Proposed Qualified Residential Mortgage and Risk Retention Rule: Net Impact Bad for Housing

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Summary

The Federal banking agencies joint notice of proposed rulemaking to implement the credit risk retention requirements required by Dodd-Frank is intended to encourage the creation of good loans and to protect the financial system against the creation of riskier loans. In defining the Qualified Residential Mortgage (QRM) and Qualified Mortgage (QM), regulators are specifying what they view to be a good loan and thereby eligible for securitization without risk retention. In the draft of the proposals, however, regulators make two key mistakes.

- The definition of QRM is too restrictive as it describes a risk-less loan rather than a low-risk loan. These restrictions eliminate far too many credit-worthy potential borrowers.
- The approach to risk retention is too easy to evade and is too simplistic with its two-size-fits-all approach.

If the QRM is enacted as drafted, it will irrevocably alter the demand for homeownership. House price appreciation will stall or decline. New home construction will remain curtailed and employment in construction and real estate will shrink. Homeownership will fall below the long-term average of 65% of U.S. households. In particular, minority households will be severely disadvantaged, as even during the easy credit era, only 49% of Black households and 50% of Hispanic households were owners. The net negative impact on housing will slow growth in the overall economy.

In combination with risk retention requirements, these regulations will position large banks and REITs to be the only entities able to profitably make and securitize loans. While some aspects will raise costs for banking entities, the five large banks will have the flexibility to optimize profits between portfolio and securitized lending. All smaller entities will be priced out of the industry, curtailing finance employment growth. Moreover, the proposed regulations will also fail to achieve two of the stated goals. Though private securitization may be revived, its size will be severely limited. The small size of the private securitization market will not allow the Federal Government to reduce its role without further impairing housing markets and related economic growth.

To be effective, the QRM must be broadened to allow for more borrowers to qualify and for more originators to participate in the market. Risk retention must be strengthened to allow the private market for securitizing good loans to reactivate and grow.

Qualified Residential Mortgage

History shows that no home loan is risk-free. It is possible, however, to create a prudent and low-risk loan if traditional tried-and-true structures are properly underwritten. The 30-year, fixed-rate mortgage and related conservative structures worked for more than 40 years. Homogenous, predictable mortgage creation is good business favorable to borrowers, originators and investors.

Traditional structures with low historical default performance include:

- 15 and 30 year-terms;
- Fixed principal and interest payments;
- Adjustable principal and interest payments with capped resets;
- Mortgage guaranty insurance (or other insurance or credit enhancement) obtained at the time of origination for loans with higher than 80% loan-to-value;
- Prohibitions/restrictions on balloon payments, negative amortization, pre-pay penalties, interest-only and other similar high-risk features;
- Prohibition against refinance to extract equity and addition of second liens.

Proper underwriting requires:

- Full appraisal;
- Documented and verified financial resources for the borrower;
- Standards for residual income after meeting all obligations; ratio of housing payment to income; and the ratio of all installment payments to income; and
- True appreciation of applicant's ability to enter into the responsibility of home ownership.

As defined in the Credit Risk Retention proposed rule, the QRM includes too many restrictions, but also misses important underwriting considerations.

- The definition of QRM requires a 20% down payment and excludes mortgage insurance. Each requirement individually is too restrictive. Combined, these restrictions would result in an exclusive mortgage market with credit available only for the wealthy.

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- Congressional legislators chose not to specify a down-payment requirement in asking regulators to define the QRM. They did choose, however, to specifically call for the use of mortgage insurance to ensure the access of reasonably priced mortgages to low and moderate income borrowers and first-time buyers. The legislators were also specifically aware that current owners with diminished equity will potentially be trapped without the availability of mortgage insurance. They recognized that the elimination of these key groups from the housing market would reduce the pace of home sales and have a dampening effect on house prices.
- Dodd-Frank specifies the goal of defining QRM taking in to consideration underwriting and product features that "historical loan performance data indicate result in a lower risk of default." Fifty-three Senators and more than 300 Representatives have responded to the proposed restrictions, declaring them to be overly restrictive beyond the intent of Congress. Letters from Capitol Hill emphasize that Dodd-Frank allowed for mortgage insurance.
- In their request for comment, the agencies specifically ask for data on loan performance with mortgage insurance, focused on the issue of whether or not having it in place reduces the risk of default. Such analysis has been undertaken by various parties and clearly shows that loans with mortgage insurance reduce the risk of default among similar, uninsured high LTV loans.[1] This is particularly true when comparing mortgage insured loans to first lien loans that had a simultaneous second lien ("piggybacks") in lieu of mortgage insurance, further reinforcing our view that there should be strict limitations on the use of second liens.
- If traditional structures are fully underwritten, the vast majority of borrowers will make timely payments throughout the life of the loan. The exceptions are circumstantial and include loss of job, illness, lack of health insurance, divorce and other events that disrupt the income verified in the underwriting process. Historical data shows the infrequency of such events in the performance of traditional, well-underwritten loans. If mortgage insurance is in place, it will cover losses should any of these events occur.
- In addition to the restrictive down-payment requirements, the proposed regulations require especially low front- and back-end debt-to-income standards.
- The definition also excludes borrowers with 60-day delinquencies within the previous 24 months. Given the range of problems associated with mortgage loans created in the 2003-2008 bubble period, we believe that not all delinquencies are the fault of the borrower. This restriction is unfair in light of recent mortgage practices and will limit mobility and move-up purchases.
- As each layer of these stringent requirements is applied, more and more credit-worthy borrowers are excluded. As an indication of the restrictiveness of the proposed QRM definition, according to the proposal, only 19.8% of loans guaranteed between 1997 and 2009 by Fannie Mae or Freddie Mac would qualify as QRMs. CoreLogic estimates that repeat buyers in states with high levels of underwater mortgages will be particularly affected because these buyers will not have enough equity to qualify; only 54% of homeowners with mortgages would qualify using the 20% down-payment requirement.
- At the same time that the QRM is overly restrictive, we find the proposal misses the mark when it comes to second liens. Although the proposal restricts the use of second liens at the time of origination, it does not restrict the addition of a second lien after origination. It is critical for regulators to curb the use of second liens and to ensure that investors can count on the lien priority order going forward. In the present crisis, debt service on second liens has been covered in lieu of first liens, and first liens have been foreclosed without the second being foreclosed. This skewing of contract law must be prevented in the future.

We favor some, but not all aspects of the alternative approach outlined in the Risk Retention Proposal.

- We agree that the options to reduce a borrower's required cash down-payment through the use of mortgage insurance or other types of third-party credit enhancement should be included in QRM guidelines. In addition to the FHA's low down-payment loans, the agencies and private lenders must be encouraged to underwrite 5% and 10% down-payment loans. The mortgage performance record shows that low-risk, 85%-97% loan-to-value loans can be made to fully underwritten borrowers with the income to make monthly interest and principal payments.
- Allowing a lower down-payment is the most critical element to ensuring access of mortgage credit to all credit-worthy households. The additional suggestions to increase DTI would also open mortgage credit to a wider pool of potential borrowers while still creating good loans. The most important restrictions are the ones in Dodd-Frank that exclude negative amortization, payment shocks, no-document lending and other weak underwriting features.
- It is critical, however, to restrict the use of subordinate liens at closing and during the life of the loan.

Risk Retention

There are two key problems with risk retention as defined in the proposal. The primary problem is the assessment of risk in mortgage portfolios is more nuanced than the two sizes proposed.

- The Dodd-Frank legislation provided for risk retention to be set at

1 Assessing the Delinquency and Default Risk of Insured and Non-Insured High LTV Mortgages, July 15, 2011, Promontory Financial Group, LLC.

levels appropriate to the risk of the instruments. The QRM was included to define loans with less risk. Five percent was set as a minimum, but legislators were careful to note that there were cases when risk retention should be lower and higher.

- The 5% risk retention is proposed to cover all mortgage structures outside of the QRM. While Dodd-Frank requires income verification for all loans and specifically requires lenders to determine if the borrower is capable of repaying all loans on any single dwelling, it allows the use of riskier structures including balloon payments, negative amortization and interest-only loans. The exact requirements for these loans would be set by the Consumer Financial Protection Bureau.
- Data show as each factor is added, the risk of default increases. If one or more of these risk factors are present, we would argue that it is likely that risk retention of greater than 5% would be required.

The second problem is that it is too easy to evade through the wide range of structuring options.

- Issuers are afforded a great deal of flexibility in selecting the 5% of risk they retain.
- The large banks, favored under the proposed regulations, are likely to serve as both originator and issuer. These banks will have the ability to cherry pick, keeping lower-risk loans on the books and securitizing higher-risk loans.
- Moreover, originators and issuers will be free to create instruments with levels of risk beyond what a 5% retained piece could cover if the loans went bad.
- A continuum of risk retention must be provided for so regulators are assured that the level of retention truly matches the level of risk.
- The Premium Capture Reserve Account, designed to prevent the upfront profit on securitization from negating the meaning of risk retention, may merely increase the cost of securitization and serve as a deterrent. Banks may opt to make and keep only low-risk loans.

The intent of Dodd-Frank is to prevent another crisis, while ensuring a liquid mortgage market. To be effective, the QRM must be broadened to allow for more borrowers to qualify and for more originators to participate in the market. Risk retention must be strengthened to allow the private market for securitizing good loans to reactivate and grow.

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Biographies

Lewis S. Ranieri

Lewis S. Ranieri is the prime originator and founder of the Hyperion private equity funds ("Hyperion") and is a principal partner and founder of Selene Residential Mortgage Opportunity Fund. Prior to forming Hyperion in 1988, Mr. Ranieri had been Vice Chairman of Salomon Brothers, Inc. ("Salomon"). He is generally considered to be the "father" of the securitized mortgage market. Mr. Ranieri helped develop the capital markets as a source of funds for housing and commercial real estate, established Salomon's leadership position in the mortgage-backed securities area, and also led the effort to obtain federal legislation to support and build the market.

Kenneth T. Rosen

Ken Rosen is Chairman of Rosen Consulting Group, a real estate market research firm, and Chairman of the Fisher Center for Real Estate and Urban Economics and Professor Emeritus at the Haas School of Business at the University of California, Berkeley. Mr. Rosen is also the special real estate advisor to The Davos World Economic Forum. He was Chairman of Rosen Real Estate Securities. Mr. Rosen received his Ph.D. in Economics from the Massachusetts Institute of Technology in 1974 and a B.A. with highest honors from the University of Connecticut in 1970.

Andrea Lepcio

Andrea Lepcio, Principal, joined Rosen Consulting Group in 1997. She is based in New York and is responsible for business development and Eastern region client relations. Prior to joining RCG, Ms. Lepcio was Vice President and Head of Market & Investor Research at Chase Manhattan Bank. Before that, she was a founding member of the Real Estate Research group at Salomon Brothers. Ms. Lepcio earned a B.A. from the College of the Atlantic and an M.B.A. from the University of California, Berkeley.

Buck Collins

Buck Collins is the Senior Associate to Lewis S. Ranieri. Prior to joining Mr. Ranieri, Mr. Collins held a position as a consultant at Morgan Stanley in the Private Wealth Management division. A former member of the American Ballet Theater, Mr. Collins retired from his long standing career in 2006.

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Refocusing the QRM/Securitization Debate

Laurie Goodman
Senior Managing Director
Amherst Securities

Washington, DC
July 26-27, 2011

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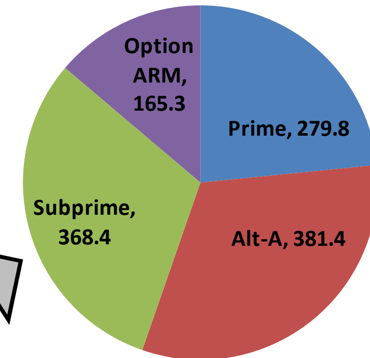
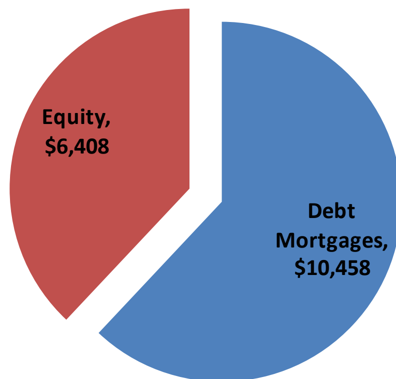
The US Mortgage Market Size Snapshot

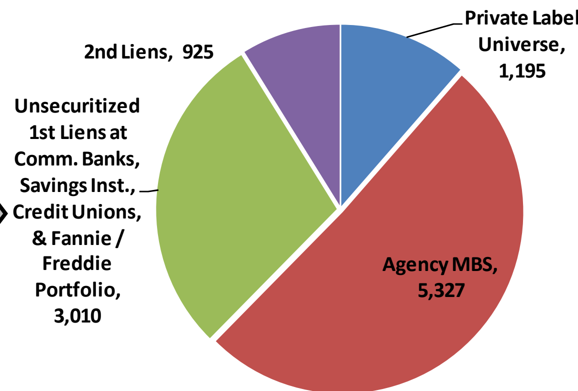
Size of the Private Label Universe
(Dollars in Billion, $1.2 Trillion Total)



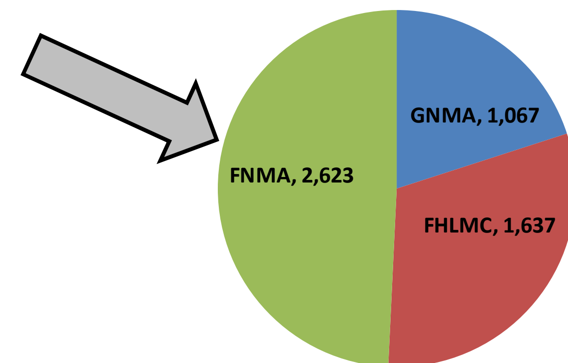
Value of the US Housing Market
(Dollars in Billion, $16.9 Trillion Total)



Size of the U.S. Mortgage Market
(Dollars in Billion, $10.5 Trillion Total)



Size of the Agency MBS Market
(Dollars in Billion, $5.3 Trillion Total)



Source: Federal Reserve as of Q1 2011, Fannie Mae, Freddie Mac, Ginnie Mae, CoreLogic, Amherst Securities as of May 2011

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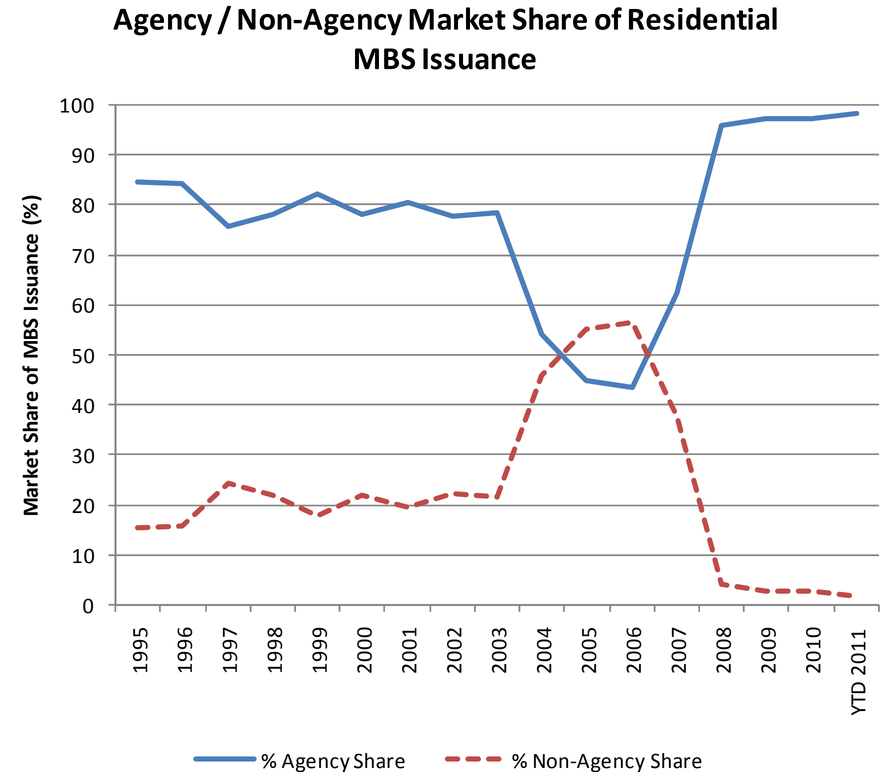
Residential MBS Issuance In Securitizations

Date	Total MBS ($million)	Total Agency MBS ($ million)	% of Total MBS								
			GNMA	FHLMC	FNMA	Total Agency	Alt-A	Jumbo	Subprime	Other	Total Non-Agency
1995	318,058	269,077	22.9	27.0	34.7	84.6	0.2	8.1	5.6	1.5	15.4
1996	440,541	370,495	22.9	27.2	34.0	84.1	0.4	7.1	7.0	1.4	15.9
1997	487,016	367,697	21.3	23.5	30.7	75.5	1.3	10.3	11.7	1.2	24.5
1998	929,163	725,676	16.0	27.0	35.1	78.1	2.3	10.5	8.2	0.9	21.9
1999	832,977	685,540	18.2	28.0	36.1	82.3	1.4	9.0	6.7	0.6	17.7
2000	614,970	479,062	16.8	26.9	34.2	77.9	2.7	8.7	8.5	2.2	22.1
2001	1,354,819	1,087,920	12.7	28.8	38.8	80.3	0.8	10.5	6.4	2.0	19.7
2002	1,858,381	1,442,104	9.3	29.4	38.9	77.6	2.9	9.2	6.6	3.7	22.4
2003	2,718,170	2,131,045	8.0	26.3	44.1	78.4	2.7	8.7	7.2	3.0	21.6
2004	1,882,836	1,018,614	6.7	19.4	28.0	54.1	8.4	12.4	19.3	5.8	45.9
2005	2,156,007	965,891	4.0	18.5	22.3	44.8	15.4	13.0	21.6	5.2	55.2
2006	2,070,089	900,489	4.0	17.4	22.1	43.5	17.7	12.6	21.7	4.5	56.5
2007	1,867,676	1,161,694	5.3	23.8	33.1	62.2	13.4	9.7	10.8	3.9	37.8
2008	1,248,488	1,195,618	22.4	29.2	44.2	95.8	0.2	0.6	0.2	3.3	4.2
2009	1,735,385	1,687,890	25.0	27.6	44.8	97.3	0.0	0.1	0.0	2.6	2.7
2010	1,417,826	1,377,953	27.4	26.8	43.1	97.2	0.0	0.1	0.0	2.7	2.8
2007-Q1	537,136	265,345	3.4	21.3	24.7	49.4	18.0	11.2	16.5	4.9	50.6
2007-Q2	548,249	289,475	4.0	21.5	27.3	52.8	18.4	11.0	13.6	4.2	47.2
2007-Q3	433,291	308,936	6.1	25.7	39.5	71.3	8.8	9.3	6.2	4.4	28.7
2007-Q4	349,000	296,301	9.1	28.8	47.0	84.9	3.9	5.5	3.3	2.4	15.1
2008-Q1	345,325	323,224	11.2	33.6	48.8	93.6	0.1	1.6	0.6	4.1	6.4
2008-Q2	403,514	378,093	16.9	32.7	44.1	93.7	0.4	0.3	0.0	5.6	6.3
2008-Q3	256,132	253,827	31.8	25.6	41.7	99.1	0.0	0.2	0.0	0.7	0.9
2008-Q4	243,516	240,473	37.5	21.0	40.3	98.8	0.0	0.0	0.0	1.2	1.2
2009-Q1	351,600	346,729	25.4	29.5	43.7	98.6	0.0	0.0	0.0	1.4	1.4
2009-Q2	597,957	575,447	19.2	25.1	51.9	96.2	0.0	0.0	0.0	3.8	3.8
2009-Q3	457,980	449,426	28.0	26.7	43.5	98.1	0.0	0.0	0.0	1.9	1.9
2009-Q4	327,848	316,288	30.7	31.1	34.6	96.5	0.0	0.0	0.0	3.5	3.5
2010-Q1	310,872	301,940	29.0	28.2	39.9	97.1	0.03	0.0	0.0	2.8	2.9
2010-Q2	296,153	284,940	32.6	25.4	38.2	96.2	0.0	0.6	0.0	3.1	3.8
2010-Q3	349,519	342,219	28.8	26.3	42.9	97.9	0.0	0.0	0.0	2.1	2.1
2010-Q4	461,282	448,854	21.8	27.1	48.5	97.3	0.0	0.0	0.0	2.7	2.7
2011-Q1	357,831	349,629	22.8	26.7	48.2	97.7	0.0	0.1	0.0	2.2	2.3
2011-Q2	234,170	230,791	31.1	26.3	41.1	98.6	0.0	0.0	0.0	1.4	1.4
2011-Apr	81,352	79,945	29.3	26.5	42.4	98.3	0.0	0.0	0.0	1.7	1.7
2011-May	72,791	71,671	32.8	26.5	39.2	98.5	0.0	0.0	0.0	1.5	1.5
2011-Jun	80,027	79,175	31.5	25.8	41.6	98.9	0.0	0.0	0.0	1.1	1.1



Source : Inside MBS & ABS, CoreLogic, Amherst Securities

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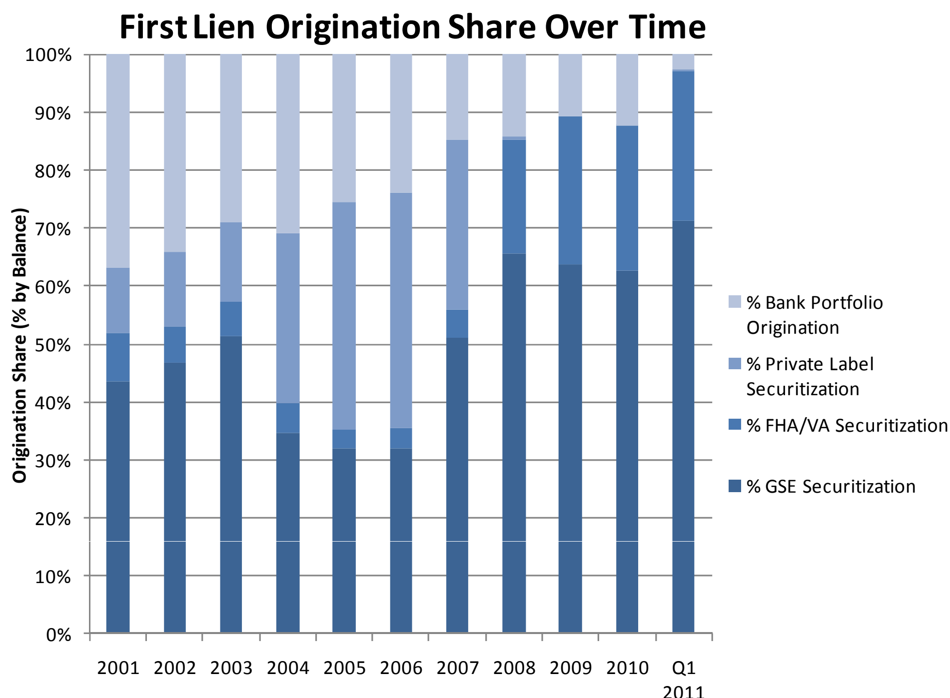
Origination And Securitization Volumes

	Total	GSE Securitization	FHA/VA Securitization	Total GSE and FHA/VA Securitization	Private Label Securitization	Bank Portfolio Origination
Estimated originations 2001	$ 2,215.0	$ 965.0	$ 182.2	$ 1,147.2	$ 253.8	$ 813.0
% of Total Origination	100.0%	43.6%	8.2%	51.8%	11.5%	36.7%
Estimated originations 2002	$ 2,885.0	$ 1,347.5	$ 182.6	$ 1,530.1	$ 368.7	$ 983.6
% of Total Origination	100.0%	46.7%	6.3%	53.0%	12.8%	34.1%
Estimated originations 2003	$ 3,945.0	$ 2,025.3	$ 231.4	$ 2,256.8	$ 536.5	$ 1,147.0
% of Total Origination	100.0%	51.3%	5.9%	57.2%	13.6%	29.1%
Estimated originations 2004	$ 2,927.0	$ 1,015.5	$ 143.8	$ 1,159.3	$ 858.6	$ 903.9
% of Total Origination	100.0%	34.7%	4.9%	39.6%	29.3%	30.9%
Estimated originations 2005	$ 3,118.0	$ 995.7	$ 96.9	$ 1,092.6	$ 1,221.0	$ 795.0
% of Total Origination	100.0%	31.9%	3.1%	35.0%	39.2%	25.5%
Estimated originations 2006	$ 2,983.0	$ 954.5	$ 97.2	$ 1,051.7	$ 1,207.3	$ 714.1
% of Total Origination	100.0%	32.0%	3.3%	35.3%	40.5%	23.9%
Estimated originations 2007	$ 2,431.0	$ 1,243.6	$ 115.5	$ 1,359.1	$ 715.0	$ 356.8
% of Total Origination	100.0%	51.2%	4.7%	55.9%	29.4%	14.7%
Estimated originations 2008	$ 1,485.0	$ 974.6	$ 291.4	$ 1,266.0	$ 9.2	$ 209.8
% of Total Origination	100.0%	65.6%	19.6%	85.3%	0.6%	14.1%
Estimated originations 2009	$ 1,815.0	$ 1,155.8	$ 466.0	$ 1,621.8	$ -	$ 193.2
% of Total Origination	100.0%	63.7%	25.7%	89.4%	0.0%	10.6%
Estimated originations 2010	$ 1,559.0	$ 976.2	$ 388.1	$ 1,364.3	$ 0.2	$ 194.5
% of Total Origination	100.0%	62.6%	24.9%	87.5%	0.0%	12.5%
Estimated originations Q1 2011	$ 325.0	$ 231.6	$ 84.1	$ 315.7	$ 0.3	$ 8.9
% of Total Origination	100.0%	71.3%	25.9%	97.2%	0.1%	2.8%



Source : CoreLogic, Inside MBS & ABS

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Can The Private Markets Provide Financing to Housing? Not Without Securitization

Estimated Prime Jumbo Mortgage Origination

Source: Inside MBS & ABS, CoreLogic, Amherst Securities

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Sizing the Crisis

	DQ Status	Number of Loans	% of Loans	Total Balance	% by Balance	WA MTM LTV	3Mo cTr	3Mo vPr	3Mo D/TV
Total	NPL	4,501,006	8.2%	943,380,507,426	9.9%	118.5	-	-	-
Total	RPL	3,836,392	7.0%	653,918,485,660	6.9%	105.3	43.7%	2.7%	94.2%
Total	APL >120 MTM LTV	2,761,985	5.0%	542,840,326,323	5.7%	140.9	13.8%	5.7%	70.9%
Total	APL 100-120 MTM LTV	5,541,784	10.1%	1,088,499,455,331	11.4%	110.7	6.4%	7.5%	45.8%
Total	APL <=100 MTM LTV	38,427,579	69.8%	6,278,580,877,681	66.0%	68.6	2.2%	12.8%	14.9%
Grand Total		**55,068,746**		**9,507,219,652,421**					

Total Number of Loans	Estimated Default Rate: Lower Bound Estimate	Estimated Default Rate: Reasonable Estimate	Number of Homes in Jeopardy: Lower Bound Estimate	Number of Homes in Jeopardy: Reasonable Estimate
4,501,006	80%	90%	3,600,805	4,050,906
3,836,392	50%	65%	1,918,196	2,493,655
2,761,985	25%	40%	690,496	1,104,794
5,541,784	10%	15%	554,178	831,268
38,427,579	4%	5%	1,537,103	1,921,379
		Total	8,300,779	10,402,001

	DQ Status	Number of Loans	% of Loans	Total Balance	% by Balance	WA MTM LTV	3Mo cTr	3Mo vPr	3Mo D/TV
* NonPLS	NPL	3,137,323	6.2%	573,778,827,117	6.9%	114.2	-	-	-
NonPLS	RPL	2,899,014	5.7%	450,349,348,192	5.4%	100.2	42.7%	3.4%	92.6%
NonPLS	APL >120 MTM LTV	2,363,876	4.7%	433,734,690,632	5.2%	148.9	12.3%	6.6%	65.1%
NonPLS	APL 100-120 MTM LTV	5,226,689	10.4%	986,096,900,782	11.8%	106.7	5.7%	7.8%	42.2%
NonPLS	APL <=100 MTM LTV	36,851,753	73.0%	5,883,920,719,767	70.7%	68.4	2.0%	12.7%	13.6%
Subtotal		**50,478,655**		**8,327,880,486,490**					

	DQ Status	Number of Loans	% of Loans	Total Balance	% by Balance	WA MTM LTV	3Mo cTr	3Mo vPr	3Mo D/TV
PLS	NPL	1,363,683	29.7%	369,601,680,309	31.3%	125.3	-	-	-
PLS	RPL	937,378	20.4%	203,569,137,468	17.3%	116.5	45.8%	1.0%	97.8%
PLS	APL >120 MTM LTV	398,109	8.7%	109,105,635,691	9.3%	108.9	19.6%	1.9%	91.1%
PLS	APL 100-120 MTM LTV	315,094	6.9%	102,402,554,549	8.7%	149.5	12.7%	4.8%	72.6%
PLS	APL <=100 MTM LTV	1,575,826	34.3%	394,660,157,914	33.5%	71.9	5.8%	13.8%	29.7%
Subtotal		**4,590,091**		**1,179,339,165,931**					

- The estimated default rates used in the "reasonable" calculation are more conservative than what is currently being experienced
- Assumes no change in overall housing prices, interest rates, or new home construction

Legend:
NPL = Non-Performing Loans
RPL = Re-Performing Loans
APL = Always Performing Loans
Non-PLS = Agency/Portfolio Loans
PLS = Private Label Securitized Loans

cTr = Annualized Monthly New Default Transition Rate
vPr = Annualized Voluntary Prepay Rate
D/TV = cTr / (cTr + vPr)

* - CoreLogic reports on approximately 60% of the non-PLS universe, which is extrapolated to the entire mortgage market

Source: CoreLogic, Amherst Securities as of June 2011

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Amherst® Securities Group LP

A Breakdown of Non-Performing Loans

Total Mortgage Market				
NPL Status	Count	% of Loans	Balance	% of Balance
60 Days DQ	606,958	13.5%	$ 104,203,035,359	11.0%
90+ Days DQ	1,777,636	39.5%	$ 380,171,729,680	40.3%
Foreclosure	1,804,899	40.1%	$ 395,424,872,404	41.9%
REO	311,514	6.9%	$ 63,580,869,983	6.7%
Grand Total	4,501,006	100.0%	$ 943,380,507,426	100.0%

Non-PLS Universe *				
NPL Status	Count	% of Loans	Balance	% of Balance
60 Days DQ	467,030	14.9%	$ 74,343,065,199	13.0%
90+ Days DQ	1,227,805	39.1%	$ 233,356,190,337	40.7%
Foreclosure	1,250,277	39.9%	$ 235,779,138,297	41.1%
REO	192,211	6.1%	$ 30,300,433,282	5.3%
Subtotal	3,137,323	100.0%	$ 573,778,827,115	100.0%

PLS Universe				
NPL Status	Count	% of Loans	Balance	% of Balance
60 Days DQ	139,928	10.3%	$ 29,859,970,159	0.08079
90+ Days DQ	549,831	40.3%	$ 146,815,539,343	39.7%
Foreclosure	554,622	40.7%	$ 159,645,734,107	43.2%
REO	119,302	8.7%	$ 33,280,436,701	9.0%
Subtotal	1,363,683	100.0%	$ 369,601,680,309	100.0%

Legend:
REO = Real Estate Owned

* - CoreLogic reports on approximately 60% of the non-PLS universe, which is extrapolated to the entire mortgage market

Source: CoreLogic, Amherst Securities as of June 2011

Growth of the Shadow Inventory

Loan Count

Date	Shadow Inventory Outstanding	REO Outstanding	Loans Sold per Quarter	Avg Loans Sold per Month	Current Overhang in Months
Q1 2010	1,370,588	432,444	253,901	84,634	28
Q2 2010	2,471,575	450,490	275,980	91,993	27
Q3 2010	2,559,658	497,581	266,737	88,912	29
Q4 2010	2,698,640	494,942	252,815	84,272	32
Q1 2011	2,883,744	470,500	284,271	94,757	30
Apr 2011 (pro rata)	2,857,754	489,839	281,708	93,902	30

>12M DQ & FCL | REO | Loans Sold

- Despite Liquidations averaging 90k per month, since January 2009 the balance of the Shadow Inventory (loans greater than 12 months DQ, loans in foreclosure and REO properties) has increased by an average of 60k each month
- These figures DO NOT include any contribution from borrowers less than 12 months DQ, who have a very substantial chance of entering the Shadow Inventory over the next year, or re-performing borrowers, who have a reasonable chance of becoming delinquent again over the near term
- Current Overhang = (Shadow Inventory Outstanding + REO Outstanding) divided by Average Loans Sold Per Month

Source: CoreLogic Prime Servicing Database, CoreLogic Securitized Loan Database, FDIC, Fannie Mae, Freddie Mac, FHA, Amherst Securities

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Mortgage Market Math: Supply/Demand Gap

- 10.40 million homes are at risk of default over the next 6 years. Even if we try to be extremely conservative we can't get the number below 8.3 million units.

Estimate of Supply (per Year)

	1.38 – 1.73 million distressed units per year
+	0.40 million units new construction
	1.78 – 2.13 million units total annual supply

Estimate of Housing Demand (per Year)

	0.60 million demand due to demographics (1.00 million housing formation x 0.60 home ownership)
	0.40 million obsolescence
+	0.20 million second home purchase
	1.20 million units total annual demand

	1.78 – 2.13 million total supply per year
-	1.20 million total demand per year
	0.58 – 0.93 million units net annual supply

Over the next 6 years:

3.5 – 5.6 million units

- To solve the housing crisis you must create **3.5 to 5.6 million units** of housing demand over the next 6 years.

Source: CoreLogic Prime Servicing Database, CoreLogic Securitized Loan Database, Amherst Securities

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The Supply & Demand Function of Housing Is Broken

Status since June 2007	Loan Count	% of Loans
Prepaid	19,892,400	36%
Never 90 days DQ	24,549,503	45%
Reached 90+ DQ	7,400,774	14%
Defaulted	2,954,733	5%
Total Universe as of June 2007	54,797,410	100%

Based upon payment history of mortgages originated before June 2007,

***19%** of all homeowners **NO LONGER QUALIFY** for a mortgage loan based solely upon Payment History.*

We have only liquidated ~26% of the loans that are in trouble

Source: CoreLogic, Amherst Securities

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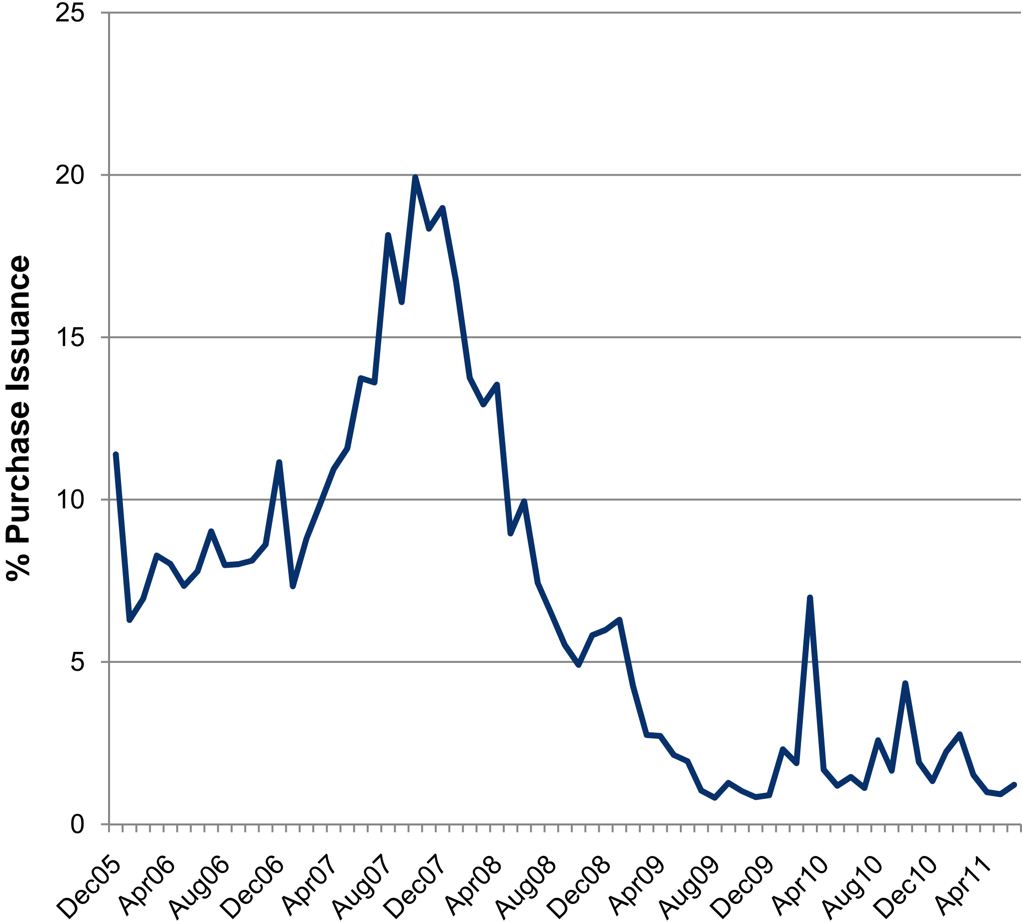
GSE Origination Characteristics Are Quite High

Origination Characteristics (excluding HARP refi loans)

Orig Year	Orig FICO	% FICO < 675	Orig LTV	% Orig LTV > 80	% Balance > 90 LTV
2010	762	3	67	7	3
2009	762	3	66	7	2
2008	741	11	71	19	8
2007	723	21	74	20	12
2006	726	19	73	13	6



Source: Freddie Mac Loan Level Data, Amherst Securities

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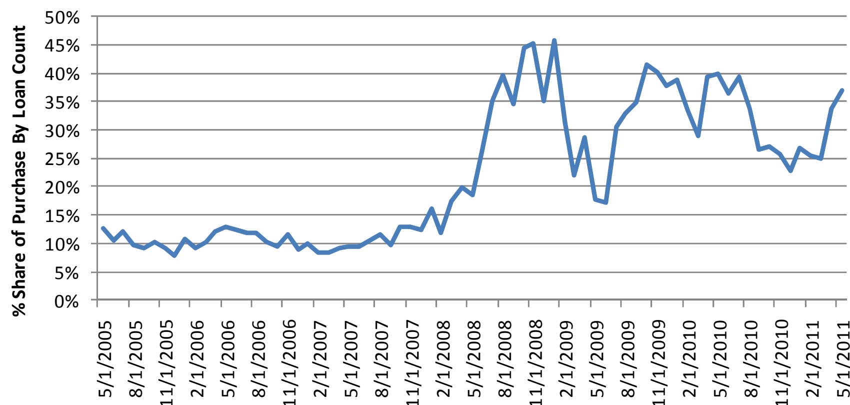
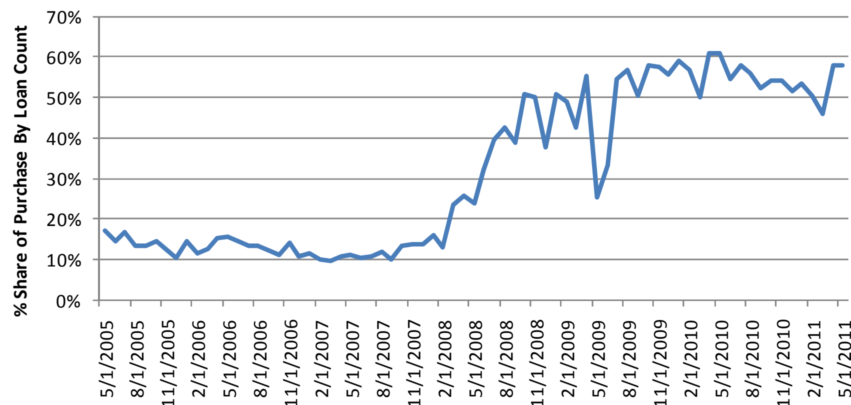
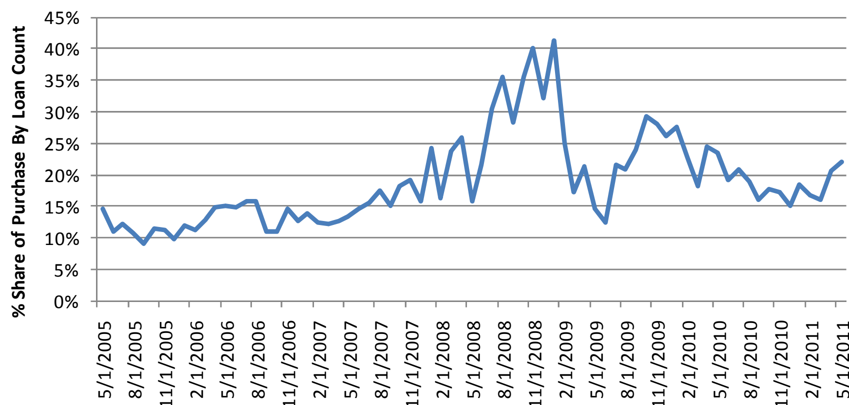
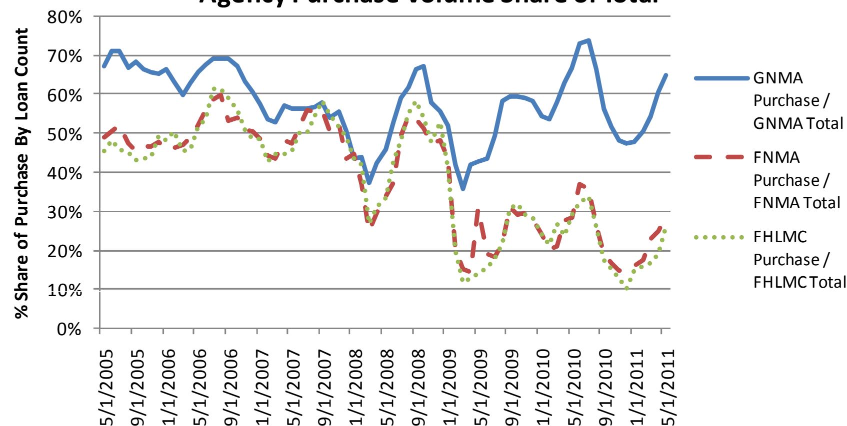
GNMA Has Become The Major Outlet For Purchasing A Home (All Are %s In Loan Count Terms)









Source: Freddie Mac, Fannie Mae, Ginnie Mae, Inside MBS & ABS, Amherst Securities

QRM and QM, as Proposed, Crimp Credit Availability

- Risk Retention: 5% for all loans that are not QRMs, GSE loans exempt
- What is a QRM? A very tight definition—
  - Be a closed end 1st lien mortgage to purchase or refinance a 1-4 family property, at least one unit of which is the principal dwelling of the borrower. (Investor loans cannot be QRM loans).
  - Have a maximum maturity of 30 years.
  - No other lien on the mortgage can, to the creditor's knowledge, exist at closing of the mortgage transaction (*i.e.*, a junior lien cannot be used in conjunction with a QRM to purchase a home).
  - The Agencies wanted to incorporate credit score, but were reluctant to use FICO or another measure designed by a private entity, as models may change materially at an entity's discretion. Instead, a set of derogatory factors was used; each lowers a borrower's credit score significantly; thus using derogatory events was thought to be a good proxy for credit scores. A mortgage can qualify as a QRM if the borrower was not >30 days past due, in whole or in part on any obligation at the time of closing, and the borrower had not been >60 past due on any debt obligation within the preceding 24 months. A borrower must not have, within the preceding 36 months been a debtor in a bankruptcy proceeding, had property repossessed or foreclosed upon, engaged in a short sale or deed-in-lieu of foreclosure, or been subject to a Federal or State judgment for collection of any unpaid debt.
  - Mortgages cannot be structured with interest only payments, negative amortization, or balloon payments, or prepayment penalties.
  - Interest rates on hybrid ARMs cannot increase more than 2%/year (or 6% over the life of the loan). Thus, 5/1 hybrids with a 5/2/5 cap structure (5% at the first reset, 2% at subsequent resets. 5% life cap) would not qualify, as the initial reset could potentially introduce too big a payment shock.
  - **The maximum LTV would be 80% for purchase loans, 75% for rate and term refi loans, and 70% for cash out refinancing. The LTV must reflect the appraised value of the home if the purchase price was higher than the appraised value. Down payments can include gifts, but not loans.**
  - **The maximum front-end DTI would be 28%; the maximum back-end DTI would be 36%.**
- What is QM? Ability to pay—
- 2 ways to implement—as a safe harbor, as a rebuttable presumption
- Interaction between QM and QRM—If QM was done as a rebuttable presumption, QRM could be the new standard

QRM: What Percentage GSE Loans Qualify?

Year	QRM	PTI/DTI Relaxed	LTV Relaxed	FICO Relaxed	Product Type Relaxed	All Loans
1997	20.44%	13.04%	13.74%	5.81%	3.75%	$ 286,497,878,371.00
1998	23.29%	13.30%	17.10%	6.24%	2.17%	$ 691,033,994,509.00
1999	19.48%	14.83%	12.95%	5.37%	3.16%	$ 481,450,519,442.00
2000	16.44%	17.00%	8.40%	4.53%	3.70%	$ 356,779,731,420.00
2001	19.37%	14.33%	13.11%	4.62%	3.01%	$ 1,039,412,013,403.00
2002	22.37%	15.35%	10.72%	4.62%	4.28%	$ 1,385,056,256,240.00
2003	24.57%	16.68%	10.02%	4.98%	4.55%	$ 1,924,265,340,603.00
2004	17.03%	17.68%	6.25%	4.34%	6.35%	$ 937,643,914,289.00
2005	14.41%	18.78%	5.45%	3.36%	6.74%	$ 939,069,358,457.00
2006	11.52%	17.59%	3.91%	2.73%	7.11%	$ 887,443,942,464.00
2007	10.72%	16.14%	4.95%	2.24%	5.44%	$ 1,027,460,511,244.00
2008	17.39%	22.01%	9.22%	2.12%	4.64%	$ 793,136,249,487.00
2009	30.52%	24.47%	15.26%	1.74%	3.38%	$ 1,176,445,135,548.00
Total	**19.79%**	**17.36%**	**9.86%**	**3.91%**	**4.62%**	**$ 11,925,694,845,477.00**

Source: OCC Docket No. OCC-2011-0002

Largest Servicers Also Own A Large Share Of Second Liens

	Q1 2011 FR Y-9C REPORT								
	1-4 Family Servicing				Residential Revolving	Share of	Total Revolving	Tangible Common
Originator	Q1 11	Q1 Share	1st Liens	Closed-End 2nd Liens	Lines of Credit	Total Revolving	and 2nd Liens	Equity Capital
Bank of America	$ 2,040.7	19%	$ 292.1	$ 22.3	$ 107.7	17%	$ 130.0	$ 132.0
Wells Fargo	$ 1,807.7	17%	$ 235.9	$ 15.4	$ 99.5	16%	$ 114.9	$ 87.9
JP Morgan Chase	$ 1,233.0	12%	$ 139.7	$ 9.3	$ 92.8	15%	$ 102.1	$ 120.7
Citigroup	$ 584.4	6%	$ 112.9	$ 20.3	$ 28.9	5%	$ 49.2	$ 139.3
Total Top 4	$ 5,665.8	54%	$ 780.7	$ 67.4	$ 328.8	52%	$ 396.2	$ 479.9
Total	$ 10,540.0				$ 636.9		$ 928.8	

Notes:

- -Individual bank data from Q1 2011 FRB Data
- -Total 1-4 Family Servicing from Inside Mortgage Finance
- -Total Residential Revolving Lines of Credit Refers To Revolving Lines of Credit held at FDIC Insured Institutions. It is not the total universe.
- -Total Revolving Second and Second Liens Total and by Investor is from Fed Flow of Funds Data (Z.1)

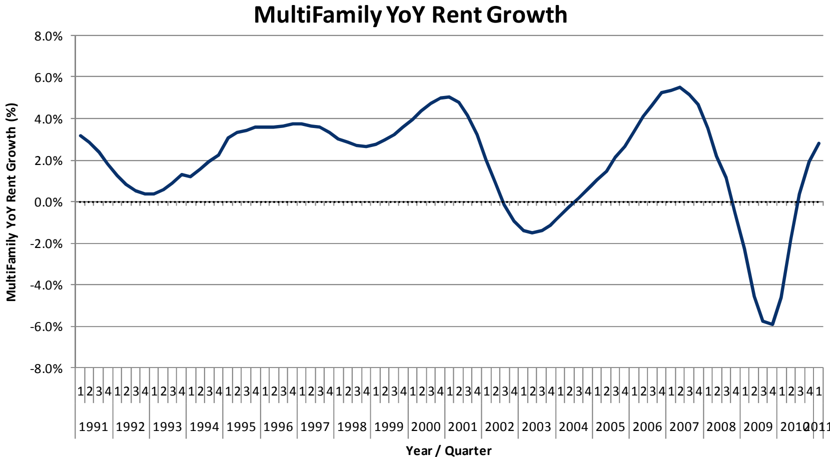
Total Revolving and 2nd Liens By Investor:

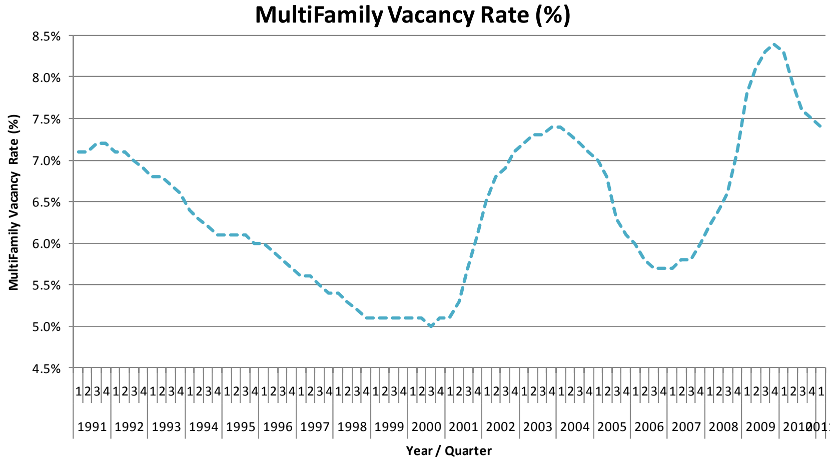
All Commerical Banks	$ 692.3
Credit Unions	$ 86.1
Savings Institutions	$ 72.3
Finance Companies	$ 54.4
ABS Issuers	$ 23.7
TOTAL	$ 928.8

Source: Inside Mortgage Finance, Federal Reserve, FDIC, Amherst Securities

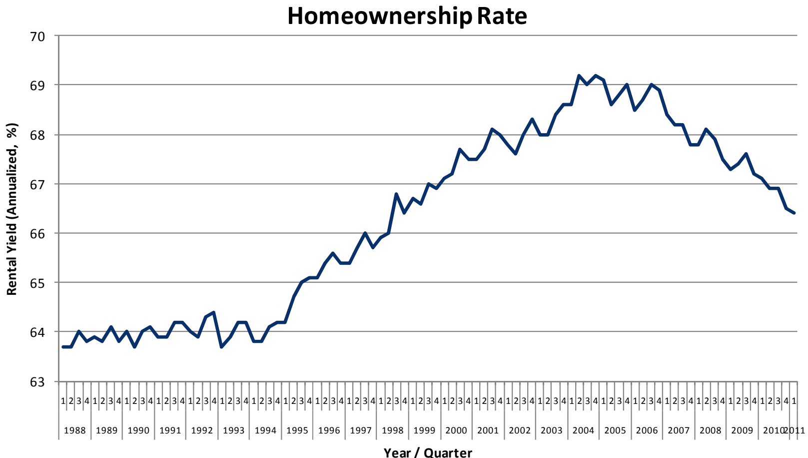
Rental Demand Is Outpacing Rental Supply

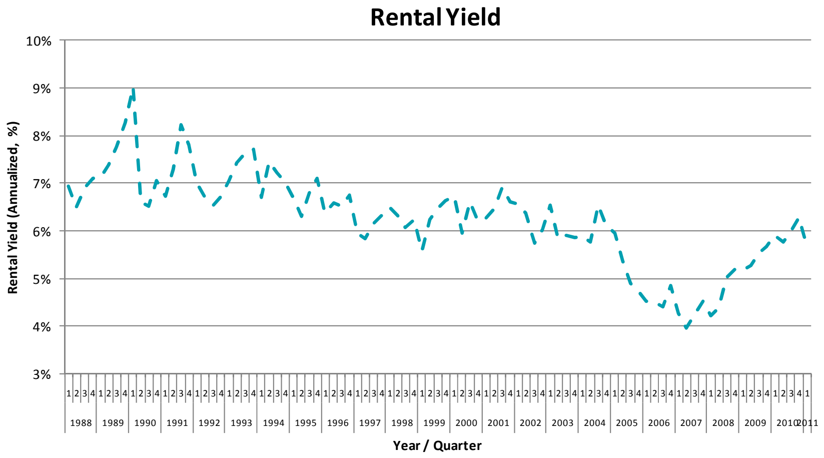
Multifamily Rents Are Up, Vacancies Are Down





Residential Homeownership Has Declined, Rental Yield Has Increased

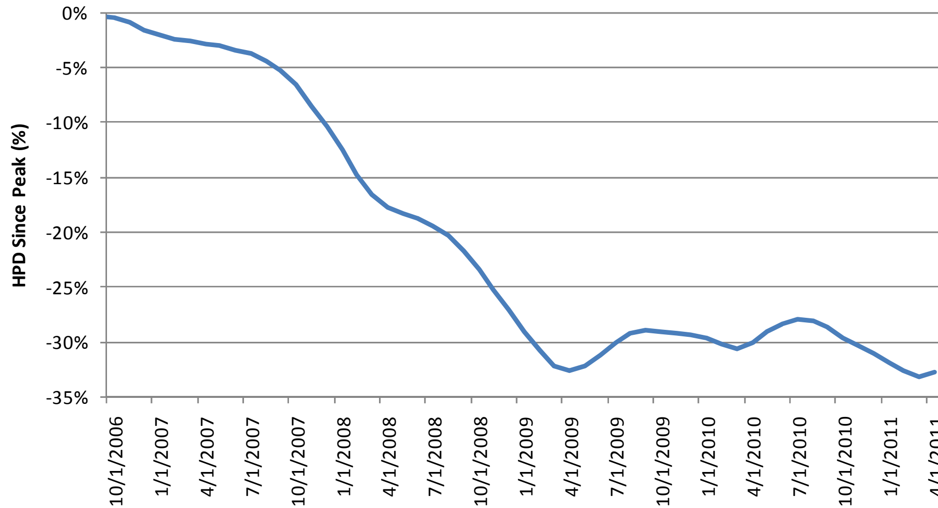


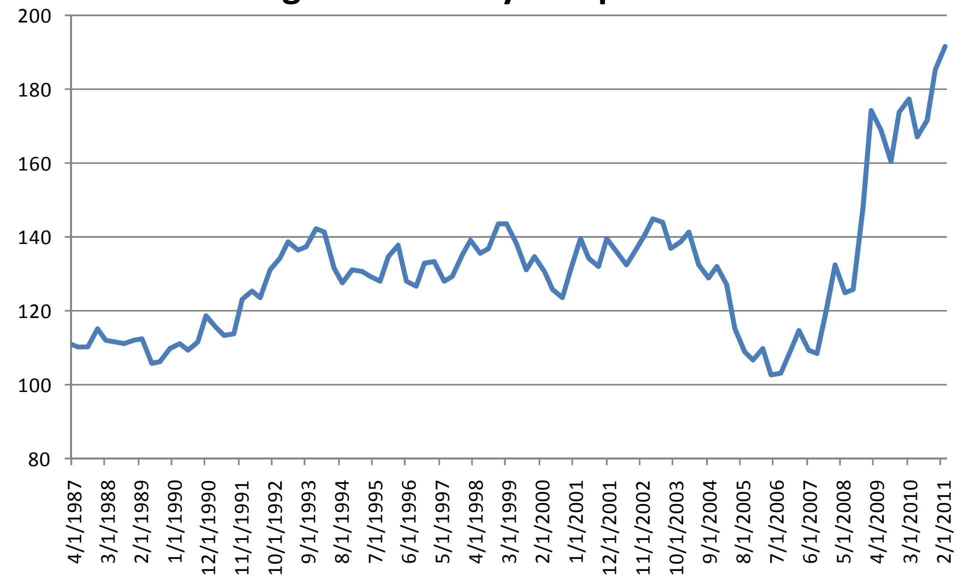


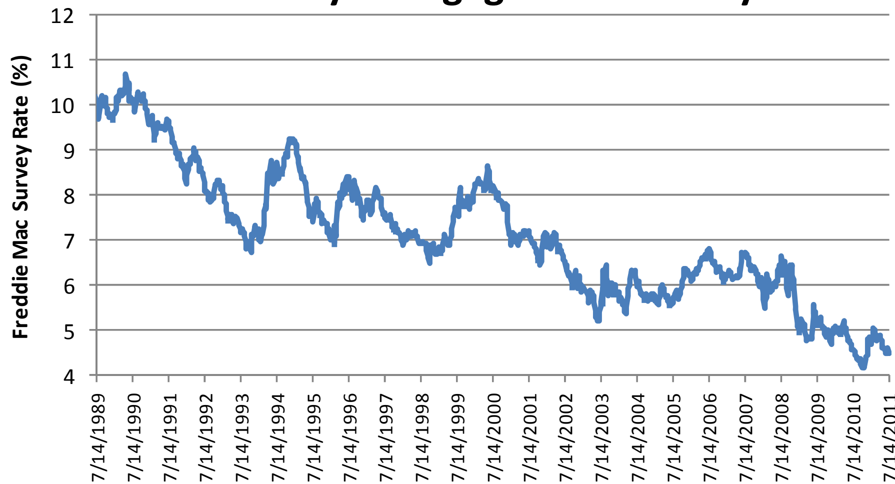
** - Rental Yield = Median Rent / Median Sales Price*

Source: US Census, PPR, Amherst Securities

Prices Down, Rates Low → Affordability is at a 20 Year High







Source: Freddie Mac, National Association of Realtors, S&P/Case-Shiller, Amherst Securities

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What Does it Take to Re-Start Private Label Securitization?

- The Regulatory Rules of Engagement Must Be Established
  - Risk Retention & QRM
  - QM
- The Securitization Must Be Economic
  - As a part of this, the rating agencies need to regain some credibility; better transparency will help; new entrants will help
- Governance Standards For Securitizations Need To Be Set—Conflicts of Interest Addressed
- Credit Standards Need to be Wider—Lack of Demand at Current Credit Standards
- Origination Expertise Must Be Developed for The PLS Market
  - Underwriting will most likely be done using a variant of the GSE underwriting systems
  - Title perfection, credit approval, and documentation processes have to be re-built.

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When Does Securitization Begin Again?
Mid-July 2011

A simple prime jumbo fixed securitization would require a **5.375%** Mortgage Rate to target a $99-17+ price, 4.32% yield senior bond (2.75 points or ~60bps behind agencies):

	Size ($mm)	WAL	NWAC	Price	Yield (%)
NET COLLATERAL	$100	7.7	5.125%	100.30	5.06
Senior Tranches	$92	7.2	4.32%	99.55	4.32
Senior IO	$92	7.2	0.875%	3.50	11.43
Subordinates	$8	12.4	5.125%	68.65	10.00
Proceeds				100.30	

Costs to Originate = $100.00 loans + $1.00 costs + $0.30 profit = $101.30

Proceeds from Deal = $100.30 bonds + $1.25 servicing – $0.25 deal fees = $101.30

Assuming 25bps of servicing priced at a 5x multiple and a AAA IO priced at a 4x multiple above, a **5.375%** GWAC pool of loans would create a breakeven securitization. Jumbo rates are now 4.91%; an economic securitization would require rates to be **47 bps** (5.38% – 4.91%) above jumbos or **87 bps** (5.38% – 4.51%) above agencies.

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Source: Yieldbook, Amherst Securities

Risk Retention Does Not Resolve Conflicts of Interest

Major Conflicts of Interest in Securitizations:

- Originators who are also portfolio lenders may be incented to adversely select loans for securitization
- Underwriters (deal sponsors) are generally incented to select loans and structures to maximize profit—i.e., to push adverse selection to the market limit
- Trustees are responsible for the enforcement of representations and warranties (reps and warrants), but the servicers are the only ones with the information to detect the violations.
- Servicers are often 2nd lien investors
- Servicers may have additional items on their agenda, resulting in a failure to maximize the NPV of the loans
- Goals of different investor groups are not necessarily aligned
- Rating agencies are issuer paid

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Premium Recapture & Re-REMIC Provisions—Misconceived

- Premium Recapture Provisions need to be clarified. The goal was to prevent an upfront "Profit" on the securitization that would negate the impact of the risk retention, it has some unintended consequences.

- Was risk retention meant to be 5% of the par amount or the market value?
  - If par amount, it does not allow for the costs of origination.
  - If par amount, it would make rate locks less available.
  - If par amount, hedging the loan during the securitization period would be more difficult.

- Risk Retention would be required on virtually all re-securitizations. This doesn't make sense to us.
  - The goal of a re-securitization is to create a multi-tranche deal that better first the need of investors. No new risk is being created.
  - If the goal of risk retention is better-quality loans, it makes no sense to apply risk retention to pre-existing assets.

Conclusions

1. US Housing Market is in a very fragile condition. There is a huge overhang of severely delinquent and foreclosed homes. The problem is exacerbated by very limited credit availability.
2. A vibrant securitization market is essential to return liquidity and affordability to housing finance. QRM is critical to securitization.
3. To stabilize the housing market, you need standards broad enough to encourage the prudent extension of credit to qualified borrowers, and a framework that encourages the securitization of these loans.

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