Lehman Said to Return to Mortgage Market Through Aurora Unit

By Jody Shenn

Oct. 21 (Bloomberg) -- Lehman Brothers Holdings Inc., the investment bank brought down by the U.S. mortgage crash after 158 years, is set to return to funding home loans through its Aurora Loan Services unit, people familiar with the matter said.

Aurora, which helped make Lehman the top underwriter of mortgage bonds during the housing boom, has started hiring staff for the effort, said the people who declined to be identified because the plan isn’t public.

The expansion comes even as New York-based Lehman is shrinking through asset sales, 13 months after filing for the biggest bankruptcy in history and selling its North American investment-banking unit to Barclays Plc. While Aurora will be forced to focus on the government-backed mortgages now accounting for 90 percent of new home loans, rather than the riskier debt it specialized in as recently as two years ago, reduced competition has made that market more profitable.

"For the ones that are left, there’s opportunity,” Steve Jacobson, chief executive officer of Madison, Wisconsin-based Fairway Independent Mortgage Corp., said in an interview. His originations soared 67 percent from a year earlier to $2.6 billion in the first nine months of 2009.

Less competition has boosted per-loan profits, to $1,088 in the first quarter from $657 in 2004, according to Mortgage Bankers Association studies. The difference between rates on typical 30-year mortgages and 10-year Treasuries has widened to 1.80 percentage point, compared with an average of 1.27 percentage point in the five years through the end of 2007, according to data compiled by Bloomberg and Bankrate.com.

Averting Seizure

Aurora, once a specialist in so-called Alt-A mortgages, may start lending again through other companies and brokers, as well as directly to consumers, according to the people familiar with the plans. The Littleton, Colorado-based firm has remained a servicer of outstanding mortgages and is owned by Aurora Bank FSB, formerly Lehman Brothers Bank FSB. The bank unit didn’t enter bankruptcy protection with its parent.

Deborah Munies, a spokeswoman for Aurora, Kimberly Macleod, a Lehman spokeswoman, and Janet Frank, a spokeswoman for Office of Thrift Supervision, the bank’s regulator, declined to comment.

Lehman was the largest underwriter in 2007 of so-called non-agency home-loan securities, selling $67.6 billion of the debt, or 9.6 percent of the total, according to newsletter Inside MBS & ABS. The firm ranked as the second-largest issuer, creating $49.5 billion of the bonds.

Aurora, which ranked as the top Wall Street-owned lender with $98 billion of originations in 2004 and 2005, announced plans to end most lending in January 2008. During the bankruptcy, Lehman has been lending to Aurora Bank, as well as contributing assets to the unit and buying its loans, to avert a regulatory seizure and protect its stake.

Spinning Off Assets

Lehman also has supported its Salt Lake City-based Woodlands Commercial Bank. A seizure of both bank units could reduce returns to Lehman’s creditors by as much as $3.6 billion, Lehman CEO Bryan Marsal has said.

Lehman listed a record $639 billion in assets in its bankruptcy filing. Lehman’s North American brokerage and New York headquarters building and other real estate were bought by Britain’s Barclays within days of the bankruptcy for $1.54 billion. Nomura Holdings Inc. took over the investment bank’s Europe, Asia and Middle East operations. Managers at Lehman’s Neuberger Berman money management unit acquired 51 percent of that firm without putting up any cash. The

rest of Neuberger is owned by Lehman’s creditors.

Aurora ranked as the 14th-largest servicer as of June 30, handling billing and collections on about $93 billion of loans, according to industry newsletter Inside Mortgage Finance. Aurora has been granting new mortgages to its servicing customers, one of the people said.

Subprime Lending

Lehman founded Aurora in 1997 with servicing contracts and staff acquired from Harbourton Mortgage, and later began lending through the unit. Aurora grew in originations through its acquisition in 2003 of Independence Community Bank Corp.’s SIB Mortgage Corp. unit, which split from its parent as the bank sold itself in a sale arranged by Lehman.

Lehman entered subprime lending in 1999, buying a stake in Finance America and made an investment in BNC Mortgage the next year, before taking full control of those lenders and merging them by 2005, under the BNC name. Lehman exited subprime in 2007, after shifting some of BNC’s business and staff to Aurora. BNC joined its parent in bankruptcy in January.

Subprime mortgages were offered to borrowers with the worst credit records. Alt-A loans, a step above, were given to borrowers seeking atypical terms, such as a lack of income verification.

Reduced Competition

Few start-ups have tried to take advantage of reduced competition in the remaining mortgage market because lenders to mortgage banks and bigger mortgage companies that buy loans remain wary, Fairway’s Jacobson said. For instance, they may seek to only do business with firms with $10 million in net worth, he said.

That’s a shame because “what’s great about today is the big guys are very vulnerable,” as they struggle to manage costs and service levels as they adjust to a new environment, said Terry Wakefield, a consultant in Grafton, Wisconsin, and former Salomon Brothers Inc. executive who helped run a lender owned jointly by that firm and a Prudential Financial Inc. predecessor.

The bankruptcy case is In re Lehman Brothers Holdings Inc., 08-13555, U.S. Bankruptcy Court, Southern District of New York (Manhattan).

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