

The World of Secondary Marketing and How it Affects You

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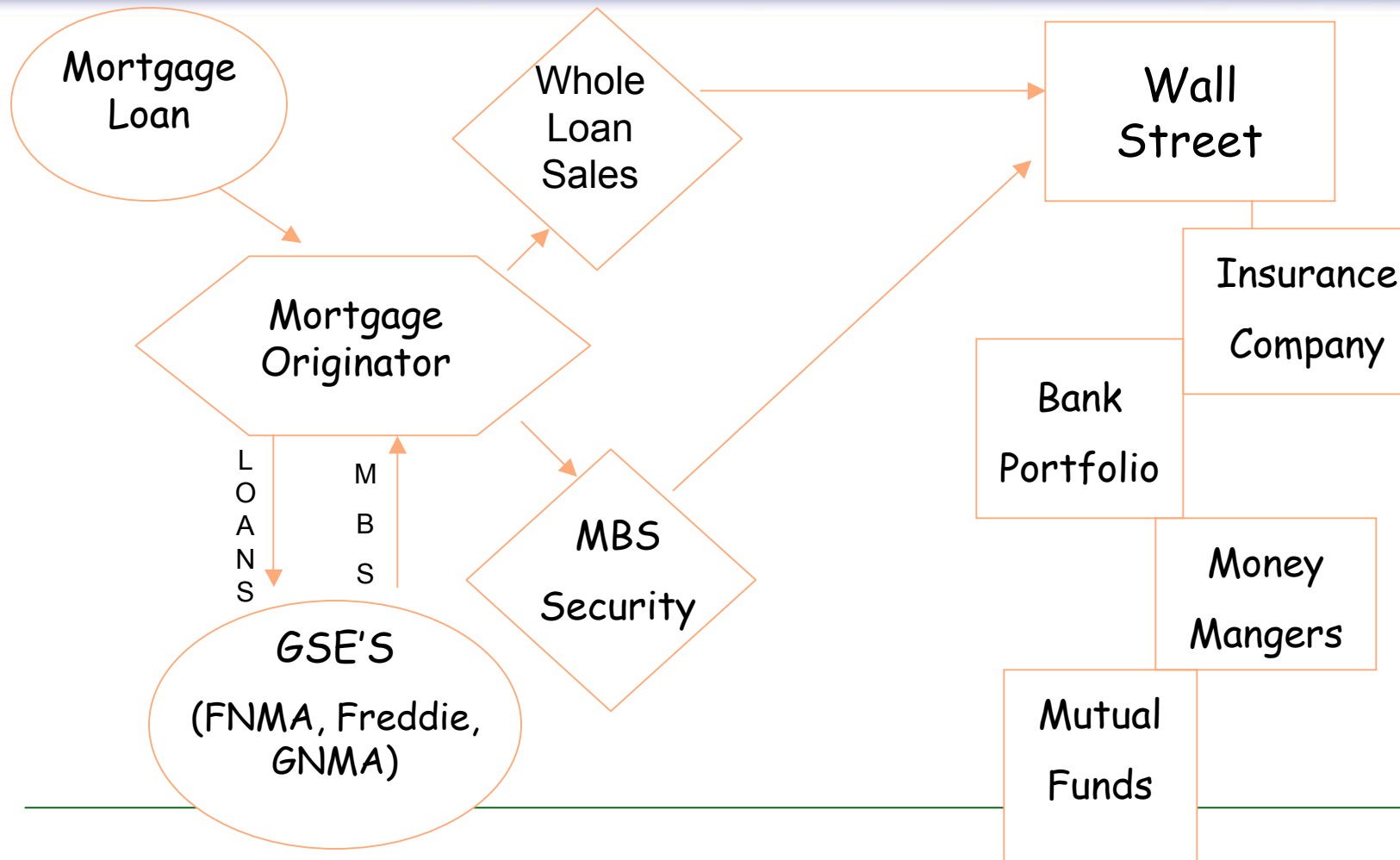


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Secondary Marketing

- The Secondary Marketing department of a Mortgage Banker is responsible for mortgage product pricing and sale, and to manage pricing risk.
- In order to sell products, Secondary Marketing interacts with several market participants.
- Participants include:
 - » Government Sponsored Enterprises (GNMA, Fannie Mae and Freddie Mac)
 - » Wall Street Firms: UBS, Lehman Bros, Merrill Lynch, Morgan Stanley etc.
 - » Insurance Companies
 - » Mutual Funds
 - » Money Managers

Tracking a Loan Through the Secondary Market



GSE's Role in MBS

GSE-->**Government Sponsored Enterprises**-->Privately owned, publicly chartered entities created by Congress to reduce the cost of capital for certain borrowing sectors of the economy including homeowners, farmers and students

the Originator sells loans to GSE's (FannieMae, FreddieMac etc.) for securitization and guaranty. Once security is issued, the Originator can then sell to Investors- (Wall Street Firms)



Government Sponsored Enterprises charge a guaranty fee to insure timely payments of Interest and ultimate payment of principle to Investors

Loans must meet Agency requirements/criteria before they are guaranteed ie., Loan amount, Property Type, and LTV limits.

Development of the Mortgage Backed Securities Market

- Until 1970, individuals generally had to go to the local banking institutions to borrow money for housing needs
- Mortgage lending and investment was susceptible to local economies producing a wide range in interest rates nationally
- With the advent of GNMA and the GSE's, loans no longer were made on a local basis
- Investors were comfortable lending knowing the individual property met basic criteria set by the GSE's and that the principle and interest was guaranteed. This led to the creation of a national mortgage market thereby reducing rates for the homeowner.
- As of 2004, 60% of the \$8.1 trillion of 1-4 family residential debt has been securitized.

The MBS Appeal

- What makes Agency MBS appealing to Investors?
 - » No due diligence to property, credit, and/or borrower qualification required
 - » Quasi government guarantee of principle and interest
 - » Investors are able to collect approximately 100 bps better on their return versus investing in a treasury security

Why do we do what we do?

- Mitigate Interest Rate Risk
- Sell loans to the agencies (GSE) to eliminate interest rate risk and release capital in order to originate more loans
- Retain a small percentage of the Note Rate as servicing to generate annuity like cash flows with less interest rate risk
- Most loans are guaranteed by the agency which relieve the Originator of default risk



Common Terms

- **Note Rate** - the interest rate paid by the consumer
- **MBS(Mortgage Backed Securities)** - Collateralized by mortgages in which the monthly Principle and portion of Interest are passed through to the Investor
- **Coupon** - the rate of interest paid to an investor
- **Servicing Fee** - the piece of the Note Rate that is retained by the Originator to cover its servicing expenses and profit, typically 0.25% but can be greater
- **guaranty fee** - is a piece of the Note Rate interest that is paid to an Agency in order to obtain their guarantee that investors will be paid on time. The guaranty reduces the investor's risk and lowers the rate of return (interest) they demand.
- **Conforming Loan Limits** - maximum mortgage amounts set by Government Sponsored Enterprises that reflect increases in the national average price for single family homes. These amounts apply to all conventional mortgages that are delivered for cash purchase or MBS pool issuance. (Current U.S Limit for 1 Unit is \$417,000)
- **Non-Conforming (Jumbo)** - mortgage amounts over the GSE maximum mortgage limit.
- **Basis Point Value**- one one hundredth of one percent

Ex: 1% = 100 bps



Mortgage Backed Security (MBS) Makeup

Interest Rate (Note Rate) 6.875%

guaranty fee (variable) 0.10%

The guaranty fee is variable and negotiated between GSE and the Originator

servicing rate 0.25%

Excess servicing rate 0.025%

The total Servicing fee must be at least 25 bps but can go up to 200 based on originator discretion

Bond Basics

Interest Rates and Bond prices Move in opposite directions.

While Interest Rates go up...Bond prices go down

and the opposite when

Interest Rates go down...Bond Prices go up

LkUp 1Sec One Sec

COMPTBAFNMA30 ?

Econ/Cal MarketCall IFR AXEit

4.5-7.0 5.5-8.0

TradeWeb FNMA 30 Year TBA MBS

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Coupon	Month	Price	Change	Dlr	Coupon	Month	Price	Change	Dlr
4.500	Aug		+0-11+	-	6.000	Aug	99-12 /12+	-0-02	2- 4
4.500	Sep	91-31+/01+	-0-03+		6.000	Sep	99-10+/11+	-0-02	
4.500	Oct	91-30+/00+	-0-03+		6.000	Oct	99-08 /09	-0-02	
4.500	Aug/Sep	001/003		DB- 2	6.000	Aug/Sep	016/017		4- 4
4.500	Sep/Oct	00 /012		-LB	6.000	Sep/Oct	021/023		2- 2
5.000	Aug	94-23+/24+	-0-03	2- 2	6.500	Aug	101-04 /04+	-0-01+	3- 6
5.000	Sep	94-23+/24+	-0-02+		6.500	Sep	101-02 /03	-0-01+	
5.000	Oct	94-22+/23+	-0-02		6.500	Oct	100-31+/00+	-0-00+	
5.000	Aug/Sep	00+/005		3- 4	6.500	Aug/Sep	016/017		4- 4
5.000	Sep/Oct	007/012		LB- 2	6.500	Sep/Oct	02+/026		LB-LB
5.500	Aug	97-06+/07	-0-02	3- 2	7.000	Aug	102-04+/05	-0-11+	GC-GC
5.500	Sep	97-05+/06+	-0-02		7.000	Sep	102-14 /15+	-0-00+	
5.500	Oct	97-04 /05	-0-02		7.000	Oct	102-11 /13	-0-00+	
5.500	Aug/Sep	01 /011		4- 4	7.000	Aug/Sep	012/016		MS-MS
5.500	Sep/Oct	01+/015		LB-LB	7.000	Sep/Oct	00 /04		-LB
TRSY	2 yr	100-016/02	-0-01	4.970-966	10 yr	101-05+/06	-0-022	4.971-969	
	3 yr	99-276/282	-0-01+	4.924-918	30 yr	91-146/15+	-0-04	5.060-058	
IRS	5 yr	99-286/29	-0-02	4.898-896					

Main MBS30 MBS15 FN30 FN15 PC30 PC15 GN30 GNII Swp30 Swp15 Basis FH Rem FN Rem BFLY COMM



Best Execution/Pooling Decisions

- **Securitization**- Sale of Loan to Agency in exchange for MBS investment vehicle.
- **Whole Loan Sale**- Sale of the loan and risk of credit and repayment, keeping continued servicing value. Generally price is less than MBS execution.
- **Agency Cash Window**- Based on product to be sold.
- **Story/Specified MBS Pools**-
 - » **Geographies**: certain states are more costly to refinance and as a result repayment is at a slower speed, giving more value to the investor
 - » **Loan Balances**: lower loan balances tend to prepay slower
 - » **Occupancy**: vacation vs. primary have a slower prepayment speed
 - » **Weighted Average Loan Age (WALA)**: newly originated loans initially pay slower

Best Execution/Pooling Decisions

Ex: Customer borrows \$100,000 @ 6.875% Fixed for 30 years and pays 1% (point) at origination

	FNMA 6% Execution*		FNMA 6.5% Execution	
Note Rate	6.875%	\$(100,000.00)	6.875%	\$(100,000.00)
Origination Fee		\$ 1,000.00		\$ 1,000.00
Security Price	FN 6% (Aug) 99 - 12/32	\$ 99,375.00	FN 6.5% (Aug) 101 - 04/32	\$ 101,125.00
Servicing Value	75 bps @ 4.0 multiple	\$ 3,000.00	25 bps @ 4.0 multiple	\$ 1,000.00
Guarantee Fee	12.5 bps		12.5 bps	
		\$3,375.00		\$3,125.00

*Pooling the loan in FN 6% creates the greatest profit



Custody's IMPACT on Secondary Marketing

- **Time Sensitivity** to resolving custodial issues in an efficient accurate fashion. Delays in the settling of securities or whole loan trades result in a lower sale price.
- **Accuracy** in data as well as a complete credit and collateral package available to the end buyer for diligence is extremely important for whole loan sales that lack GSE guaranty. Incomplete data could reduce the investors purchase price.
- **Loss of Funds** associated to errors compounded by inaccurate data, and slow response. Inaccurate data could break an existing deal which could have catastrophic consequences depending on market movement.
- **Regulation AB** allows the Investor to have recourse with the seller if they find specific issues with documentation and/or reporting of data.