U.S. Mortgage Credit Opportunity

Collateral Review & Differentiation of Legacy RMBS vs. CRT GSE Collateral

FALCON BRIDGE Capital

May 29th, 2020

Collateral Review & Differentiation.

Legacy RMBS vs. CRT Collateral, Structure, and Performance.

Housing Landscape & Collateral Profile

	Legacy RMBS	Post-Crisis CRT
Housing Landscape		
Home Prices	▪ Significant Home Price Depreciation ("HPD") ~35% and ranging between 20%-60% depending on location.	▪ Prices expected to be flat for 2 years, with certain areas possibly experiencing limited home price depreciation. Goldman Sachs has 2% HPD in 12 months. ▪ Continued shortages of housing inventory will continue to positively affect home valuations in the long-term.
Housing Supply (4 to 6 months reflects market in equilibrium)	▪ 12 to 14 months in some CBSA	▪ 3 to 4 months
Mortgage Rates	▪ 3.0% to 3.5%	▪ 3.0 % to 3.5%
Availability of Financing	▪ Very Weak post crisis. Tight underwriting and negative equity resulted in dislocation in refinancing.	▪ Very strong competition for Agency borrowers
Household Formation	▪ Massive disruption	▪ Long-term normal trend observed at 1.2mm per year. ▪ Slow-term disruption is expected during the duration of the pandemic.
Unemployment	▪ Peaked at 10.0%	▪ Crisis level to be higher in near term w/LT Expected to Peak at 9%-15% for modeling purposes.
Collateral Profile		
LTV	▪ 110% to 130% depending on the level of HPD	▪ Low LTV Deal Avg. 73% at origination
FICO Distribution Average	▪ 690 to 710 Option Arm Deals ▪ < 680 Sub Prime Deals	▪ Median 745
Documentation	▪ Typically less than Full Doc ▪ Stated income loans were prevalent	▪ Full Doc under Federal & State penalties for borrower and brokers.
DTI	▪ Unknown due to Alternative Doc or No Doc loans ▪ No Income No Asset Verification was a standard loan product	▪ ~ 35% DTI

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	Legacy/Non-Agency RMBS	Post-Crisis CRT Structure
Collateral Performance		
Cumulative Losses – Alternative Product Types	▪ Alt-A Hybrid Arm 2006 - 26.10% ▪ Alt-A Hybrid Arm 2007 - 28.20% ▪ Option Arm 2006 - 31.30% ▪ Option Arm 2007 - 34.30% ▪ Sub-Prime Fixed 2006 - 29.50% ▪ Sub-Prime Fixed 2007 - 21.20% ▪ Sub-Prime Hybrid Arm 2006 - 39.40% ▪ Sub-Prime Hybrid Arm 2007 - 39.10%	▪ Not Originated Under QM Guidelines
Cumulative Losses – Prime	▪ Prime Fixed 2006 - 5.80% ▪ Prime Fixed 2007 - 6.90% ▪ Prime Hybrid Arm 2006 - 7.54% ▪ Prime Hybrid Arm 2007 - 9.52%	**Collateral of similar quality to our Agency target reference pool that experienced the Great Financial Crisis**: ▪ 2000 - 0.05% ▪ 2001 - 0.08% ▪ 2002 - 0.11% ▪ 2003 - 0.22% **Post-crisis target collateral has been observing negligible losses:** ▪ 2011 - 0.03% ▪ 2012 - 0.01% ▪ 2013 - 0.01% ▪ 2014 - 0.01% ▪ 2015 – 2019 - 0.00%
Prepayments Observed at 3.0% - 3.5% Mortgage Rates Post Crisis in 2009 & Current Mortgage Rates at 3.5%		
Monthly CPR (Annual Prepayment Speeds)	▪ Option Arm - 2% - 10% ▪ Sub-Prime - 2% - 5% ▪ Prime - 12% - 20% ▪ Alt-A - 5% - 10%	▪ 20% to 40% depending on refinance incentive
Loss Severities on Liquidations		
Loss Severities	▪ Option Arm - ~60% ▪ Sub-Prime - 60% to 80% ▪ Prime - ~40% ▪ Alt-A - ~55%	▪ Low LTV 15% to 20% ▪ High LTV 5% to 10% (Mortgage Insurance Protection)

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	Legacy RMBS	Post-Crisis CRT Structure
Structural Differences		
Waterfall	▪ Pro-rata share: principal cash flows were distributed on a pro-rata basis across AAA stack.	▪ Sequential - Upon Payoff of M1, all principal cash flows are directed to M2 ▪ M1 typically amounts to ~30% of the capital structure; A consistent 20 CPR will payoff M1 in 1.5 years
Weighted Average Life (“WAL”)	▪ 6yrs to 8yrs.	▪ Expected WAL of 2.5 yrs. to 4 yrs.
Credit Enhancement	▪ 20% to 40% depending on collateral and structure to protect against cumulative losses of 30%+	▪ 1.10% to 1.25% at origination with build-up through de-leveraging. ▪ Cumulative losses of 2000-2003 vintage origination that also went through the Great Financial crisis ranged 5-22bps.

Great Financial Crisis	COVID-19
Mortgage Servicing Policies	
▪ Lack of uniformity resulted in unsuccessful loan modifications, massive foreclosure volume, extended liquidation timelines and high loss severities. ▪ FHFA’s programs like Home Affordable Modification Program (“HAMP”) or Home Affordable Refinance Program (“HARP”) took ~18 months to implement.	▪ Agency loans follow strict and uniform procedures aimed at helping borrowers stay in their homes and minimal losses to bond investors. ▪ Temporary Forbearance Program was announced immediately to minimize borrower hardship amid economic shut-down. ▪ Modification programs are uniform and waterfall steps clearly defined.
Federal Reserve Monetary Intervention	
▪ Federal Reserve Liquidity Program like TARP was created provide liquidity to various asset classes. ▪ Several Months after Lehman collapse even though first signs of crisis were noticed in mid-2007	▪ Days after first signs of liquidity problems, Fed responded with a comprehensive monetary stimulus including (not limited to): ▪ Cutting FFR by 50bps (and by another 100bps shortly thereafter) and restarting Quantitative Easing (“QE”). ▪ Establishing Term Asset-Backed Securities Loan Facility (“TALF”), Commercial Paper Funding Facility (“CPFF”) and Primary Dealer Credit Facility (“PDCF”).
Fiscal Response Was Slow During 2008 Crisis	
▪ The American Recovery and Reinvestment Act of 2009 helped us avoid a second Great Depression and kick started renewed economic growth. ▪ The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 strengthened the economic recovery by cutting the payroll tax and continuing extended unemployment insurance benefits.	▪ A $2 trillion Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law within two weeks of the economic shut-down. ▪ Several other economic program through the SBA have also been passed to assist businesses. ▪ Federal Unemployment Insurance (“UI”) of $600 per week has been approved and extended to 39 weeks in addition to State UI.

Historical Performance & Collateral Characteristics

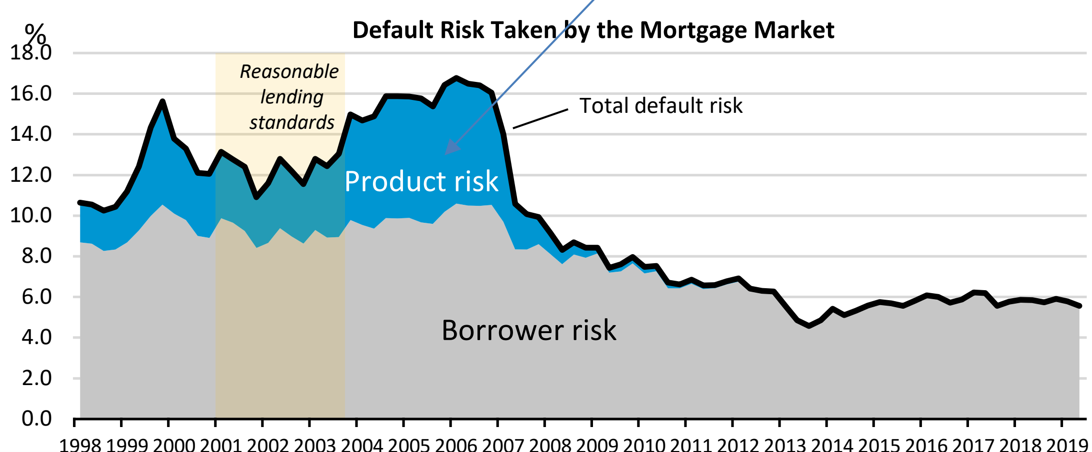
Better loan quality results in improved loan performance

Cumulative Default (%)

			FICO					
Doc	DTI	CLTV	>740	(700-740]	(660-700]	(620-660]	(580-620]	<=580
Full	(0-40)	(0-68]	-	0.50	1.00	3.00	5.00	10.00
Full	(0-40)	(68-78]	-	1.00	2.00	3.50	7.00	12.00
Full	(0-40)	(78-82)	-	1.00	2.00	3.50	6.00	10.50
Full	(0-40)	[82-90]	1.00	1.00	2.50	5.00	9.00	13.50
Full	(0-40)	(90-95]	1.00	2.00	4.00	7.50	11.50	15.00
Full	(0-40)	above 95	3.00	5.00	8.50	17.00	30.00	43.00
Not full doc		(0-68]	2.00	7.00	10.00	14.00	18.00	21.00
Not full doc		(68-78]	8.00	17.00	22.00	28.00	25.00	34.00
Not full doc		(78-82)	11.00	20.00	24.00	30.00	28.00	34.00
Not full doc		[82-90]	16.00	26.00	31.00	33.00	31.00	36.00
Not full doc		(90-95]	17.00	27.00	29.00	31.00	29.00	41.00
Not full doc		above 95	29.00	36.00	36.00	35.00	38.00	48.00

Strategy focus – Superior collateral expected to outperform across business cycles:

- Low LTV deals (60-80% Original LTV)
- Full income documentation
- Down payment verification/no reliance on silent seconds
- Independent appraisals
- Minimal risk layering
- Stronger borrower profile
- Low Risk mortgage products
- Personal lability of mortgage brokers/originators.



- The Housing Finance Policy Center's credit availability index (HCAI) suggests that today's borrowers are subject to stringent underwriting standards resulting in stronger borrower profile and low risk mortgage products.

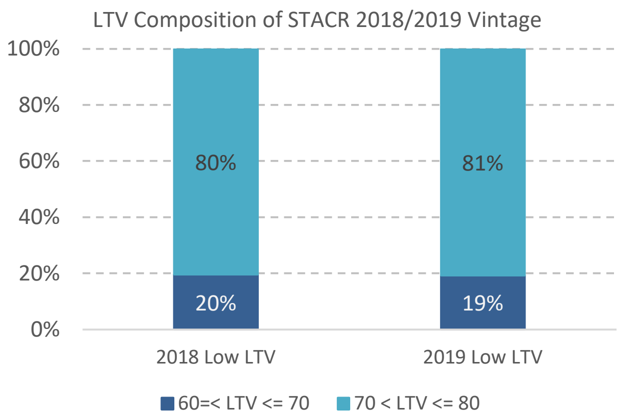
Notes: The HCAI indicates the level of purchase mortgages expected to become severely delinquent and is likely to ultimately default. A lower HCAI reading suggests low risk tolerance and overall low credit availability. Examples of product risk include but is not limited to negatively-amortizing or interest-only mortgages.

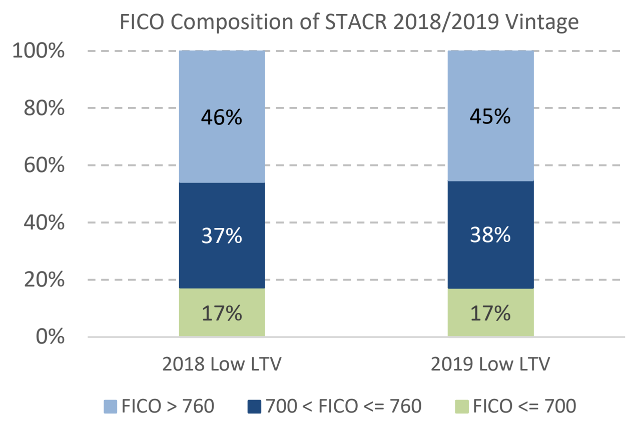
Source: 1010data, Urban Institute, FBC

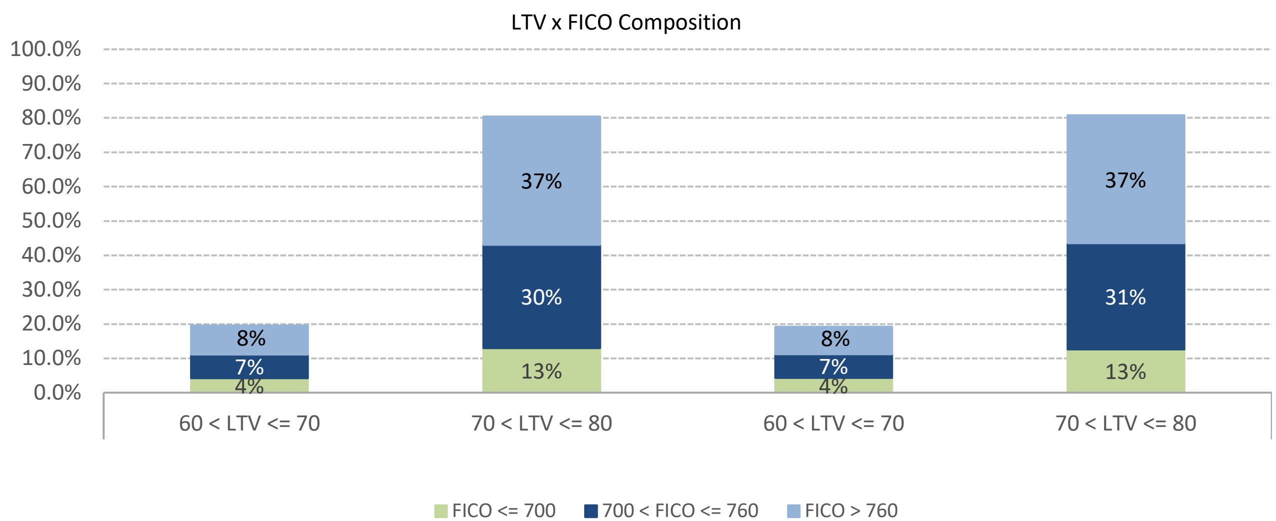
Notes: "Full Doc" loan performance is based on cumulative defaults experienced by loans originated in 2001 and 2002, while "Not Full Doc" represents 2005-2006 experience.

Collateral Composition: LTV and FICO of CRT 2018 and 2019 Vintages

Over 80% of collateral in deals targeted for acquisition have FICO scores over 700.







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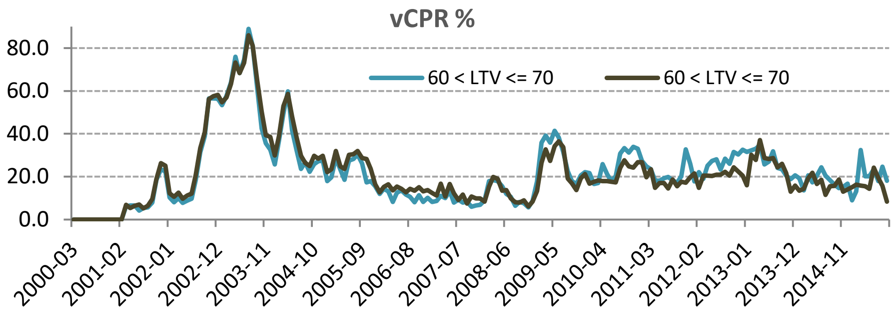
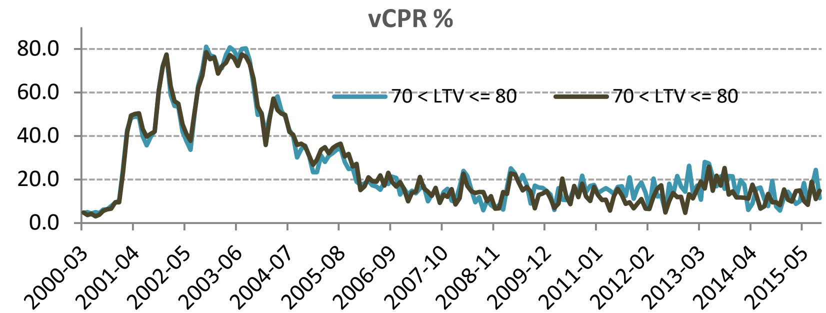
Source: Freddie Mac, 1010data, FBC

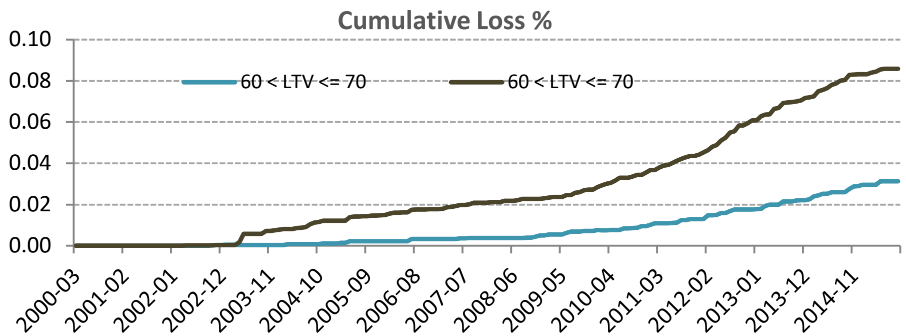
Historical Performance – Target Collateral

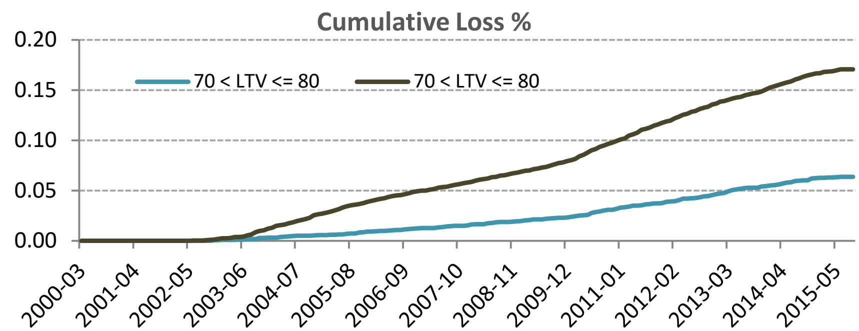
Loans originated in 2001 experienced the Great Financial Crisis "GFC", but ultimately suffered low levels of losses due to the following:

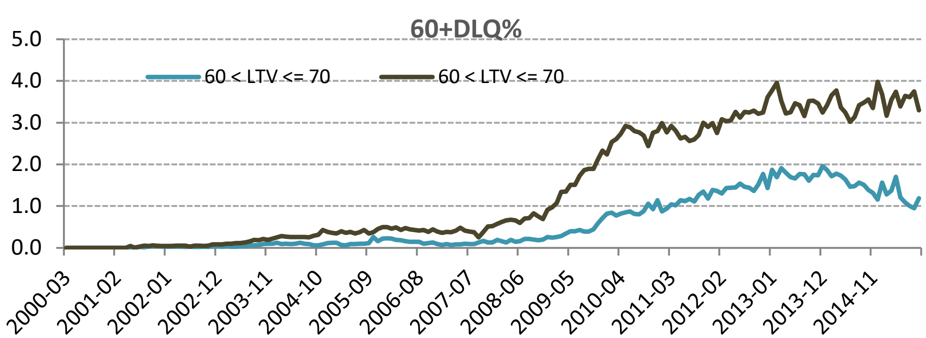
- **Relatively high prepayment speeds even during the crisis,**
- **Limited home price depreciation,**
- **Sound loan underwriting and good borrower characteristics.**

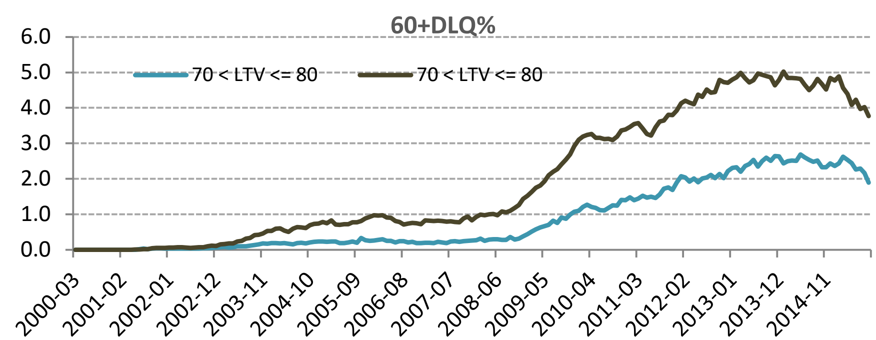












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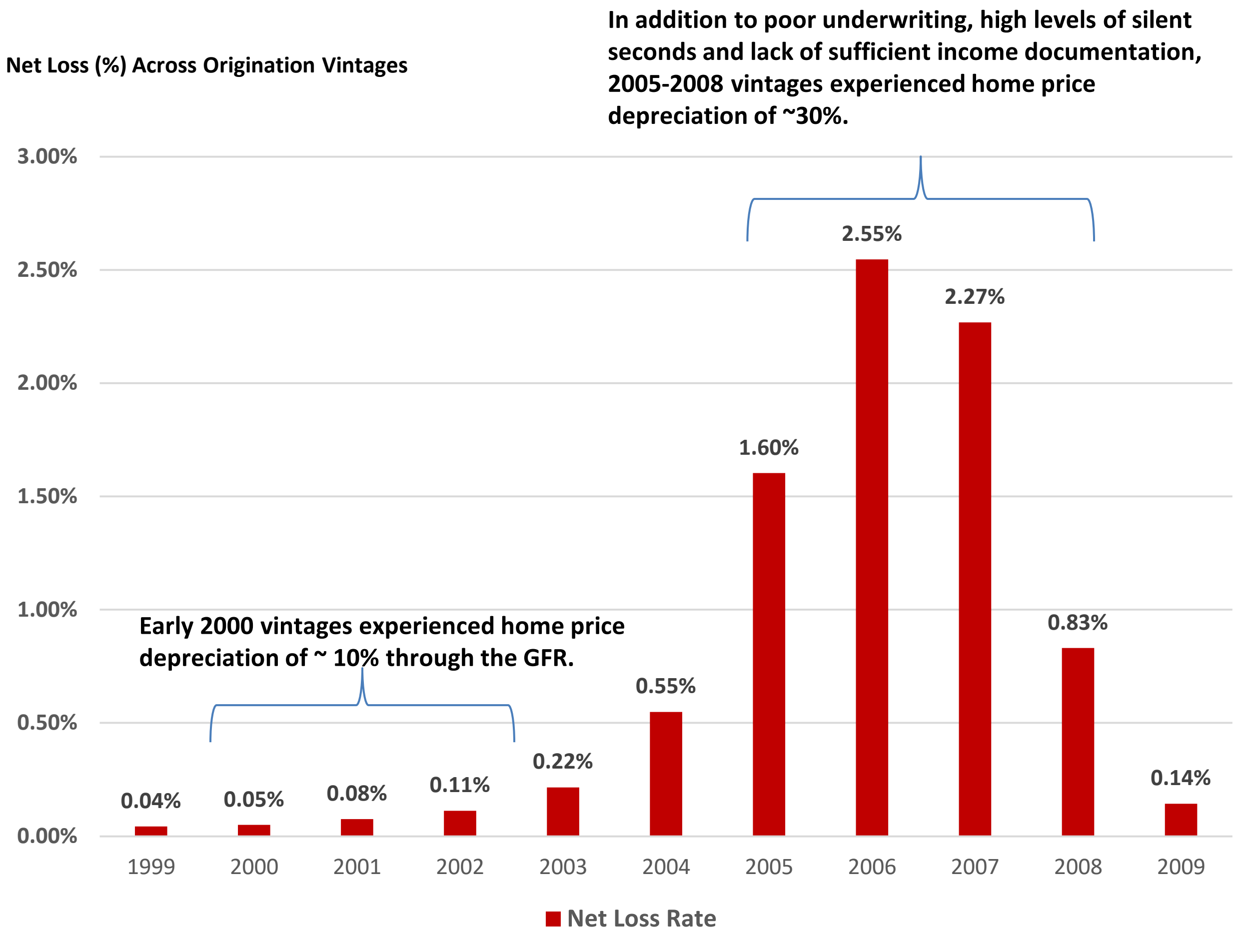
Source: Fannie Mae, FBC

Notes: Target collateral performance is based on 2001 vintage.

Acquisition Target Collateral Performance

- Net Loss % Across Vintages represents performance of loans with LTV between 60%-80%, FICO>700 and DTI<=45%.



Source: Fannie Mae, FBC

Collateral Strength: Minimize Risk Layering

Investment process is designed to identify risk layering within the collateral pool and estimate defaults based on historical performance of similar collateral through various economic cycles.

Qualities of the current Housing Market::

- **Tighter underwriting standards:**
  - Full income documentation
  - Down payment verification/no reliance on silent seconds
  - Independent appraisals
  - Minimal risk layering
  - Stronger borrower profile
  - Low Risk mortgage products
  - Personal lability of mortgage brokers/originators.

- **Proactive Mortgage Servicing that avoids foreclosure:**
  - Focus on loss mitigation strategies to avoid losses to bond holders

Post-crisis collateral is much cleaner, with marginal exposure to weaker performing loans.

2000 -2004 Origination: FNMA 30 year

FICO Range	LTV Range <70	=>70 <80	=>80 <90	=>90 <100
<620	1.34%	1.52%	1.37%	1.09%
=>620 <640	1.05%	1.34%	1.47%	1.26%
=>640 <660	1.46%	1.84%	2.26%	1.82%
=>660 <680	1.94%	2.40%	3.03%	2.23%
=>680 <700	2.48%	2.75%	3.45%	2.45%
=>700 <720	3.00%	2.99%	3.59%	2.40%
=>720 <740	3.37%	3.16%	3.73%	2.33%
=>740 <760	4.28%	3.48%	3.90%	2.18%
=>760 <780	5.25%	3.37%	3.44%	1.54%
=>780	4.65%	2.15%	1.96%	0.69%

21.63%

2017 - 2019 CAS Deals

FICO Range	LTV Range <70	=>70 <80	=>80 <90	=>90 <100
<620	0.02%	0.04%	0.01%	0.01%
=>620 <640	0.43%	0.89%	0.18%	0.29%
=>640 <660	0.65%	1.44%	0.34%	0.62%
=>660 <680	0.92%	2.26%	0.57%	1.02%
=>680 <700	1.27%	3.69%	1.22%	2.17%
=>700 <720	1.49%	4.97%	1.66%	2.91%
=>720 <740	1.56%	5.66%	1.94%	3.47%
=>740 <760	1.75%	6.76%	2.35%	3.86%
=>760 <780	2.17%	8.18%	2.68%	3.90%
=>780	4.01%	14.22%	3.83%	4.61%

7.66%

- Total defaults experienced by loans of low vs. high quality are significantly different.
- Fully documented loans have performed much better than partial documentation loans.
- Current underwriting is Full Documentation. Some Non-Agency deals are accepting less than full documentation.

Default performance of loans originated in 2000-2001

Doc	DTI	CLTV	FICO >740	(700-740]	(660-700]	(620-660]	(580-620]	<=580
Full	(0-30)	(0-68]	0	0	1	3	5	11
Full	(0-30)	(68-78]	0	1	2	3	7	12
Full	(0-30)	(78-82)	0	1	2	3	6	10
Full	(0-30)	[82-90]	1	1	2	5	9	13
Full	(0-30)	(90-95]	1	2	4	8	12	16
Full	(0-30)	above 95	3	5	9	17	31	43
Not full doc		(0-68]	2	7	10	14	18	21
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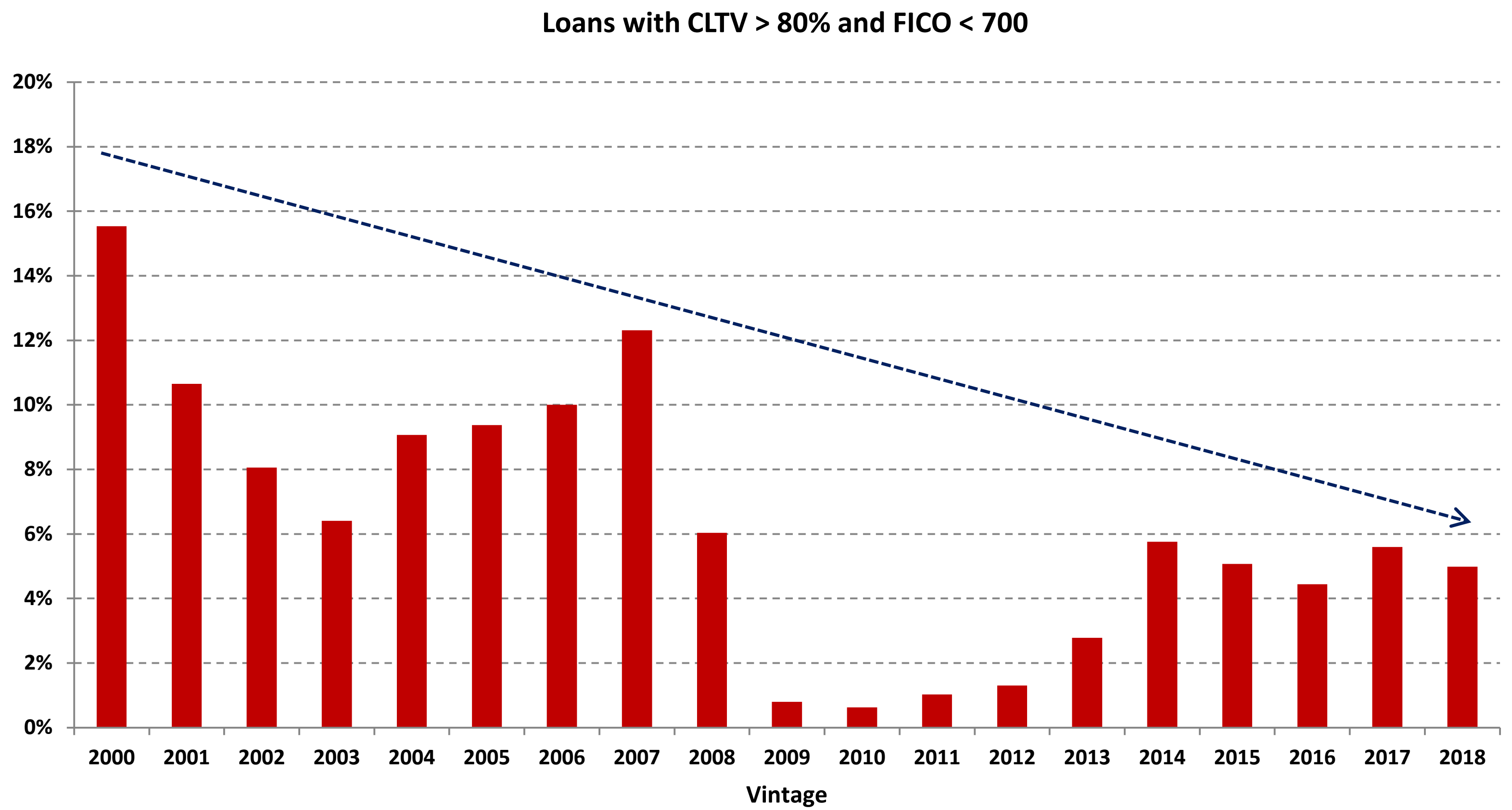
Not full doc		(90-95]	17	27	29	31	29	41
Not full doc		above 95	29	36	36	35	38	48

Source: 1010data, Urban Institute, FBC

Layered Risk Exposure Has Slightly Increased Since 2013

Credit expansion of riskier collateral bucket not back to pre-crisis levels.
Immediately following the housing crisis, mortgage credit availability tightened to unprecedented levels.



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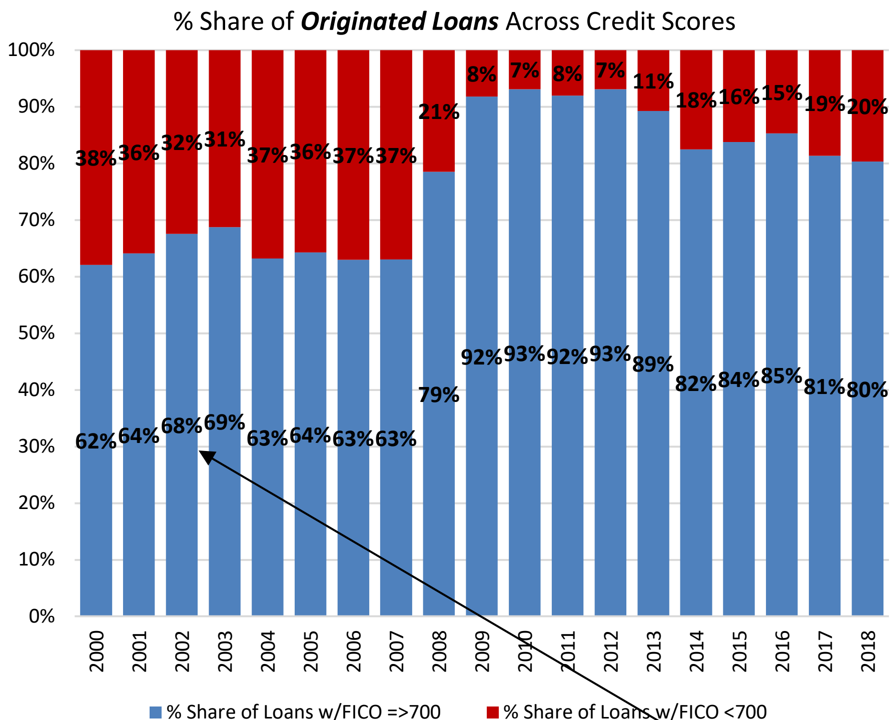
Sources: Fannie Mae's Data Dynamics, FBC

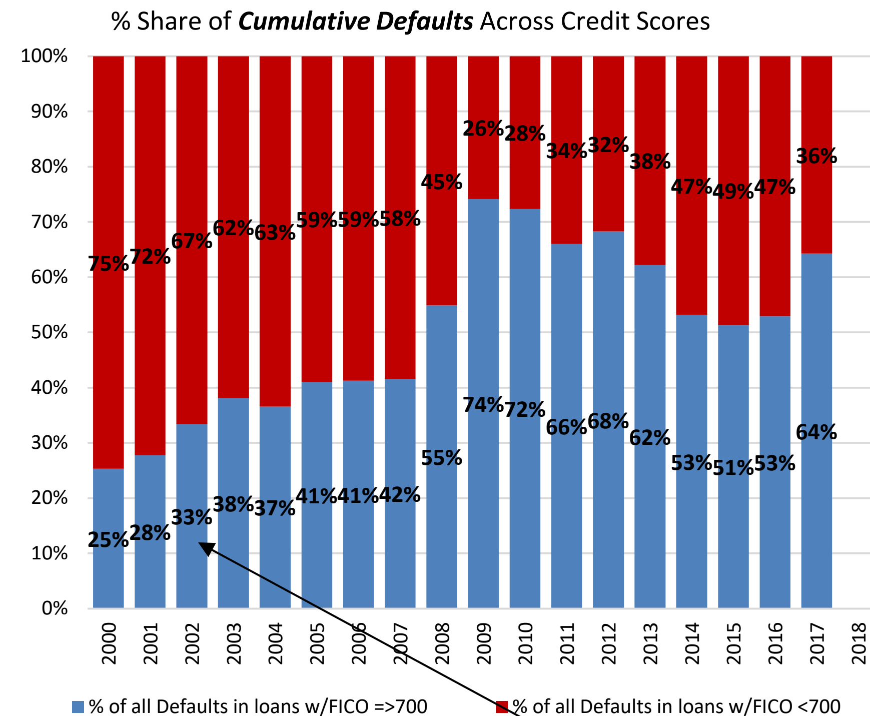
Proportion of Borrowers with Layered Risk Remains Low

The share of low FICO borrowers that historically experienced disproportionately higher defaults continues to amount to approximately half of the pre-crisis levels.

Cumulative Defaults % by Vintage

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
0.86	0.74	0.78	1.13	2.42	5.36	7.70	8.32	4.00	0.58	0.20	0.13	0.06	0.07	0.08	0.04	0.01	0.00	0.00





~68% of all defaults in 2000-2004 vintages were realized in loans with FICO scores below 700, while they amounted to ~33% of total origination. Recent originations of Low FICO borrowers is significantly lower.

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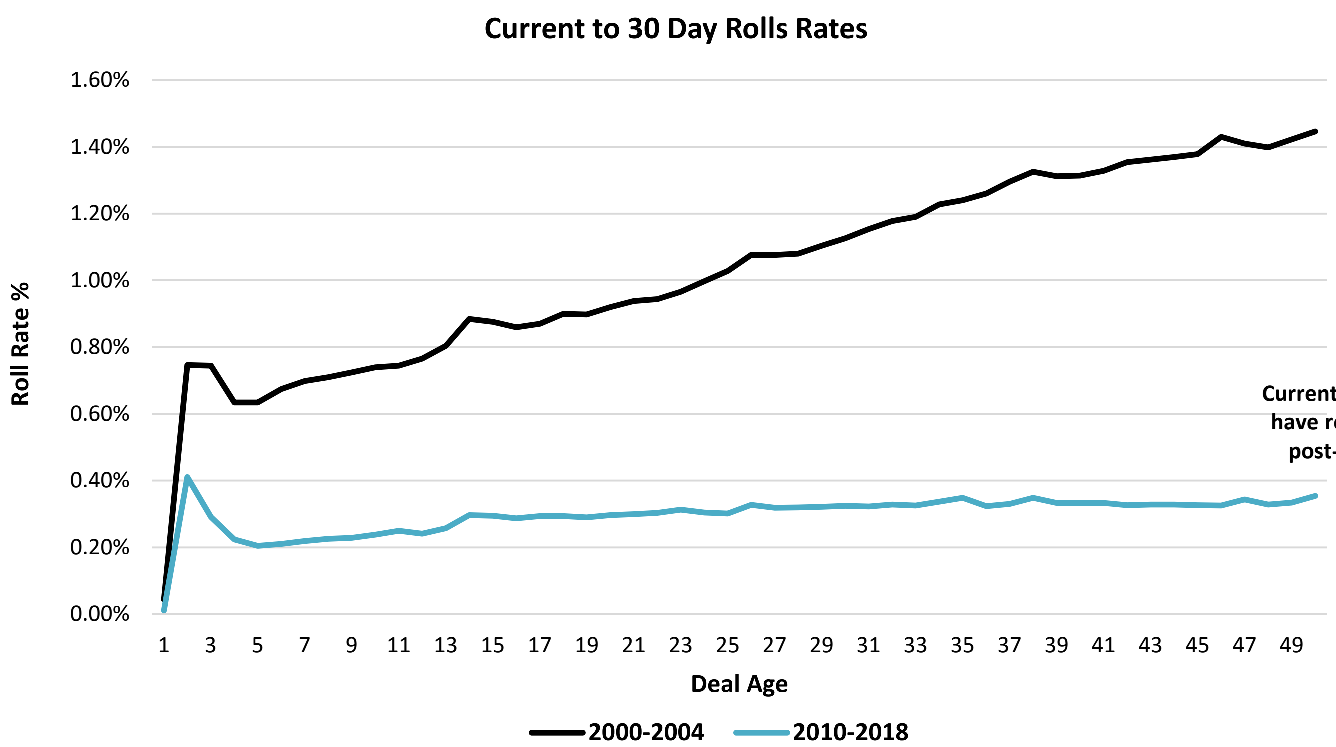
Sources: Fannie Mae's Data Dynamics, FBC

Roll Rate Comparison

Loan performance of post-crisis origination reflects its superior characteristics and underwriting.
Newly originated collateral has a much lower % of loans transitioning from Current to 30 day delinquency.

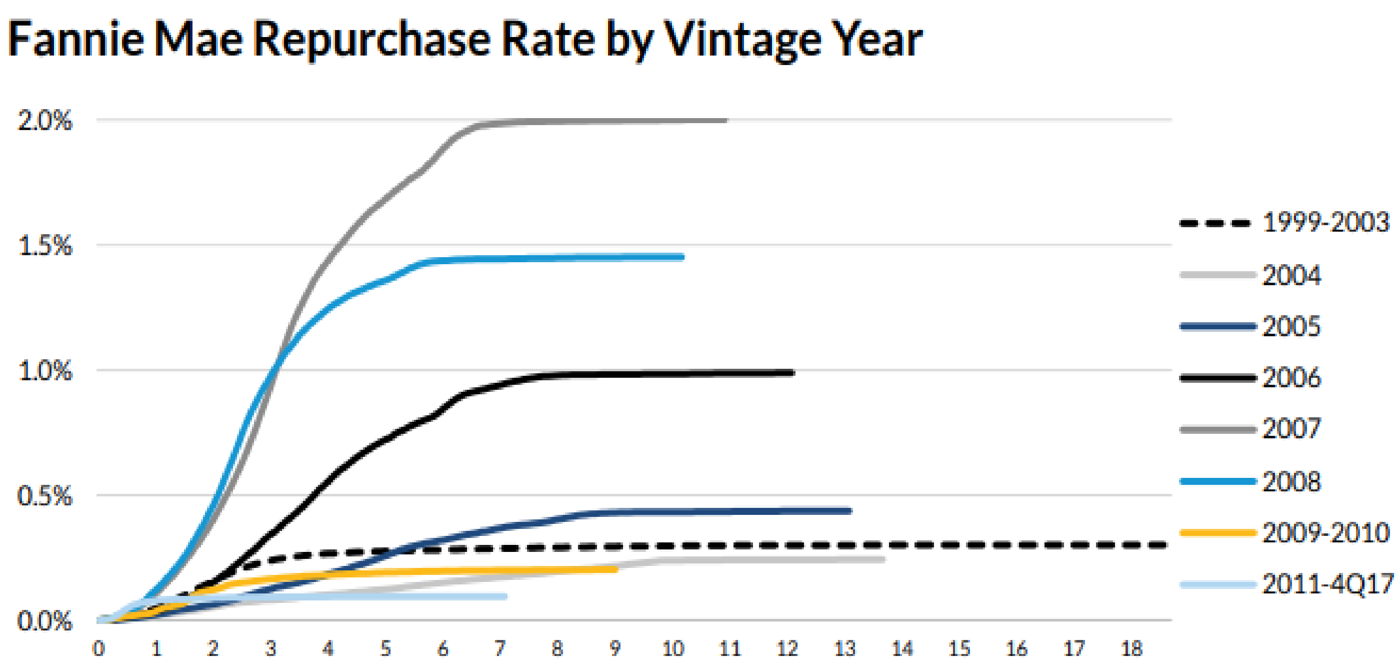


Current to 30 day roll rates have remained stable for post-crisis origination

Sources: Fannie Mae's Data Dynamics, FBC

GSE Origination and Review: Repurchases

% of loans being repurchased [1] is at an all time low pointing to improved originator and servicer processes and a significant decrease in Rep and Warranty violations.



[1] % Repurchased is defined as "the cumulative percentage of fixed-rate, full documentation, amortizing 30-year loans of a given vintage that Fannie Mae has put back to lenders due to reps and warrants violations. These numbers exclude loans put back through global settlements".

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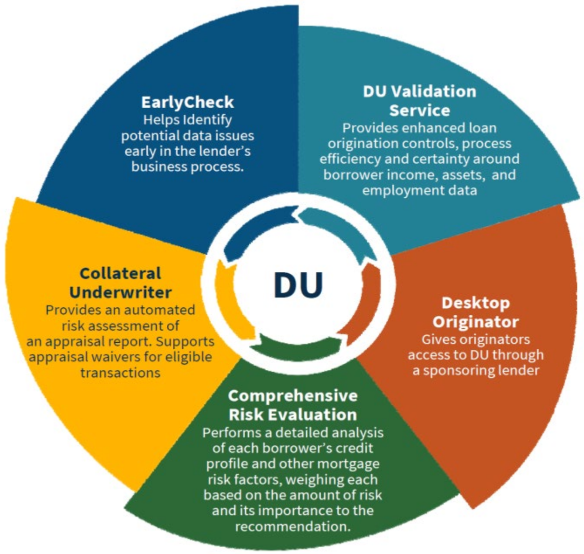
Source: Urban Institute, FBC

Fannie Mae's Desktop Underwriter is used by over 1,900 loan sellers for assessing risk of loan.



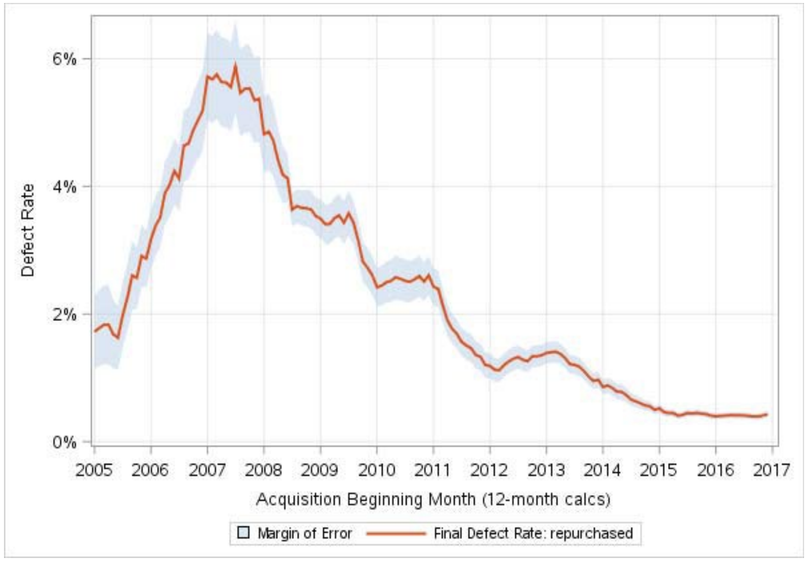
Credit Profile Factors:

a. Full review of credit history
b. Delinquent accounts
c. Installment loans
d. Revolving Credit Utilization
e. Public records search
f. FC and collections
g. Credit inquiries

Additional Risk Factors

a. Borrower's equity and LTV
b. Liquid reserves
c. Purpose
d. Term
e. Amortization type
f. Occupancy Type
g. DTI Ration
h. Property type
i. Co-borrowers
j. Self-employment

Eligibility defect rates from 2005 – 2017 acquisitions have declined significantly reflecting strong upfront origination control processes that help improve the loan manufacturing and ultimately loan defaults.



Post-Purchase Loan Review

1. Validates that loan purchases were originated in accordance with applicable requirements

2. Uses proprietary underwriting risk assessment forensics tool in quality control reviews, and finds data anomalies that may impact eligibility.

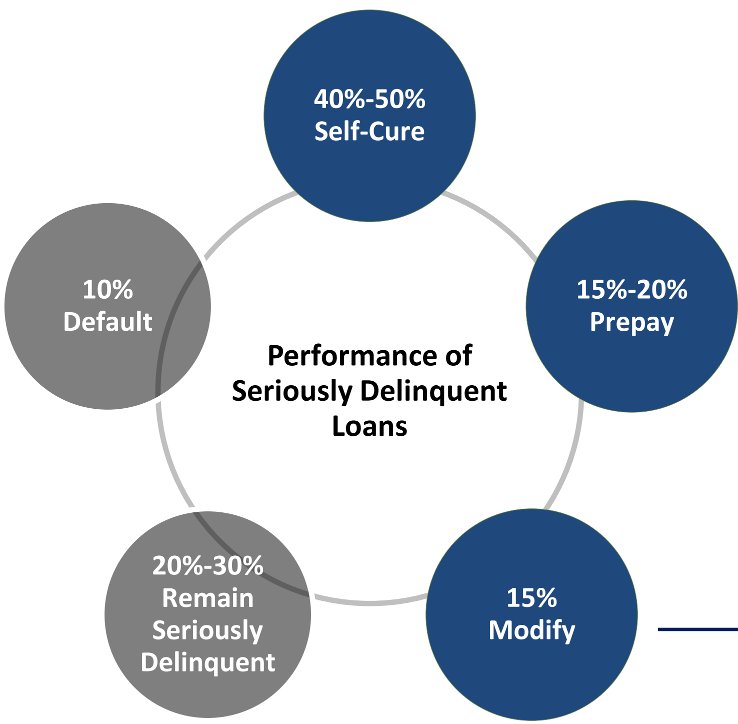
3. Full underwriting review of the loan is completed when a loan file is requested from a lender.

Source: Fannie Mae Credit Risk Management , January 2019

Delinquent Loan Performance

- Loans that become seriously delinquent exhibit high cure rates and/or undergo successful modifications that result in the overall low levels of defaults.

- **To date, ~ 64% of loans in 2013-2019 CRT issuance that became seriously delinquent (missed at least two payments) either prepaid their loans, self-cured or obtained a permanent loan modification (Term Extension, Rate Reduction, Forbearance, Capitalization of the Delinquent Amount or a combination of thereof).**



Modification Results

- Based on ~ 30,000 loans modified for 2013-2019 CRT issuance, **approximately 86% of loans that have undergone modification have either remained current/30day delinquent or paid-off, suggesting a very high modification success rate.**

Modification Performance (2013-2019 CRT Deals)					
	Current	30DQ	60+DQ	Prepaid	Default
STACR	56.1%	15.4%	12.3%	12.9%	3.2%
	65.7%	8.5%	10.7%	12.4%	2.6%

- Majority of modifications have been term extensions and rate reductions. **Fannie Mae and Freddie Mac do not allow principal forgiveness**; thereby avoiding immediate losses.

- Superior borrower profile, streamlined modification process and Servicer focus on loss mitigation at the early stages of loan delinquency resulted in improved recidivism rate (% of modified mortgages that again went 60 or more days past due).

- **Recidivism Rates:**
  a) Post 2013 origination 10% to 15%
  b) Pre Crisis 2000 to 2003 origination 40%
  c) Crisis Vintages of 2005 to 2008, 70% to 80%

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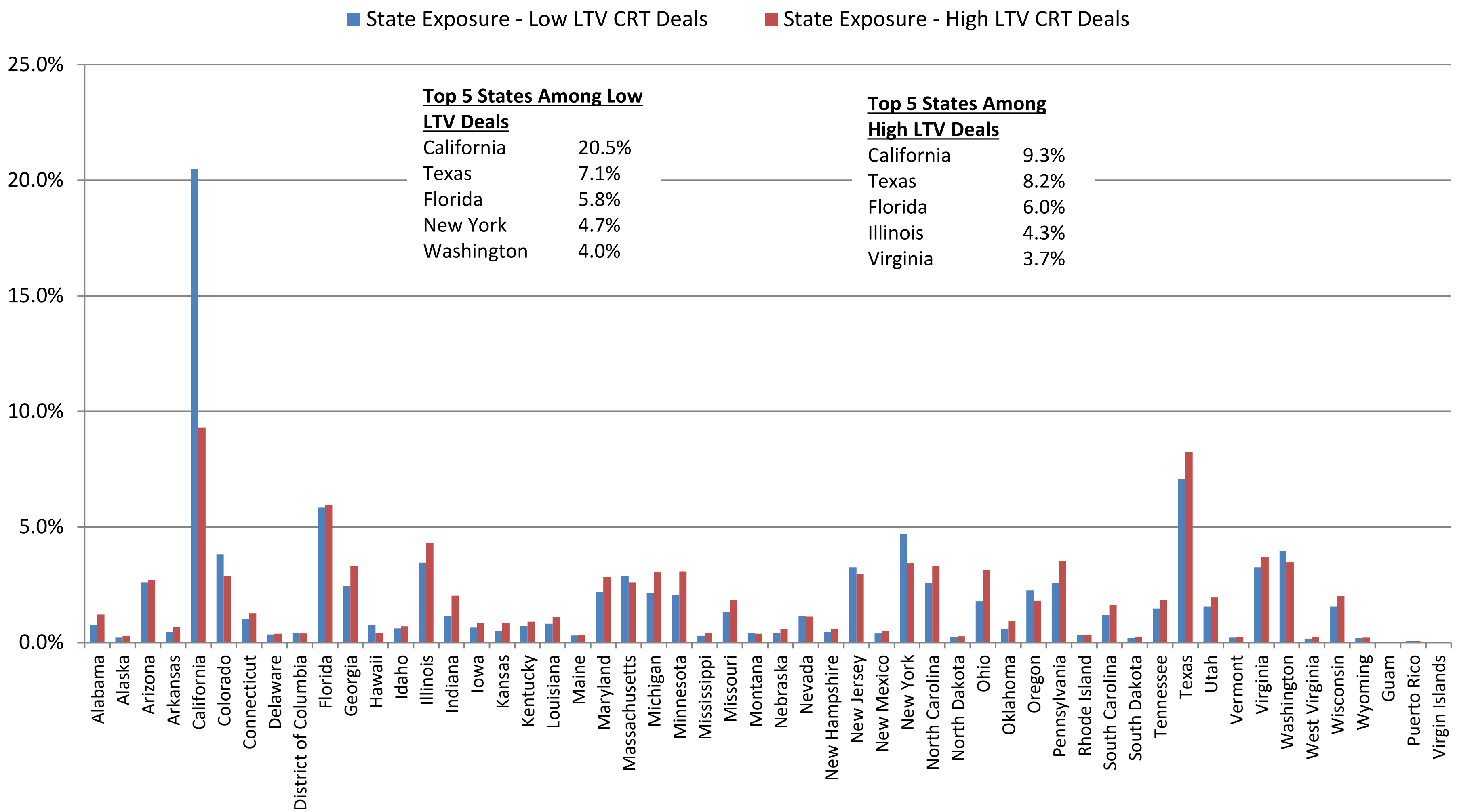
Source: 1010data, S&P Global Ratings, FBC

Geographical Distribution of CRT Collateral



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Sources: 1010Data, FBC, As of May 2020.

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