Loan Modifications: Will They Save the Day?

: **Presented to the Mortgage Bankers Assoc.**

Paul Miller

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Paul J. Miller, Jr., CFA – Managing Director

Employment

- Friedman, Billings, Ramsey - Equity Analyst Covering Mortgage Related Stocks since 1997
- Federal Reserve Bank of Philadelphia – Examiner

Education / Certifications

- B.S. Economics
- B.A. International Relations
- M.S. Economics
- Chartered Financial Analyst

Introduction

- Believe loan modification will materially reduce losses on loan pools and to bond investors.

- No way to quantify financial impact.

- Modifications can improve credit profile of a securitization and benefit investors.

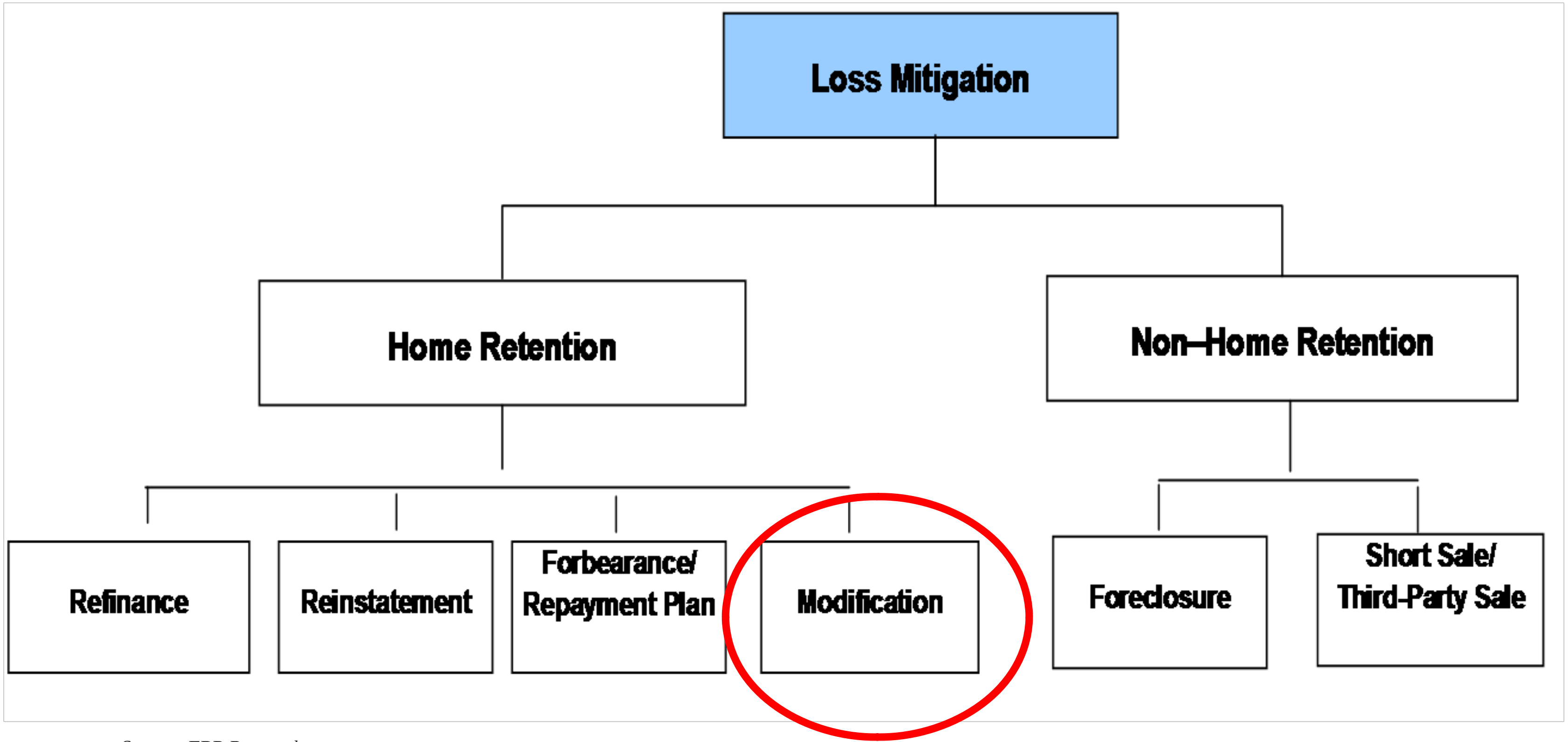
- Regulators are advising servicers to assist subprime borrowers with modification to reduce impact of resets, but want option used carefully and with controls.

Key Points

- Looking at possible pending second wave of defaults.
- What will the economic impact be of modifications and can we measure it?
- Any loan modification program will be complex.
- Mortgage banking environment not getting better any time soon.

The Loss Mitigation Process

- Servicers use default decision technology to calculate and compare the NPV of each alternative.



Source: FBR Research

Criteria for Loan Modification

Willingness	Financial Ability	Equity
Dialogue with servicer Payment history	Stable work history Other Sources of Funds Positive Disposable Income	80 to 95% LTV based on original value Local housing market trends

Source: FBR Research

Foreclosure

Foreclosure	
Unpaid Principal Balance	$125,270
P&I, Escrow, Corp Advances	($4,672)
Projected Property Sale Price	$107,950
Future Interest, Taxes, Insurance, Legal Fees	($30,173)
FC/REO	$73,105
Projected Loss	($52,165)
Projected Loss Severity	41.6%

Source: FBR Research

Short Sale

Short Sale	
Unpaid Principal Balance	$125,270
P&I, Escrow, Corp Advances	($4,672)
Projected Property Sale Price	$107,950
Short Sale	$103,278
Projected Loss	($21,992)
Projected Loss Severity	17.6%

Source: FBR Research

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Loan Modification

Loan MOD	
Interest Rate Reduction	(4yr x 3%) =12 %
Principal Forgiveness	

Source: FBR Research

Projected Loss Severity

Projected Loss Severity	
Loan Modification	12 %
Short Sale	18%
Foreclosure	42%

Source: FBR Research

Loan Modifications

- Resets of more than $170 billion of subprime hybrid loans in 2H 07.

- Additional $130 - $140 billion resets in 1H 08.

- Servicers preparing for increasing level of loan modifications.

Modification Terms

- Modifications allow for one or more mortgage terms to be changed.

  - Conversion from adjustable to fixed.
  - Interest rate reductions
  - Principal and interest forgiveness
  - Maturity extensions
  - Capitalization of unpaid amounts

No Clear Guidelines on Reporting Modifications

- Cannot be certain of capturing and reporting credit performance of modified loans to the trust.

RESULT

MAY NEVER KNOW EXTENT OF MODIFICATIONS OR ECONOMIC LOSS TO THE TRUST

Analyzing Losses to Bondholders

- Use of unlimited or non-controlled modifications may result in additional losses.

- Can estimate loss to trust if involves forgiveness of principal/interest payments.

- Other strategies can make estimates more complicated.

Conclusions

- Modifications have tradeoffs.
  - Benefits to homebuyer, residual holder and regulators.
  - Increased risk to AAA-rated tranches.

- Higher costs to servicers.
  - Large volume requires an increase in loss mitigation proficiency and staffing.
  - No way to anticipate expenses that could come with loan workouts or foreclosure.

Boston
100 Federal Street, 29th Floor Boston, MA 02110
617.757.2900

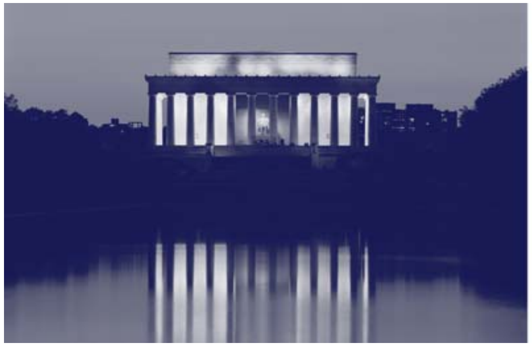
Dallas
2100 McKinney Avenue, Suite 1940 Dallas, TX 75201
469.341.1200

Houston
600 Travis Street, Suite 6070 Houston, TX 77002
713.343.1000

Irvine (Los Angeles)
18101 Von Karman Ave., Suite 950 Irvine, CA 92612
949.477.3100

New York
299 Park Avenue, 7th Floor New York, NY 10171
212.457.3300

FBR Metropolitan Washington, D.C. Headquarters
1001 Nineteenth Street North . Arlington, VA 22209
T 703.312.9500 . F 703.312.9501 . www.fbr.com



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Phoenix
2555 East Camelback Rd., Suite 180 Phoenix, AZ 85016
602.794.3700

San Francisco
4 Embarcadero Center, Suite 1950 San Francisco, CA 94111
415.248.2900

London, UK
8th Floor, Berkeley Square House
Berkeley Square
London WIJ 6DB
011.44.20.7409.5300

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Paul Miller CFA, 703.469.1252