Capital Markets Solutions to America's Housing Challenges

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Speakers

- Evan Siegert, American Securitization Forum (Moderator)
- Kevin Chavers, BlackRock
- Ralph Daloisio, Natixis
- Jason Serrano, Oak Hill Advisors LP
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Overview

- Current Housing Outlook
- Panel Views on Legacy RMBS
- Impediments to New-Issue RMBS
- Investment in Mortgage Servicing Rights
- REO Bulk Sales and Rentals
- Potential Impact of Government Regulation

Housing by the Numbers

- **Delinquencies**: As of 4Q11, 7.6%. Peaked at 10.1% in the 1Q10. Longer-term pre-recession average of roughly 5%. (source: MBA)
- **Negative Equity**: As of 4Q11, 11.1 million residential properties (22.8% of the market), accounting for $2.8 trillion in outstanding mortgage debt. This is on par with previous high in 3Q09. (source: CoreLogic)
- **Foreclosure Starts**: As of 3Q11, 1%. Peaked at 1.4% in 3Q09. Longer-term average of slightly under 0.5%. (source: MBA)
- **Percentage of Loans In Foreclosure**: As of 4Q11, 4.4%. Peaked at 4.6% in 4Q10, compared to the longer-term average of 1.2%. (source: MBA)
- **"Shadow Inventory"**: In January 2012, 1.6 million units, down from high of 2 million in January 2010. (source: CoreLogic)
  - "Shadow Inventory" refers to the supply of homes that have been foreclosed upon, are in the foreclosure process, or are seriously delinquent and likely to enter foreclosure, but which are not yet on the market
- **REO:** 453,266 as of 3Q11 (source: Calculated Risk, RCG). Fannie Mae, Freddie Mac, and the FHA together hold about 50% of the outstanding REO inventory, more than 25% are held by non-agency securitized pools, and the rest are held by commercial banks and thrifts. (source: the Fed)

Foreclosures

- Foreclosure filings were reported on 1,887,777 properties in 2011, which is down 34% from 2010, 33% from 2009, and 19% from 2008.

- Foreclosure processing timelines continue to increase.
  - Length of average foreclosure process in the U.S. is 348 days
  - Judicial foreclosure states have significantly longer timelines – e.g. New York (1,019 days), New Jersey (964 days), and Florida (806 days)

(source: RealtyTrac)

Housing Market Projections

- Fitch Ratings, *U.S. RMBS 3Q11 Sustainable Home Price Projection* (3/5/12)
  - Home prices are closer to sustainable
  - Regional markets with high volumes of distressed sales (Arizona, Nevada, Michigan) have experienced a steeper correction
  - Improving macro-economic indicators may support housing on the demand side
  - Prices in the "Plains States" (Texas, Oklahoma, Kansas, Nebraska, the Dakotas) are holding steady or rising
  - However, tight underwriting standards continue to limit access to credit

Outlook for RMBS

- Panel Views

Obstacles to Private-Label Revival

- Standard & Poor's, *Positive Housing News Could Help A U.S. Private-Label RMBS Revival* (3/6/12)
  - GSEs and FHA crowd out private capital, accounting for 95% of originations
  - Lower home prices combined with higher GSE conforming loan limits
  - For banks, cheaper to fund through deposits
  - Tight underwriting guidelines lower demand for credit
  - Low mortgage rates make private-label uneconomical, as investors demand pre-crisis spreads or higher
  - Legislation, regulation and politics cast uncertainty on RMBS
  - Shadow inventory and foreclosures pushing down home prices

FHFA Outline to Build a New Secondary Market

- Shifting credit risk to private investors
  - Increase guarantee fee pricing
  - Loss-sharing: Senior-sub structures
- Single, unified securitization platform
- Standardized pooling and servicing agreement
- Servicing standards
- New servicing compensation model
- Loan-level data requirements

Mortgage Servicing Rights

- **Current Model**
  - Servicer is paid a minimum servicing fee equal to 25 basis points of the principal balance
  - A portion of the minimum servicing fee will be capitalized MSR, retained by servicer
  - A portion of the minimum servicing fee must be recognized as a capital asset by the servicer, requiring many servicers to hold capital against it
    - Must perform periodic valuations of MSR
    - MSR is subject to significant volatility
    - Difficult and expensive to hedge
  - Model may not have provided adequate incentives or funds to effectively service defaulted loans

Mortgage Servicing Rights *(cont.)*

- Current Investment Activity and Opportunity

MSR Capital Issues

- **Current Rules**
  - MSRs are included in capital up to 90% of fair value or book value, whichever is lower
  - Intangibles (including MSRs) cannot constitute more than 50% of total Tier 1 capital. Any amount above 50% is deducted from capital.
- **Basel III**
  - Under Basel III, MSRs can be counted as Tier 1 capital up to 10%, effective January 1, 2013, with a phased implementation through 2018
  - In addition, a bank must deduct from capital the amount by which aggregate of following three items exceeds 15% of Tier 1 capital: (i) significant investments in unconsolidated financial institutions; (ii) MSRs; and (iii) deferred tax assets

FHFA Alternative Mortgage Servicing Compensation

- **Reserve Fund Alternative**
  - Reduce the existing minimum servicing fee from 25 basis points to between 12.5 and 20 basis points
  - Authorize the establishment of a reserve account to cover servicing expenses once a loan becomes non-performing
- **Fee for Services Alternative**
  - Fannie Mae or Freddie Mac would be responsible for monitoring the servicing and paying servicer set fee each month for performing loan servicing
  - Guarantor would also be responsible for compensating servicer for any actions taken to service non-performing loans
  - Portion of minimum servicing fee would still be payable to related servicer; however, such excess servicing fee would be tradable asset

FHFA and Conservatorship

- The Housing and Economic Recovery Act of 2008 (HERA) granted power to appoint FHFA conservator or receiver of the GSEs "***for the purpose of reorganizing, rehabilitating, or winding up the affairs of a regulated entity***"
- FHFA exercised that authority on September 6, 2008
- HERA specified two conservator powers, stating that the agency may "**take such action as may be**

  (i) necessary to put the regulated entity in a sound and solvent condition; and

  (ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity." (12 USC 4617(b)(2)(D))

FHFA Strategic Plan for Conservatorship

- Released to Congress on February 21, 2012
- Three Strategic Goals:
  - **Build** a new infrastructure for the secondary mortgage market
  - **Contract** the GSEs' dominant presence in the marketplace gradually, while shrinking operations
  - **Maintain** foreclosure prevention activities and credit availability for new and refinanced mortgages
    - Including REO disposition initiative

Request for Information (8/10/11)

- Initiative for disposition of single-family REO
  - REO generally refers to inventory of homes held by banks, guarantors, and servicers after completion of foreclosure proceedings
- Goals:
  - Reduce REO portfolios of Enterprises and FHA in a cost-effective manner
  - Reduce average loan loss severities to Enterprises and FHA relative to individual distressed property sales
  - Address property repair and rehabilitation needs
  - Respond to economic and real estate conditions in specific geographies
  - Assist in neighborhood and home price stabilization efforts

Federal Reserve Housing Report (1/4/12)

- Large inventory of foreclosed or surrendered properties is contributing to excess supply in the for-sale market, placing downward pressure on house prices
- Rental markets are strengthening in some areas of the country, reflecting declining homeownership rate
- Reducing some of the barriers to converting foreclosed properties to rental units will help redeploy the existing stock of houses
- Rental conversions may increase lenders' eventual recoveries on foreclosed properties
- Strength of rental market reflects increased demand as families who are unable or unwilling to purchase homes are renting properties instead

REO to Rental Initiative (2/27/12)

- Targets hardest-hit metropolitan areas
  - Atlanta, Chicago, Las Vegas, Los Angeles, Phoenix, parts of Florida
- Pre-qualified investors may submit applications to purchase pools of Fannie Mae foreclosed properties with the requirement to rent the purchased properties for a specified number of years

Bidder Qualifications

- Financial Background
- Asset Management Experience
- Project Management Infrastructure
- Portfolio Management Plan
- Exit Strategy

Preliminary Summary of Assets

CREDIT SUISSE

Preliminary Summary of Assets[1]

Sub-Portfolio	Property Count	% by Property Count	Term Lease Unit Count	Month-to-Month Lease Unit Count	Vacant Unit Count	Total Units	% by Total Units
Atlanta, GA	572	23.0	426	121	58	605	21.2
Chicago, IL	99	4.0	75	11	34	120	4.2
Florida-Central and Northeast	190	7.6	133	50	14	197	6.9
Florida-Southeast	418	16.8	166	222	52	440	15.4
Florida-West Coast	167	6.7	118	44	37	199	7.0
Las Vegas, NV	219	8.8	176	33	36	245	8.6
Los Angeles / Riverside, CA	484	19.4	349	164	150	663	23.2
Phoenix, AZ	341	13.7	248	89	48	385	13.5
Total	2,490	100.0	1,691	734	429	2,854	100.0

Property Type	Property Count	% by Property Count	Term Lease Unit Count	Month-to-Month Lease Unit Count	Vacant Unit Count	Total Units	% by Total Units
Single Family	1,743	70.0	1,172	435	136	1,743	61.1
Condo	527	21.2	310	159	58	527	18.5
Manufactured Housing	7	0.3	6	0	1	7	0.2
Co-op	1	0.0	0	1	0	1	0.0
Duplex (2 units)	118	4.7	102	54	80	236	8.3
Triplex (3 units)	36	1.4	35	28	45	108	3.8
4-Plex (4 units)	58	2.3	66	57	109	232	8.1
Total	2,490	100.0	1,691	734	429	2,854	100.0