrals on our non-mortgage consumer loan portfolio had been granted, which amounts to $137 million or 7.5% of all outstanding balances. This amount is pretty flat to where we ended last quarter as request for new deferrals have slowed to a trickle.

Average warehouse lending loans increased $1.5 billion or 64% to $3.8 billion in the quarter due to the low interest rate environment, driving strong mortgage refinance volume. Our relationship-based approach and speed of execution also enabled us to add new customers as well as increased lines for existing customers during the quarter.

At the end of Q1, we made changes to our warehouse credit box as a result of the volatility in the mortgage market. We stopped financing non-QM and jumbo loans and tightened our FICO limits around several of the products in response to the market uncertainty and to protect our own position.

As the quarter progressed and the volatility subsided, we eased some of those restrictions, particularly with our stronger clients. Through July 24, average warehouse loan balances outstanding have exceeded $5.1 billion month-to-date. Given the positive correlation warehouse lending as to the mortgage business, it acts as a nice hedge in a low interest rate environment when refinance activity is thriving.

Overall, average loans held for investment increased $1.8 billion, which, together with a 5 bps improvement in our net interest margin helped drive the $20 million or 14% increase in net interest income quarter-over-quarter. Average deposits, which include all interest-bearing and noninterest-bearing retail and custodial accounts increased approximately $1.9 billion, and we also reduced the cost of interest-bearing deposits 33 basis points during the quarter as we moved quickly to compensate for the lower interest rate environment.

We're very pleased with the performance of the Community bank, both in terms of where our asset growth has been focused on managing down our cost of deposits. We maintain a diversified lending portfolio with strong credits and no significant exposure in any one industry. We feel our disciplined approach, together with the quality of our book will ensure continued success in the future.

Please turn to Slide 17. Quarterly operating highlights for the mortgage origination business include: fallout-adjusted lock volume increased 24% to $13.8 billion quarter-over-quarter. While the net gain on loan sale margin increased 139 basis points to 219 basis points. As a result, gain on sale revenues increased to significant $213 million to $303 million in the quarter. The majority of our lot volume growth was seen in our higher-margin retail broker and non-delegated correspondent channels, and the increase in volume was predominantly driven by the robust refinance market due to low interest rates.

Refinance activity accounted for 65% of our lot volume during the quarter, and retail originations accounted for 31% of lock volume. We also saw significant margin expansion across all channels as we use margin as a lever to keep volume in check with capacity and ensure continued exceptional service for our customers. Mortgage closings were $12.2 billion in the second quarter, a 41% increase from the first quarter as we continue to add underwriting and fulfillment capacity given the increased production volume as a result of the low interest rate environment.

Our mortgage operations team continues to deliver excellent results in this work from home environment. Closings are timely, and we haven't seen any degradation in productivity or service level agreements during this pandemic, which is testament to their desire to provide certainty around the quality and service that is the cornerstone of our values.

We continue to be disciplined around the types of products we originate. At the beginning of the quarter, we moved to stop originating higher risk products and sites in the credit box in certain areas, to protect our position and minimize any future write-downs or losses.

At period end, we reported approximately $1.8 billion in Ginnie Mae early buyouts on our balance sheet. Of this, approximately $1.1 billion were a result of Ginnie borrowers opting into forbearance at the beginning of COVID-19. The accounting consequence of owning the MSR is to show them as early buyouts whether you buy them out or not, and therefore, the biggest impact for Flagstar is against capital. These loans were all performing before the pandemic, and we believe a significant number will go back to making payments and get reinstated after the forbearance period expires, either on their own or through the partial claims process. Once a loan is reinstated, it's no longer categorized as an early buyout.

We believe the small number will get modified outright or modified in conjunction with a partial claim, at which point, we will buy them out and resecuritize the loan, realizing the gain on sale benefits of doing so. Given the increase in home prices over the last few years, an equity most owners have in their homes. We don't anticipate many borrowers going into foreclosure following the end of the forbearance period. The overall impact of Flagstar of this asset class is somewhat neutral. It does create an operational need to work through these loans, and as I mentioned, it impacts capital given the accounting rules and recognition. However, it only impacts liquidity if we actually buy the loans out, and we would likely only do so if we can modify the loan and resecuritize, therefore, realizing the gain on sale benefit that would be generated.

We're thrilled with the performance of our mortgage business in the second quarter, which has always been a key component of our business model and strategy. It generates significant noninterest fee income for the bank and is a natural hedge to some of our other businesses in a declining interest rate environment.

Through July 24, gain on sale revenues are over $100 million month-to-date. Moving to servicing. Quarterly operating highlights for the mortgage servicing segment on Slide 18 include: we ended the quarter servicing or subservicing approximately 1,040,000 loans, of which over 855,000 or 82% of subservice further MSR owners. Of the 1 million loans, we service or subservice, 94% are backed by Fannie Mae, Freddie Mac or Ginnie Mae. The number of loans serviced or subserved decreased slightly in the quarter, but despite the high levels of refinance activity, we are able to replace runoff with new loans from our mortgage origination business, another advantage of our business model.

Today, we have the capacity to service or subservice 2 million loans as well as provide ancillary offerings such as recapture services and financing solutions to MSR owners.

If you look at Slide 39, you will see that we are achieving our $4 million to $6 million of operating profit before tax guidance for every 100,000 loans we add to the platform. As it relates to forbearance through June 30, 110,176 borrowers, representing 11% of the first lien mortgage portfolio that we either service or subservice of requested forbearance relief because of COVID-19. We've seen a significant decrease in new forbearance requests into the peak weeks at the end of March, beginning of April. And would say new requests are just trickling in and have been for the last several weeks.

Interestingly, 34% of those borrowers who have requested forbearance have made their April, May and June payments and not taking advantage of the forbearance option. This effectively means that right now, 7.3% of the loan book we service or subservice are actually using forbearance. As part of the forbearance period, we're also waiving certain fees, and there will be no negative reporting to the credit bureaus.

We've set up a hardship relief task force. We can add the full servicing team to proactively reach out to borrowers and work out an appropriate solution after they exit forbearance. The peak number of loans in forbearance was 129,332. And as of June 30, that number is 110,176, a reduction of approximately 19,000 or 15% as borrowers who had initially opted in have opted out, paid off their loan, reached out to say their hardship has been resolved and their loan is current or had their loan modified.

During the quarter, we sold $1 billion in a bulk MSR deal and retained the subservicing on these loans. The market for MSR strived up immediately following COVID-19, given the volatility in the market and uncertainty around liquidity needs on the advances. However, the volatility is dissipated, and there is much more certainty around the liquidity needs for advances, as a result, the market for MSRs is beginning to come back and show signs of life again.

Our MSR to CET1 ratio is currently 14.6%. So we have plenty of room before we start to approach the 25% MSR to CET1 capital level, and intend to use the runway we've created through the end of the year if necessary.

Finally, custodial deposits averaged $6.2 billion in the second quarter, a $1.4 billion increase compared to prior quarter. Again, this is just another benefit we get from our subservicing business as it provides liquidity that helps fund our balance sheet.

Our subservicing business continues to go from strength to strength and provides benefits and business opportunities to other parts of the bank. We believe we have one of the best teams and platforms in the industry and expect it will continue to thrive in the future.

Moving on to expenses on Slide 19. Our total noninterest expenses increased 26% or $61 million to $296 million quarter-over-quarter. And total revenues increased by $241 million or 69% to $546 million.

If you look at Slide 20, our core non-mortgage noninterest expenses were $147 million in Q2, an increase of $8 million from the prior quarter. This increase was predominantly driven by variable compensation, a result of the strong earnings in the quarter.

Expenses tied directly to the mortgage origination business were $149 million, an increase of $53 million or 55% versus Q1. Mortgage closings, which drive mortgage expenses increased 41% and retail closings, which have a higher cost to close made of 31% of all closings in the quarter versus 24% in Q1.

Furthermore, we continue to add capacity, given the strong origination forecast from the agencies and Mortgage Bankers Association. Our efficiency ratio was 54%, which was an improvement of 23% from the prior quarter because of our strong fee income revenue growth quarter-over-quarter. We will not be providing Q3 noninterest expense guidance at this time. It's an unprecedented time and the health and safety of the Flagstar family, our employees, customers, partners communities and stakeholders is our #1 priority. Despite the uncertainty created by COVID-19, the performance of the Flagstar team and our business model has been nothing short of outstanding. We've reported record earnings for the quarter and believe the resiliency and balance of our carefully designed business model will enable us to continue to be successful, generate strong earnings and create significant value for our shareholders in the future.

This concludes our prepared remarks, and we will now open the call to questions from our listeners.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

And our first question today comes from Scott Siefers of Piper Sandler.

Robert Scott Siefers - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

So very strong quarter. So congratulations. I was hoping maybe either Jim or Sandro, Lee, if you could talk a little bit more about how this issue with the Ginnie Mae loans sort of plays out? I mean it sounds like you have plenty of optionality, but what has to happen in your guys' minds for them to resolve just as if they were not in forbearance? In other words, what has to happen for this to just sort of go away as an issue?

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

Yes. So we try to provide a lot of detail on that in the speech, both Jim and Lee addressed it. So let me let them both enhance their responses here.

Lee Matthew Smith - *Flagstar Bancorp, Inc. - Executive VP & COO of Flagstar Bank*

Yes. Let me go first, Scott. So as I say, we had $1.8 billion of Ginnie that goes on the balance sheet at the end of the quarter, $1.1 billion were a result of Ginnie borrowers opting into forbearance. And the in consequence of owning the MSR is to show them as early buyouts, whether you buy them out or not because we actually haven't bought them out at this time. The loans were all performing going into the pandemic, as I've said, and so we believe a big portion will go back to making payments and will therefore get reinstated after the forbearance period expires, either on their own or through the partial claim process. And once they're reinstated, they're no longer categorized as an (inaudible) . We think the small number will get modified outright or they'll be modified in conjunction with the partial claim. We will likely buy those loans out because we would realize the gain on sale benefit of resecuritizing those loans after we bought them out.

As I mentioned, a lot of borrowers have equity in their homes because it's been rising home prices for a period of point now. So we don't imagine a lot of these will go into foreclosure. And net-net, we think this asset class is somewhat neutral. It does impact capital. It only impacts liquidity, if we choose to buy them out, and we're only going to buy them out if we can resecuritize them and realize the gain on sale benefit.

James K. Ciroli - *Flagstar Bancorp, Inc. - Executive VP & CFO*

Yes. So Scott, it's a good question. Look, we've raised this with our regulators, we've put it in front of Ginnie Mae, we've put it in front of even FASB. It's a court that I don't think anyone anticipated that loans in forbearance could be reconsolidated on the balance sheet. But look, there's no downside. There could be, as Lee elaborated, there could be some upside from here in that these loans are going to be more likely to have resecuritization gains that we can take advantage of in the future. So -- from a capital perspective, from a liquidity perspective, it's not something that I'm necessarily concerned about, but it's like not had the cosmetic issue on our balance sheet as well.

Robert Scott Siefers - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Yes. Okay. That's good color. And I appreciate it. Maybe just as a follow-up, how high could those balances go? I mean, I guess my inclination would be that if forbearance requests have already kind of slowed to a trickle, they might increase, it's not as if they're going to double or triple. And I realize that the risk weighting is very low. So the regulatory capital impact is kind of negligible. But all assets are treated the same from a standpoint of TCE, which a lot of investors look at. So just curious how -- sort of what the appetite is to allow the balance sheet to be impacted by this phenomenon?

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

Well, let me say, I'm not worried about the impact on the balance sheet, but trying to predict what might happen. I mean there's a lot of questions you might ask me about the future that I just am not going to try to answer because this pandemic is such that we just don't know. We don't know how long forbearance is going to go. We don't know how what the government is going to intervene on these things. So I would not want to hazard a guess on that, except to say that I think that we're in a position to the nature of those assets were not to be a negative impact in any material way at all.

James K. Ciroli - *Flagstar Bancorp, Inc. - Executive VP & CFO*

And you're right about the low-risk weight. And keep in mind, our Tier 1 leverage ratio is where we have the most capital buffer over well capitalized status. And so this will impact the leverage ratio a little bit more because it's based upon average balances, but it's not going to bring that ratio into competition with the risk-based capital ratios is what we're concerned about.

Operator

(Operator Instructions)

We'll go next to Bose George of KBW.

Bose Thomas George - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Actually, just one on the -- on your loan production mix. It looks like your Ginnie Mae production was down quite a bit. Is that tightening the credit box? Is that related to the the balance sheet issues that we just discussed as well, just curious, any color there?

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

Well, it's a lot of all of that. Both what we determined as we got into this pandemic was that the smart way to go with originations is going to be principally in the agency. So we really downplayed the non-QM and Jumbo, limited that to portfolio product, and we minimize the Ginnie Mae significantly. We left it out to a little bit for our retail originators, but doing very, very little of it. And the profitability, as you can see, has been very, very strong. So while the margins are a little wider in Ginnie Mae right now given uncertainty around a lot of that from a servicing point of view and MSR point of view. Given the fact that the agency activity is so strong, we chose to focus there.

Bose Thomas George - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Okay. That makes sense. And then just given the relative increase in the retail share for you guys, is that being driven by increased recapture, just curious there? And also just the gain on sale margin trends for direct lending versus recaptured, is that -- is there a big difference there?

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

Well, first of all, relative to the retail. So we are controlling the growth in retail. But we've had opportunity to lift out some very, very strong originators from other organizations. And that's why you see the production being greater, coupled with just the strength in the market, of course. But we're being very careful there because we want to make sure that we preserve a variable cost model that we've put in place. And so right now, we're getting paid for that retail volume and a pretty favorable fashion given the margins there. And so we're comfortable with the growth that we've seen there. With respect to recapture, let me just let Lee answer that part of that.

Lee Matthew Smith - *Flagstar Bancorp, Inc. - Executive VP & COO of Flagstar Bank*

Yes. Thanks, Sandro. Thanks for the question, Bose. So on the retail side, we've seen just really good growth both from the distributed retail point of view and in our consumer direct channel. Now the margins in the consumer direct channel are a little less when you factor in the recapture, as you can imagine, but the margins are still pretty robust at the moment given the current market. And the margins are very, very strong on the distributed retail side. But we've seen healthy growth across all of our retail channels.

Operator

Our next question comes from Daniel Tamayo of Raymond James.

Daniel Tamayo - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Congratulations on the strong quarter. So I guess just staying on the gain on sale quickly here. You mentioned the $100 million plus so far in July. What is the spread look like in July relative to what you saw in the second quarter?

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

Well, given what we've told you on the gain on sale, I think I'm comfortable in saying that the spread has held up pretty well this month.

Daniel Tamayo - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Okay. Longer term, I think you guys have talked about as we see this healthy profit margins in the business and certainly, strong volumes that would invite increased competition over time. Are you seeing that yet? And how long until you think that starts to impact spreads?

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

Competition in the mortgage business? Yes. I don't -- yes, I think capacity is what's going to drive what happens to margin. So I think whether there's new entrants to the business or not, I think a lot of mortgage originators will continue to build capacity. What we try to do to offset that a bit, and I think it's been successful is manage the capacity in a very disciplined fashion and look for where the best opportunities were to grab business with the best margins that we could do -- that we could do by not adding a lot of fixed expenses. So right now, it's working really well. How long we can continue to do that. Again, that's anybody's guess. But the mortgage market certainly looks like it's going to continue to be strong through the rest of this year. The 30-year rate what is it at 2.9%, something like that. The housing market is very strong. The year-over-year purchase activity is up. If you look at our builder portfolio, only one small credit has ask for a payment deferral. So people are still building houses and buying houses. So I think the fact that we didn't have -- why we had some price increase, we don't have a bubble that we're dealing with here in the real estate world. So -- look I feel real optimistic about the opportunity for continued strong volume in mortgage for the rest of this year. Margin is a big question, and we'll see how that goes. But I'm pretty comfortable with where we're at. Guys, anybody want to add anything to that?

Lee Matthew Smith - *Flagstar Bancorp, Inc. - Executive VP & COO of Flagstar Bank*

Yes. I mean, I think you're exactly right, Sandro. I think the only thing I would add is, I mean, look, when you look at the latest forecast from the agencies and the MBA, they're forecasting $2.9 trillion for 2020, and we'll probably go above $3 trillion. I think in the first half of this year, there was $1.5 trillion of origination. So there's good runway here. They're forecasting $2.2 trillion for 2021 right now. And it is all about capacity. But as Sandro said, we manage volume to capacity and optimize through product and channel mix so that we're maximizing returns, and we want to ensure a consistent and quality customer experience, and we'll continue to do that.

Daniel Tamayo - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

All right. Great. And if I could sneak one more in on the mortgage warehouse yields. So obviously, you've been successful with floors there in keeping those yields relatively high and they're higher than your C&I and CRE yields. So given the duration of these loans and the floors you have in place, is it sustainable for those yields to remain above the CRE and C&I books, do you think?

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

Well, I think there's a good chance, that's sustainable. It's hard to say for sure. The yields are enhanced, as I said in my prepared remarks by the draw fees. And so if the activity continues and the number of draws that we've seen in the last quarter continues in this current quarter, I think there's a really good chance that we could continue to sustain that level of yield. I certainly don't see a declining very much. So I think it's a field that's very much protected, given the floors that we have in that portfolio. And as I say, coupled with the draw fee. So it's a business I love being in right now. It's got very, very little credit risk as both Jim and I noted, less than $5 million in losses over the last 12 years, that's through an economic recession, by the way. And I'll share another little story with you, if I could. We had a -- we made a decision in late March that we were going to stop accepting non-QM and Jumbo product as collateral for our warehouse lines. And at the time, we had about $300 million of that collateral. And we were able to work together with our clients. We didn't have very many investors at that point in time to wind that collateral down to literally nothing today.

And we did that without experiencing any loss. So I think that tells you a lot about how strong that business is and if you manage the quality of the collateral properly, how there's very little risk. And I'll remind you, we had an originator last year live well that abruptly closed their doors. [We had] I think it was a $20 million line outstanding to them at the time and within 45 days, we wound it down and actually collected more than what was on the line. So it really is a very safe business. So to be able to grow our commercial loans in this environment and grow our yields and our net interest income. I mean, I couldn't be more pleased.

Operator

And our next question comes from Steve Moss of B. Riley FBR.

Stephen M. Moss - *B. Riley FBR, Inc., Research Division - Analyst*

In terms of just following up on capacity within the retail business. You guys mentioned adding a couple more originators this quarter. Just kind of curious with the mortgage [work] being as strong as it is -- how much more could we see in terms of volume for you guys there?

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

Well, look, I think you've got to be careful, right? So while we continue to add capacity to take advantage of the opportunity that we've been presented with. And as I said, we're being really careful not to do it in such a way as to increase our long-term fixed expenses in any way. So you can get all of your skis in this business and get excited and add a lot of capacity internally that is hard to get rid of when the volumes go the other way. So we're leaning on our people to work as much over time as they're willing to work. We paying them [stifs] to work longer hours, to get more work done. We're leaning on our third-party vendors to do as much as possible for us. Everybody is working nights and weekends. So we're stretching this thing out as far as we can stretch it. And -- but I'm not going to go chase another couple hundred million of business a day and then a year from now, explaining to you why our expenses are too high. We're just not going to let that happen. So hey, if we can do what we're doing and here in July, you're sitting here on what is today, the 28th of July with over $100 million through last Friday, I got to say, I think we're managing this thing pretty well.

Stephen M. Moss - *B. Riley FBR, Inc., Research Division - Analyst*

Right. Absolutely. And then in terms of the -- just on the margin here, I think the guidance was for relatively stable this quarter. Just kind of looking at the dynamics. Mortgage warehouse yields are up. Funding costs are coming down. It looks like there's some pretty good room. Just kind of curious what else could be a little bit of an offset here?

James K. Ciroli - *Flagstar Bancorp, Inc. - Executive VP & CFO*

So Steve, as you think about it, the -- as the primary secondary spreads come in, I am looking at how low can that overall mortgage yields go. I don't think there's a lot of risk of that moving meaningfully below 3%. But we fund that portfolio -- that held for sales portfolio short. So right now, it's accretive to -- it's accretive to NIM. But if that mortgage yield were to follow a lot, say, it went to 2.5, which I think is just absolutely crazy, then maybe we could see some pressure on the NIM from that portfolio. In response to that, we would shorten our turn times. But we still -- that's just a function of how long we want that on the balance sheet, what the average balances are.

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

Did that answer your question? I wasn't sure.

Stephen M. Moss - *B. Riley FBR, Inc., Research Division - Analyst*

Yes. Yes, I meant net interest margin there. Got it. And then third, just on credit here. You had [$170 million] in downgrades from the -- a $170 million in downgrades. I'm just kind of wondering what portfolio that's -- what portfolio those downgrades were from?

James K. Ciroli - *Flagstar Bancorp, Inc. - Executive VP & CFO*

Those were predominantly in the CRE portfolio. Yes. As you look at where our bigger concerns are, total, it's retail. I mean keep in mind, a big piece of our retail are single-tenant buildings or what we call neighborhood centers and neighborhood centers are -- we're not all but predominantly anchored by a grocery store. So single-tenant buildings, neighborhood centers are doing fine. But as you move up into bigger box anchored type structures, then those are experiencing some stress. So we don't see any weakness. We've got strong borrower support across the portfolio, but we buy it merited graded that watch status in the quarter.

Stephen M. Moss - *B. Riley FBR, Inc., Research Division - Analyst*

Okay. That's helpful. And then last question for me, just on hotels. I'm kind of curious as to if you have any data as to what activity you are seeing (inaudible) given you're seeing within those portfolios?

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

A hotel portfolio specifically? I'm sorry, [I was just saying hotel?]

Stephen M. Moss - *B. Riley FBR, Inc., Research Division - Analyst*

Yes, I'm sorry.

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

Yes. So hotel is obviously the most difficult piece of the hospitality portfolio. We're watching it very closely. Fortunately, we do have very, very strong sponsors in the hotel space. And so far, so good. They're hanging in there. There have been some deferrals, as we've shared with you. But at this point, we haven't got any feedback from anybody that they're thinking about throwing in the towels. So everything looks like it's holding up right now, and they all tell me and a number of them, I have the opportunity to speak to myself regularly. They're in it for the long haul. They think it's going to come back, and then they're going to do what it takes to stay out there in that business. And one in particular, I talked to recently said, we're going to have a capital call for their partner, so they could put more money into the project. And so far, we feel pretty good about the way our sponsors are handling their obligations.

Operator

(Operator Instructions)

And we'll go next to Henry Coffey of Wedbush.

Henry Joseph Coffey - *Wedbush Securities Inc., Research Division - MD of Equities Research*

Great quarter. I won't torment you about mortgage anymore. It sounds like you're queued up for a pretty good second half.

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

Henry, it wouldn't be right if you didn't ask us about mortgage.

Henry Joseph Coffey - *Wedbush Securities Inc., Research Division - MD of Equities Research*

Well, I mean, the Fannie Mae is at $3.1 trillion. So that's where all the real estates are going. It's pretty transparent. When we go back to a couple of issues. One, in terms of reserve build. How do you manage around the Moody's forecast, if that's what you're using? It's kind of like the price of oil, they get to change it whenever they change it, and then your models have to react to it. Is there a way to minimize that impact, so any future reserve build or more a function of actual credit metrics?

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

Well, I'll let Jim get into the detail. Here's what I'll tell you about how I view the reserve, building the reserve, what the right reserve is, it's an art, it's not a science. But we are being pretty true to the model. And as you noted, it is heavily swayed by the Moody's economic forecast. We do apply qualitative judgments to the model output. And we try to do that and what we believe is a conservative lean. So we want to be in the best place we possibly can be. And I think that we feel like we're in the right place. And again, if anything, means a little bit on the higher side. But it's -- you may recall, I started my career as an examiner. Maybe part of that training ever left to me. I really believe that's the right way to manage the overall reserve for credit losses, and that's the way we're doing it here. We always have and during my tenure as CEO. Now to the specifics of Moody's, let me invite our CFO, he'll handle that.

James K. Ciroli - *Flagstar Bancorp, Inc. - Executive VP & CFO*

Thanks. I'd point to Slide 12. When you look at Slide 12, you'll see that the forecast changes drove $31 million of the increase. And our judgment changes drove $63 million, more than 2x what the forecast did. So look, we're pretty much, as Sandro said, conservative when it comes to doing what is necessary to protect the balance sheet. He's made the reference to the fortress balance sheet a couple of times in his prepared remarks. But while I've seen some people take the Moody's forecast down qualitative, we've actually taken it up. And so there's a lot of room in that number to have Moody's catch up to where we think our conservative meaning puts us.

Henry Joseph Coffey - *Wedbush Securities Inc., Research Division - MD of Equities Research*

That's (inaudible) -- I'm sorry. Have you thought about selling any of these commercial real estate assets? You've got a good book. It's performing well. Maybe the answer is to offload some of the risk, given how much strength you have in your other businesses?

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

No, we really haven't. There hasn't been a topic of discussion at all. And maybe that's because we know these borrowers well, and we speak to them regularly. And we just feel that they're going to be okay. So as Jim said in his prepared remarks, we know there's going to be losses here, but knowing exactly where they're going to be. I don't know whether exactly where they're going to be. So at this point, I think hanging in there with them, working with them is the best long-term -- will produce the best long-term result for us.

Henry Joseph Coffey - *Wedbush Securities Inc., Research Division - MD of Equities Research*

Great. And congrats on a great quarter.

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

Thank you.

Operator

With no further questions in the queue, I'd like to turn the call back over to Mr. Sandro DiNello for any additional or closing remarks.

Alessandro P. DiNello - *Flagstar Bancorp, Inc. - President, CEO & Director*

Thank you. Well, while Flagstar was busy having a spectacular quarter, the world around us erupted in social unrest. It used to be that we could keep the office in the world outside pretty much in separate compartments. But I don't think that's an option today. When we started our diversity and inclusion journey, our focus was on Flagstar. I'm making it a workplace where everyone would feel comfortable being their authentic cells. I now know that we can't build a wall between our company and the outside world. We're all part of the larger community. We all bring the outside in and vice versa, and as a company, we need to do our part to make things better. That's why when the killing of George Floyd sent shock waves around the world, I thought was important to speak out and start dialogue with our employees. Since then, we've currently stopped talking and hopefully never will. And one of the first things we did was to add the word equity to our discussion around diversity and inclusion. And I'm really proud of the way our employees have suggested and embraced opportunities to engage on social justice issues. Here are some of the things we did. We held Let's Talk About It panel discussions with external leaders in diversity and inclusion. We pulled our advertising from Facebook in July to support the stock (inaudible) for profit initiative. We held the Juneteenth celebration. We communicated to employees and held a discussion about the Supreme Court's recent ruling on Daca and equal rights for LGBT workers. We publicly supported a (inaudible) proposal in Michigan to ban LGBTQ discrimination. We celebrated pride month with virtual events and speakers. And we introduced a learning module for all employees on the international day of transgender visibility and held webinars on COVID 19, racial disparities and the basics of voting. We understand trying to reverse decades of systemic inequities is a marathon, not a sprint, but we're off and running, committed to making our company and our communities better and more equitable for all. To start, we are pledging $1 million in grants to minority-owned small businesses and another $1 million in grants to nonprofits that support diversity, inclusion and equity. Additionally, our Board of Directors has approved adding 2 seats to the Board, and those seats will be filled by women representing minority groups.

You may be wondering, why am I talking to you about this? First, because I believe getting involved in social justice issues is the right thing to do. Second, I believe it makes Flagstar a better and yes, more profitable company. It's a virtuous circle where employees who feel valued and respected for their differences, treat their customers in a like manner, and the end result is a more profitable company.

Finally, I also want to make sure I thank all of our first responders who protect us so well and who find themselves in a very difficult position right now. In closing, it was a knockout quarter, and we'll take it any time, but the real message is the underlying strength of Flagstar, the strength of our net interest margin, which is sustainable. The strength of our servicing income, which is sustainable and the strength of our diversified business model, which is also sustainable. And of course, a huge shout out to all our employees. Quarters like this don't just happen. They represent a lot of long hours, extra effort and plan unvarnished hard work. Thanks to all of you. The success of the quarter belongs to you. And thanks to all that just have the time to dial-in today. Have a great day.

Operator

And this does conclude today's call. Thank you for your participation, and you may now disconnect.
