

SECURITIZED PRODUCTS:

Mortgage-Backed Securities (MBS)

Commercial Mortgage-Backed Securities (CMBS)

Asset-Backed Securities (ABS)

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RICHMOND CAPITAL MANAGEMENT
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SECURITIZED PRODUCTS - OVERVIEW

Securitized Products have been the epicenter of the storm in capital markets

- » The “**Subprime**” mortgage crisis was just the tip of the iceberg -- its effect on the bond market has been much worse than expected
 - **Loss severities have been staggering** on Mortgage-related Asset-Backed Securities (ABS)
 - Hedge funds, Banks, Brokerage and Investment firms, and Insurance companies have lost nearly \$1 Trillion
 - Disappearance of Bear Stearns, Lehman Bros. & Government takeover of Fannie Mae, Freddie Mac, and AIG
- » Federal Reserve reduced short term interest rates and has created other liquidity facilities for troubled-financial institutions
- » Stock Markets have reacted negatively in 2008; posting double-digit negative returns

AGENCY MBS - OVERVIEW

- » **MBS** - Mortgage-Backed Securities (MBS) backed by a pool of residential mortgages. Principal and interest paid by borrowers monthly are “passed through” to security holder. Only conforming mortgages are securitized through Federal Agencies
- » **FNMA and FHLMC** - Government Sponsored Entities (GSE) guarantees majority of MBS and has an implicit (now explicit) Treasury guarantee. Mortgages must *conform* to uniform strict underwriting standards (Size, LTV, DTI Ratios, Credit History, Reserves, etc.)
- » **GNMA** - Guarantees MBS and has an explicit Treasury guarantee. Mortgages are insured by Fed Housing Administration or Veterans Administration
- » **Agency MBS** market is roughly \$4.2 Trillion and is largest sector in the bond market representing 38% of Broad Market Indices

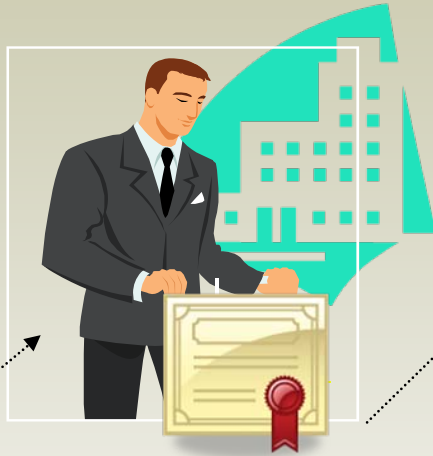
AGENCY MBS SECURITIZATION – THE PLAYERS

Borrower

Works with a lender to get a home-purchase loan or a refinancing.



Lender



Often funds loan via “warehouse” line of credit from bank. Then sells loan to Federal agency.

Federal Agencies

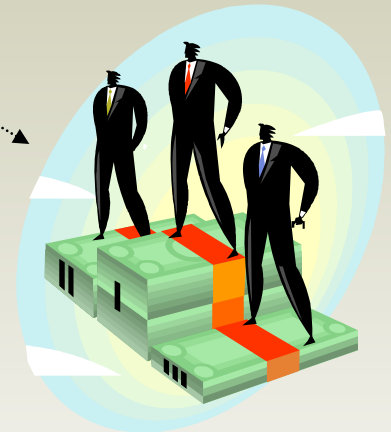


Packages numerous loans into an MBS.

MORTGAGE-BACKED SECURITY



Investors



Earn interest on the bonds and absorb any gain or loss in price of the bond.

What they get

6.0% 30 yr mortgage

1% plus processing fees

.50% of 1%

5.5% Agency MBS

AGENCY MBS - PROS & CONS OF INVESTING IN AGENCY MBS?

PRO

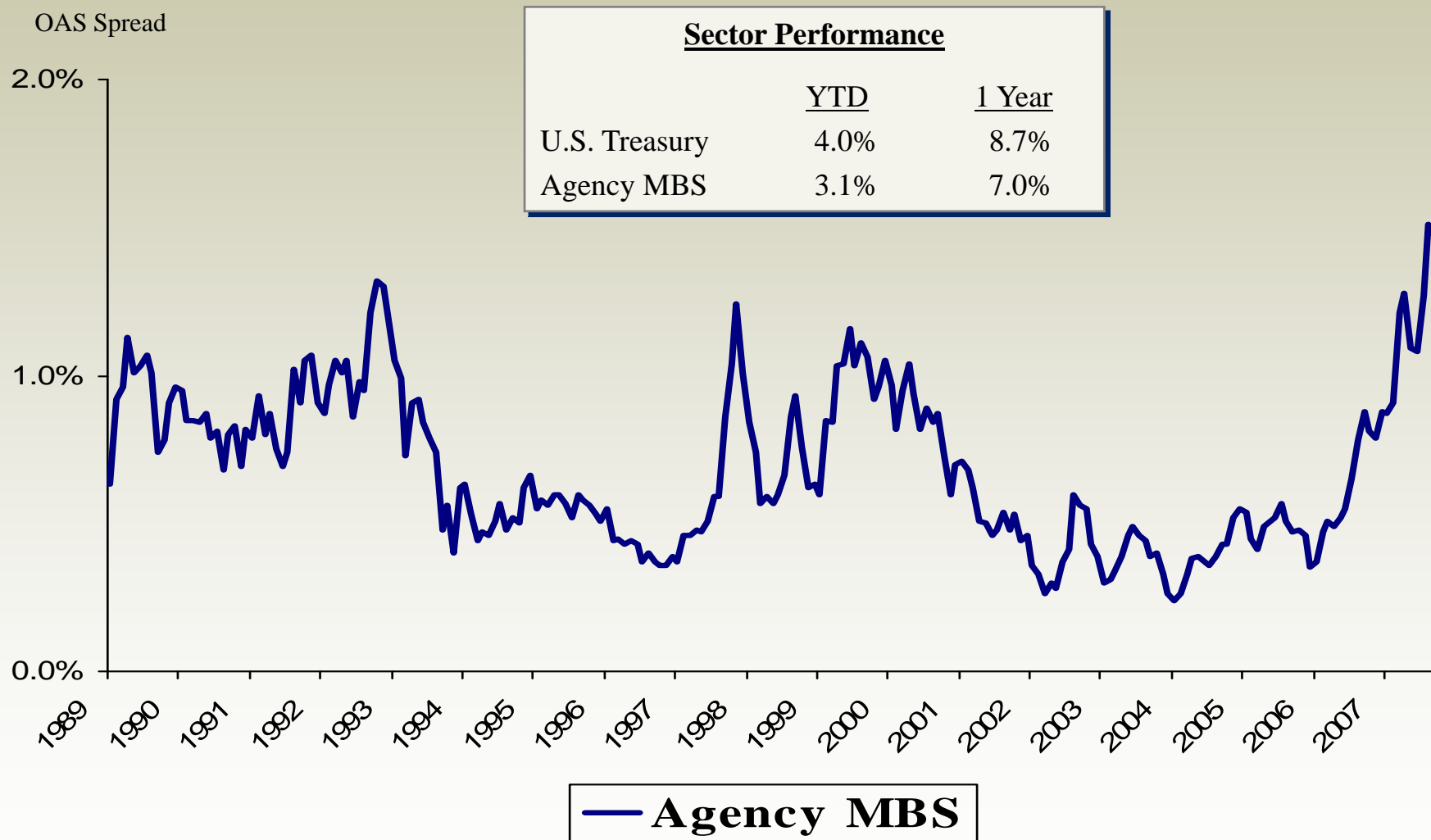
- » **Higher Returns** - Agency MBSs typically yield more than 200bps over Treasuries and more than comparable-quality corporate bonds
- » **Credit Quality** - GNMA are Treasury and FNMA/FHLMC are AAA-rated based on their status as a GSE (Now under Treasury Control)
- » **Liquidity** - Agency MBS market is very liquid and is second only to U.S. Treasuries. Agency MBS pricing and trading is available on electronic trading platforms
- » **Relatively Short Durations** - Due to typical average life of the underlying mortgage, Agency MBS have intermediate-term effective maturities

CON

- » **Prepayment Risk** - Biggest risk in investing in Agency MBS

AGENCY MBS SPREADS HAVE WIDENED

As of August 31, 2008

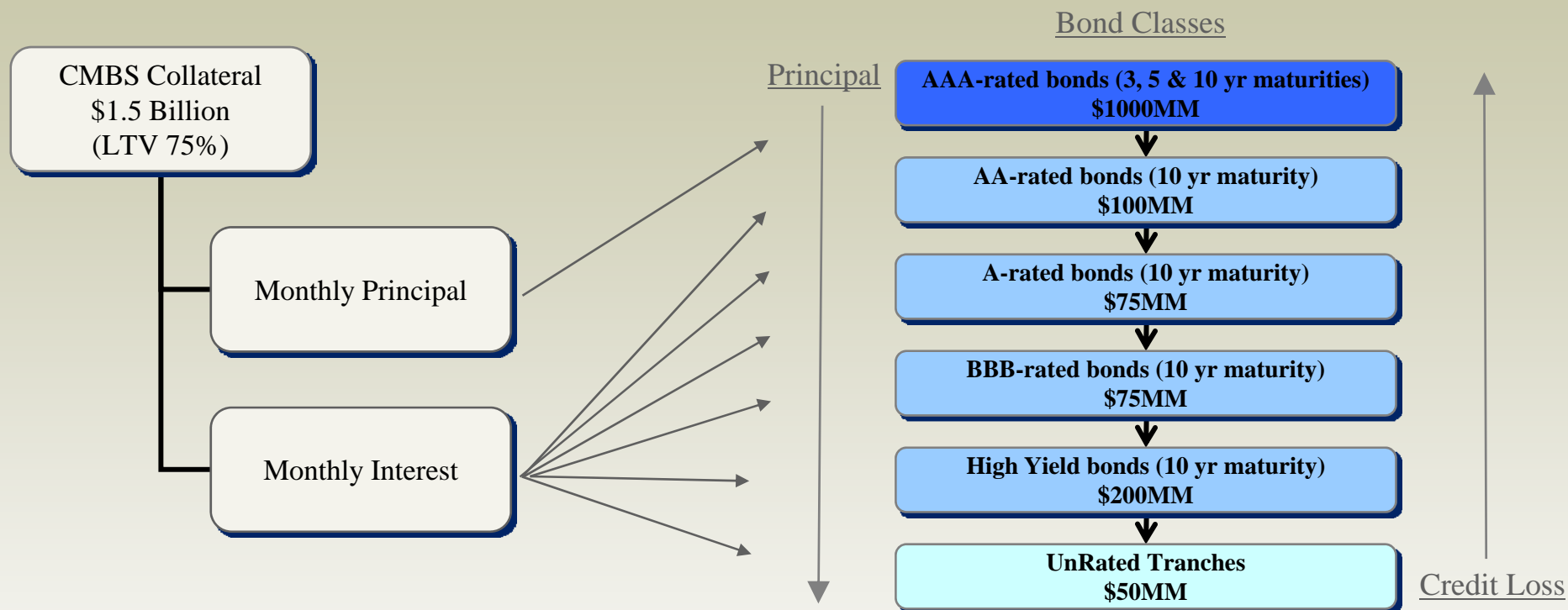


Source: Lehman Brothers

COMMERCIAL MBS (CMBS) - OVERVIEW

- » **CMBS** - Securities backed by a diverse pool of “income producing” commercial mortgages on office buildings, retail property, multifamily apartments, and hotels
- » Unlike Agency MBS, CMBS are not government guaranteed but are rated by Standard & Poor, Moody, and Fitch
- » Credit quality is achieved through “**structured finance**” – a technique utilized to redirect risk and return attributes to those designed to bare and benefit from them
- » Commercial mortgage delinquencies are currently historically low; at .44% of 1%
- » \$525 Billion CMBS outstanding, representing 5% of Fixed Income Indices

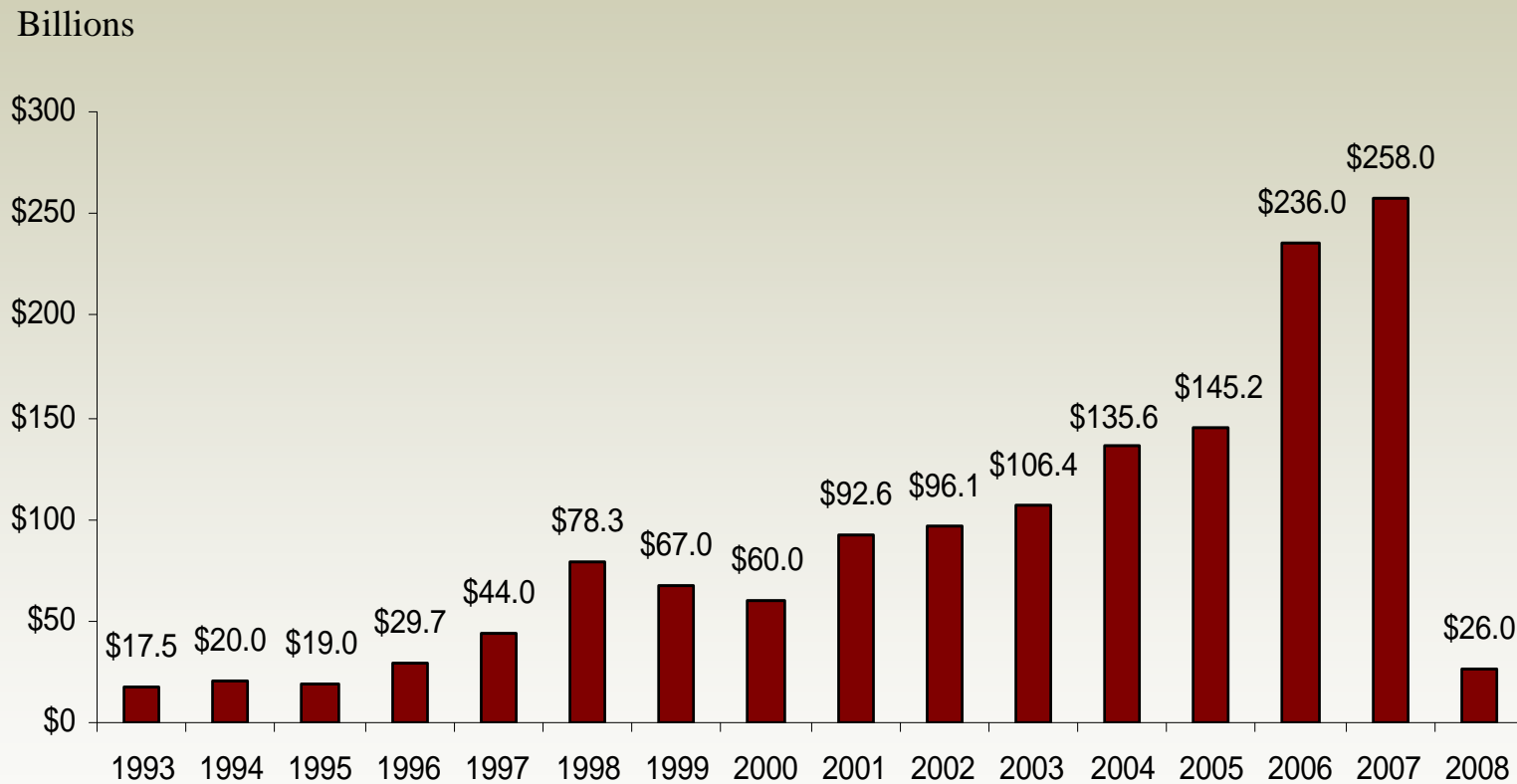
COMMERCIAL MBS – DEAL STRUCTURE



- » Structured Finance is used to structure bonds that receive priority of principal and interest and have targeted maturities
- » AAA-rated bonds receive 100% of paydown and lower-rated bonds receive repayment only after AAA-rated bonds are repaid
- » Credit losses are allocated to the lowest-rated bonds

CMBS ISSUANCE

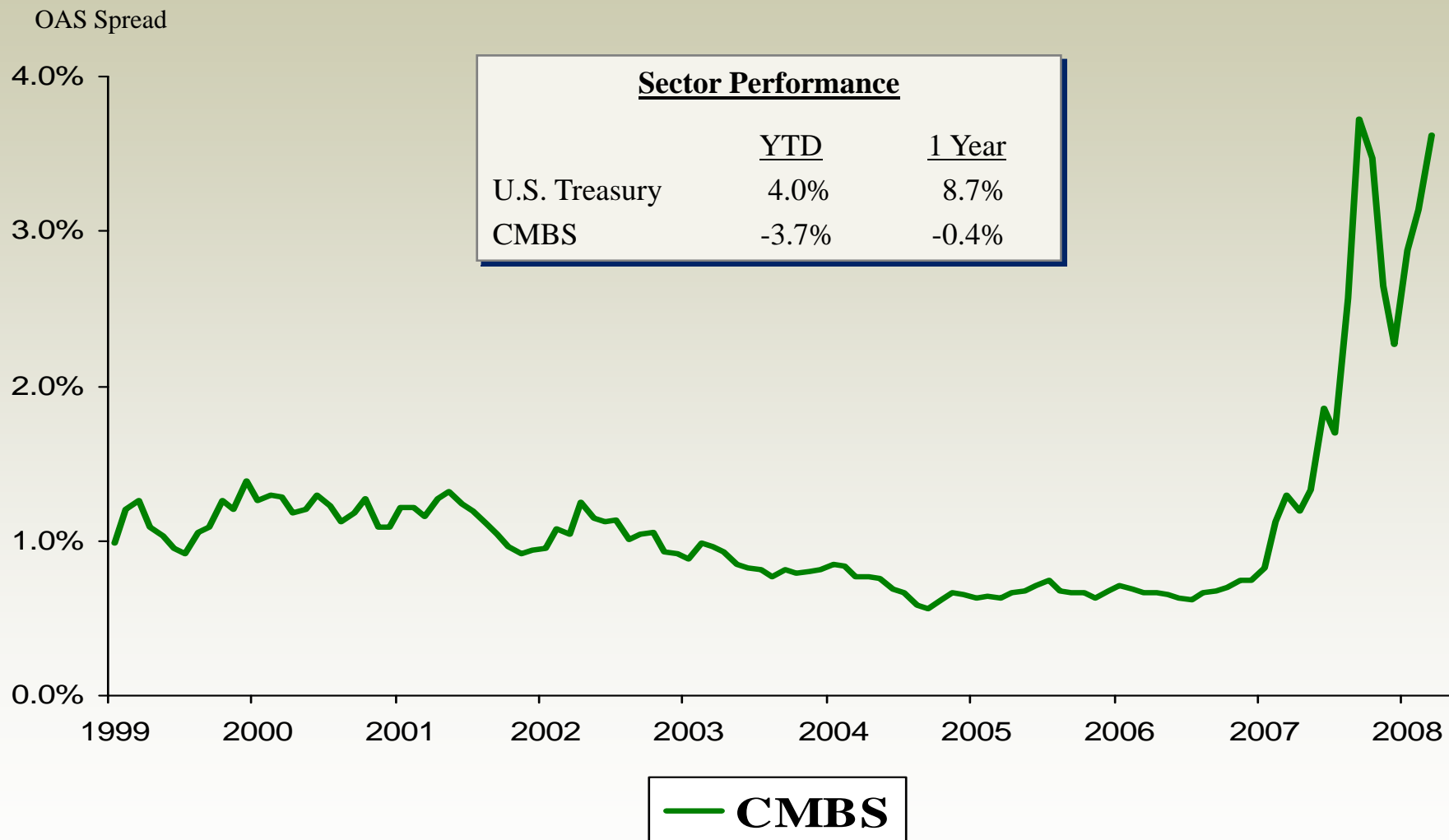
As of August 31, 2008



Source: Commercial Mortgage Alert.

COMMERCIAL MBS – SECTOR HAS LAGGED U.S. TREASURIES

As of August 31, 2008



Source: Lehman Brothers

ASSET-BACKED SECURITIES (ABS) - OVERVIEW

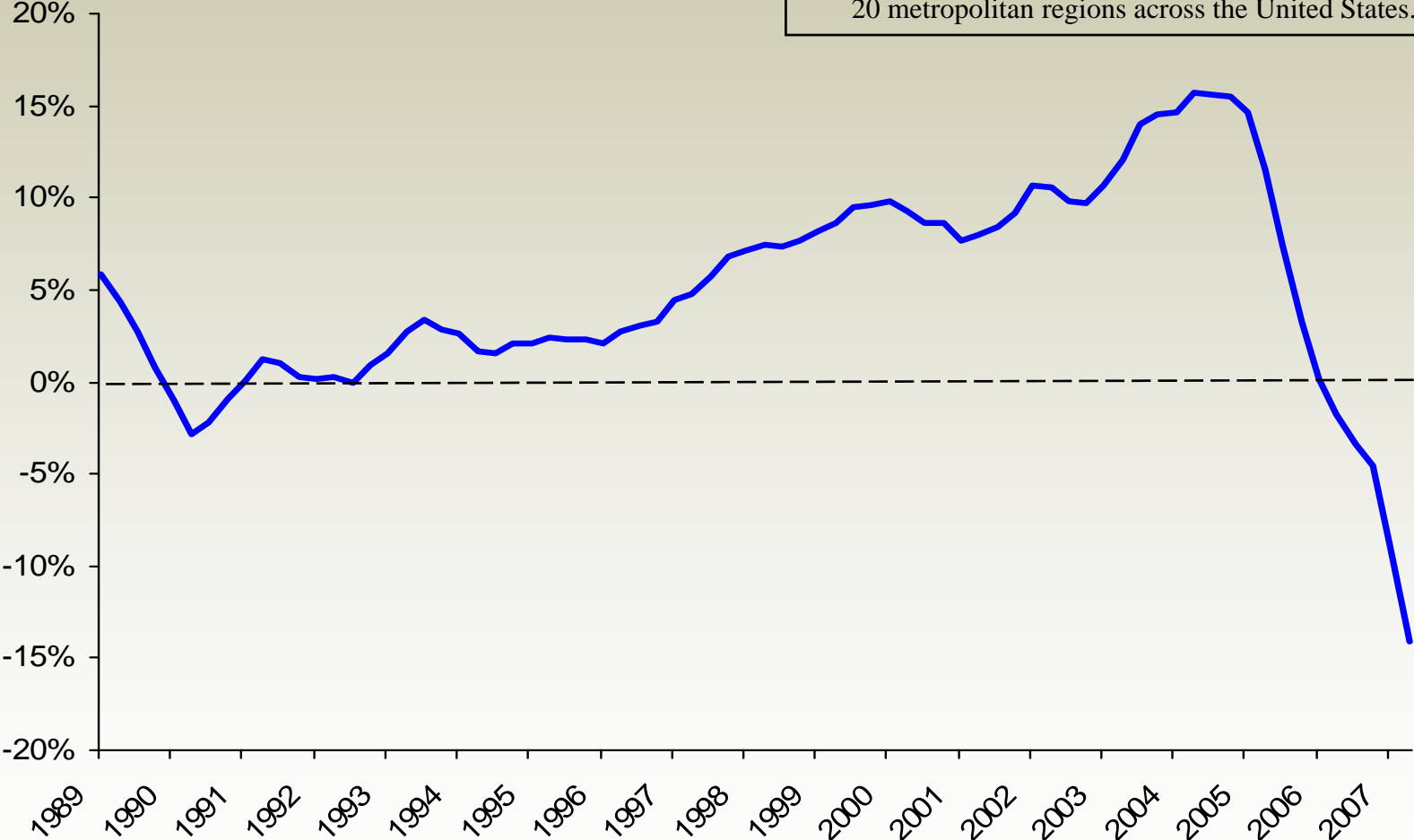
- » **ABS** - Securities backed by a pool of assets, typically credit card receivables, automobile loans, or other mortgage-related loans (i.e., non-conforming mortgages and home equity loans)
- » Securities are structured to receive priority of principal and interest and have targeted maturities and pay rules governed by a prospectus
- » ABS are rated by Standard & Poor, Moody, and Fitch
- » ABS offers attractive yields and have relative short maturities
- » \$3.2 Trillion ABS outstanding, but only represent 1% of Fixed Income Indices

ABS – MARKET COLLAPSE FOR MORTGAGE-RELATED SECTOR

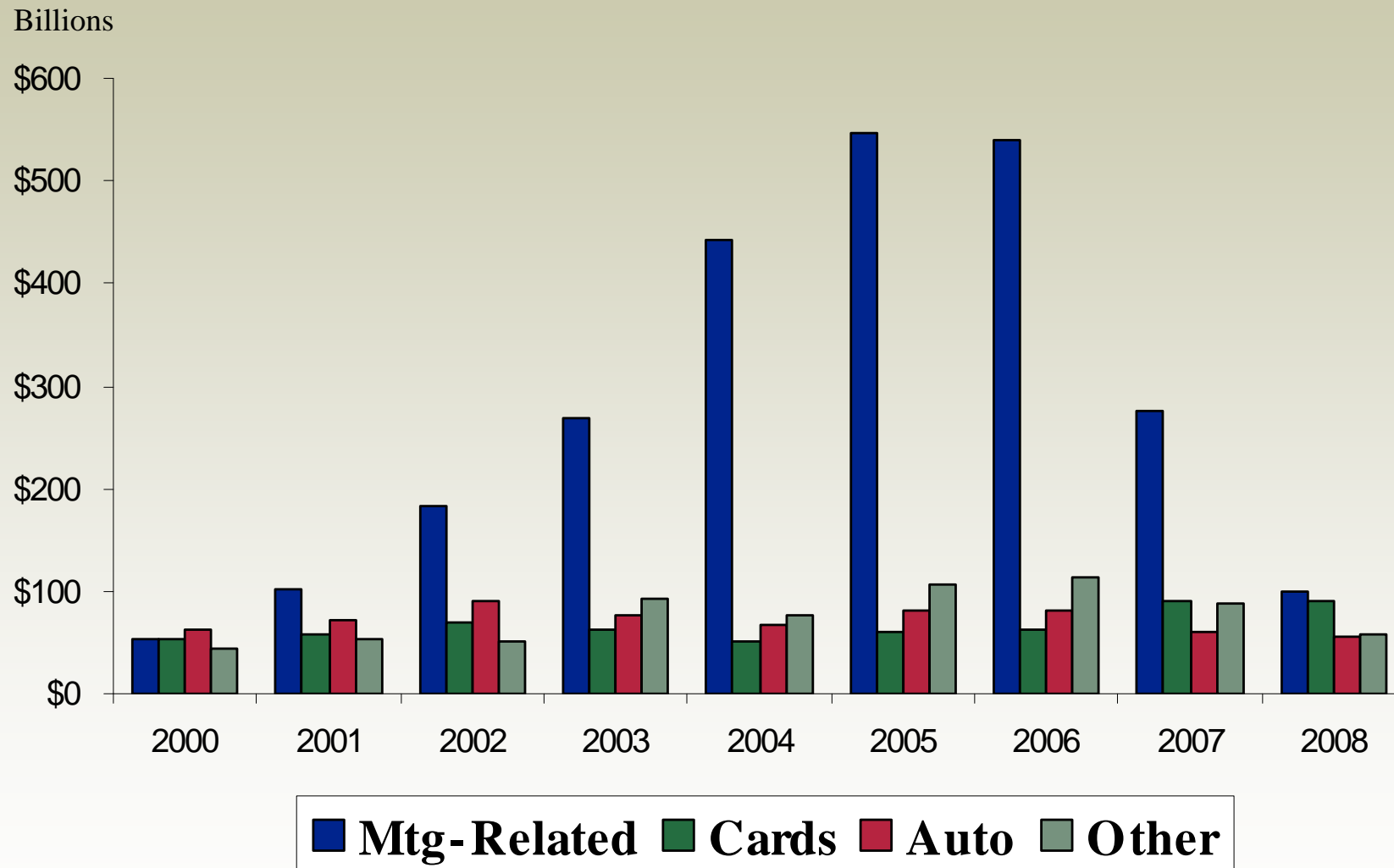
- » Mortgage-related ABS has been the main cause of global credit meltdown
- » Everyone is to be blamed - Wall Street firms/lenders, rating agencies, investors, borrowers, and regulators
- » Deal structures underestimated high default rates and foreclosure loss severities
- » Double-digit decline in housing valuations have eliminated refinancing option
- » Delinquencies are alarmingly high: subprime borrowers at 18.7% 30 days past due

HOME PRICE APPRECIATION (S&P Case-Shiller Index)

The S&P Case-Shiller Home Price Index is designed to measure the growth in value of residential real estate in 20 metropolitan regions across the United States.



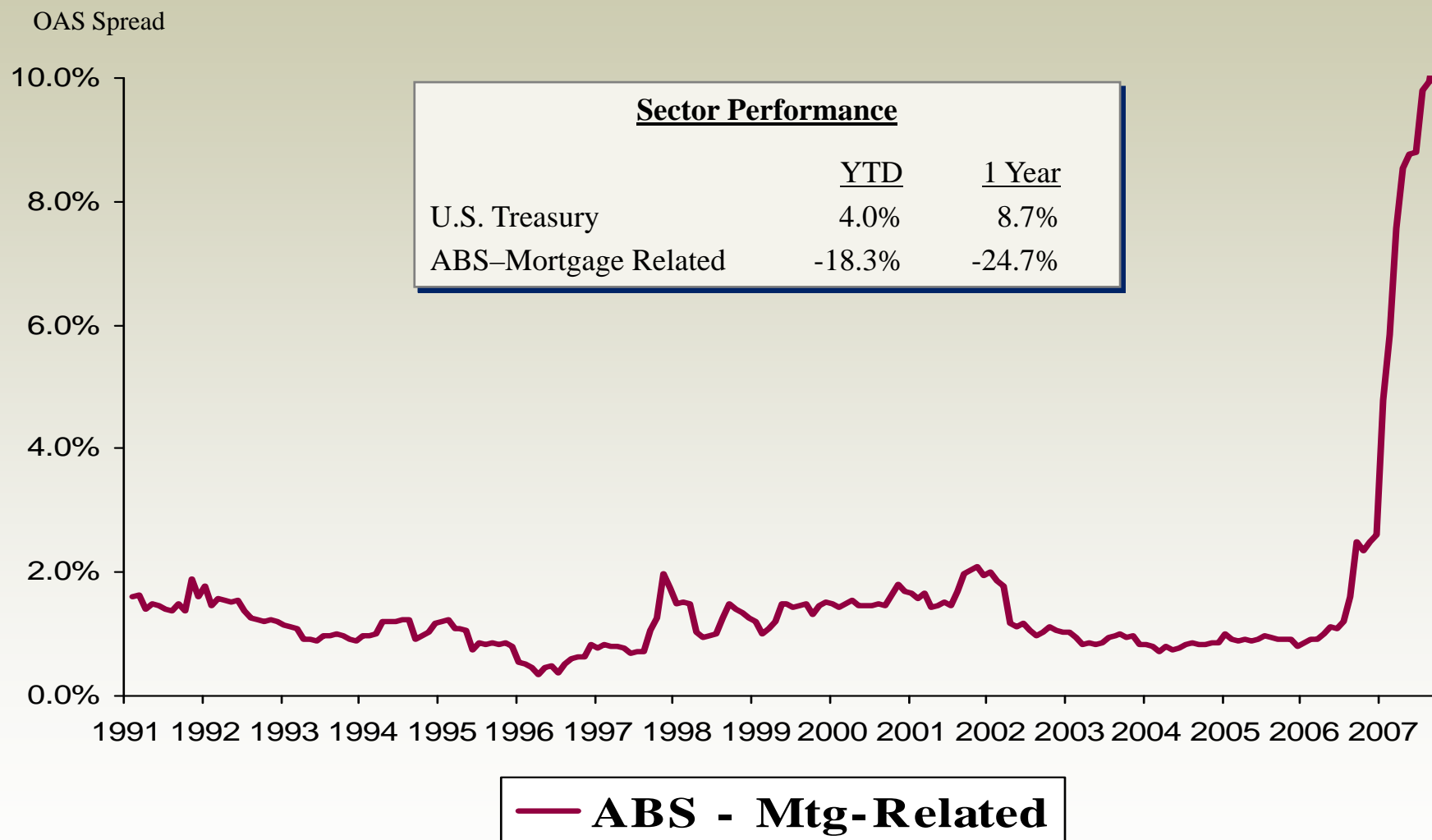
ABS ISSUANCE



Source: UBS

ABS – MORTGAGE-RELATED SECTOR SPREADS

As of August 31, 2008



Source: Lehman Brothers

SECURITIZED PRODUCTS – OUTLOOK FOR 2009 & BEYOND

- » **Agency MBS** will continue to function well and offer superior relative value opportunities for investors
- » **CMBS** - Current wide yield spreads reflect concern about slowing economy and declining fundamentals in commercial real estate
- » **CMBS** - Deal Vintage Matters - Prior to 2006 offer best value based on seasoned mortgages and conservative underwriting and structuring assumptions
- » **Mortgage-Related ABS** - Massive fund liquidations have driven prices down substantially
- » **Mortgage-Related ABS** - No liquidity; double-digit yields on most AAA-rated bonds
- » **Mortgage-Related ABS** - Excellent opportunities for distressed debt buyers but expertise and long time horizon will be required