



# MONTHLY MARKET MONITOR

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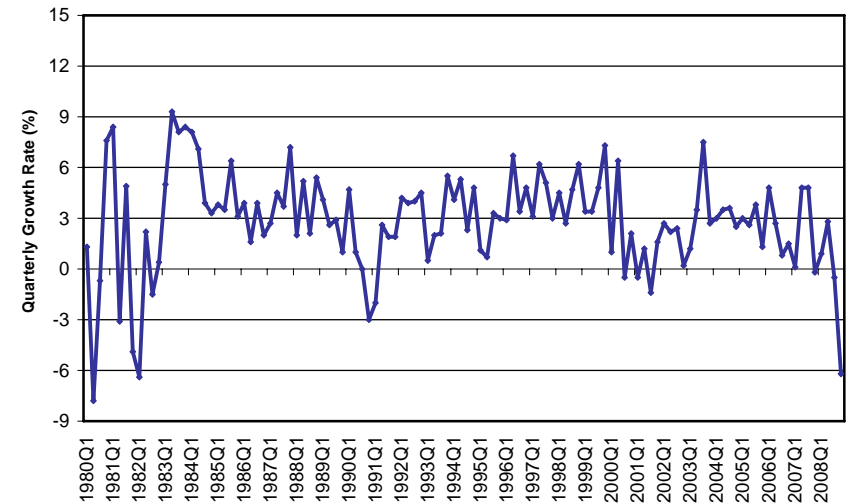
## INTRODUCTION

The severe economic downturn we discussed in last month's issue continues unabated and there isn't much to be upbeat about in recent news. January 2009 brought us a new president, a new administration, and much goodwill and optimism. The optimism has been severely strained by the continuous stream of disturbing economic news in housing, unemployment, GDP, exports and imports, personal income and personal spending (Chart 4). Even what appeared to be "good news" was really bad news. For example, the rise in the personal savings rate may have come about because consumers are becoming pessimistic and those who may wish to spend can't get credit from troubled banks. Similarly, the increase in existing home sales may be more the result of increases in supply and falling prices than any improvement in demand. The impact of the U.S. recession on the mortgage capital markets and loan performance will be addressed in the sections that follow. An analysis of the payment behavior of modified loans from subprime securitizations is also provided.

## GROSS DOMESTIC PRODUCT – GETTING BEHIND THE NUMBERS

**Real gross domestic product fell 6.2 percent in the fourth quarter of 2008.** The last time the nation's economy experienced a decline of this magnitude was in 1982 (Chart 1).

REAL GROSS DOMESTIC PRODUCT, AS OF 4Q 2008 (CHART 1)



SOURCE: BUREAU OF ECONOMIC ANALYSIS

A look at what lies behind this headline number reveals a discouraging trend. For example, consumer spending registered a worse-than-expected -4.3 percent. Capital expenditures, as measured by real private fixed domestic investment, were the weakest they had been in 28 years, coming in at -21.3 percent in the fourth quarter of 2008.

The St. Louis Fed's latest reading on the Total Business Inventory-to-Sales Ratio, at 1.44 percent, is the highest it has been since the 2001 recession, and the spike since August is virtually unprecedented in these

data (Chart 2). These results stem from the fact that the Commerce Department reported earlier this month that, while business inventories registered a month-to-month decline of 1.3 percent as of December 1, 2008, sales actually fell by 3.2 percent for the same period, exacerbating an already serious spike in the inventory-to-sales ratio depicted in Chart 2. However, the latest GDP revision showed a large drawdown in business inventories (\$191bn). This decline in inventories is very much greater than the decline in fourth quarter GDP. This suggests that the trend in the inventory-to-sales ratio will actually reverse itself the next time these data are published. However, it is likely that the level of this ratio will still be abnormally high, indicating that we should expect to see further serious cutbacks in output and increased layoffs in the first quarter of 2009.

preliminarily confirmed when the Labor Department announced on February 6<sup>th</sup> that nonfarm payrolls contracted further in January. After losing 584,000 jobs in November and 524,000 in December, the U.S. nonfarm sector lost another 598,000 jobs in January. The total number of persons unemployed rose to 11.6 million. This put the U.S. nonfarm unemployment rate at 7.6 percent, up from 7.2 percent in December. The unemployment rate is the highest it has been since 1992. Over the past year, the number of persons unemployed has risen by 4.1 million and the rate of unemployment has risen by 2.7 percentage points. Since the recession began in December 2007, the nonfarm sector has lost a total of 3.5 million jobs (Chart 3).

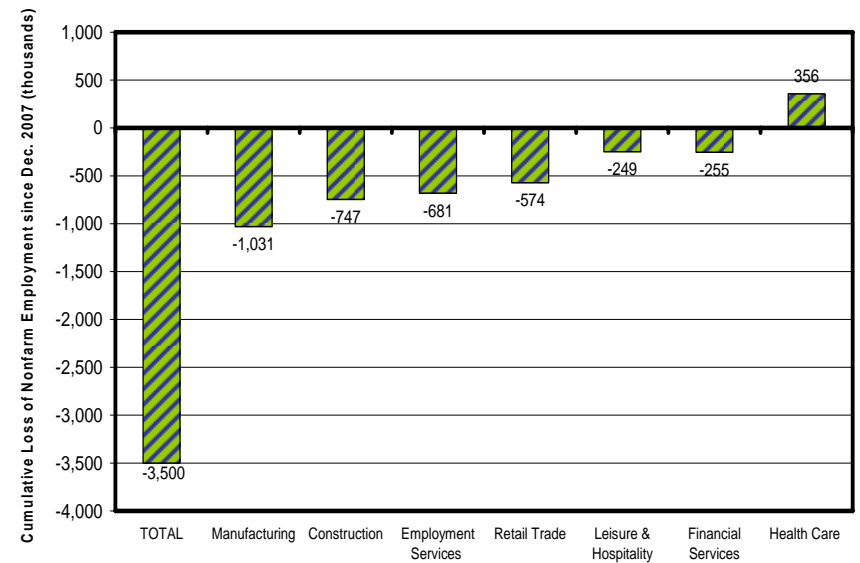
Aside from some very small gains in government and in education and health services, all components of the nonfarm sector lost jobs, especially in construction and manufacturing, both of which saw employment fall by 1.6 percent.

TOTAL BUSINESS INVENTORY-TO-SALES RATIO  
AS OF DECEMBER 2008 (CHART 2)



SOURCE: FEDERAL RESERVE BANK OF ST LOUIS

CUMULATIVE LOSS OF NONFARM EMPLOYMENT BY INDUSTRY  
AS OF JANUARY 2009 (CHART 3)



SOURCE: BUREAU OF LABOR STATISTICS

## LABOR MARKETS

**Employment fell and the unemployment rate rose in January.** The further deterioration in labor market conditions that was predicted in the prior discussions of consumer and inventory-to-sales ratio was

**ECONOMIC STATISTICS (CHART 4)**

	4 Qtr 2008	2008
GDP	-6.2%	+1.1%
Personal Consumption Exp.	-4.3%	+0.2%
Residential Investment	-22.2%	-20.7%
Non-residential Investment	-21.1%	+1.7%
Exports	-23.6%	+6.2%
Imports	-16.0%	-3.3%
Fed. Government Spending	+6.7%	+6.0%
Private Inventories	-\$19.9 billion	-\$27.6 billion
	Jan-09	Dec-08
Unemployment Rate	7.60%	7.20%
Non Farm Payrolls	-598k	-577k
Producer Price Index	0.80%	-0.18%
PPI less Food and Energy	0.40%	0.20%
Consumer Price Index	0.30%	-0.80%
CPI less Food and Energy	0.20%	unchanged

SOURCES: BUREAU OF ECONOMIC ANALYSIS AND BUREAU OF LABOR STATISTICS

**PERSONAL SAVINGS**

Another supposedly “positive” development was an increase in the personal savings rate in December 2008. But an increase in the rate of personal savings may not necessarily be much of a blessing. First, it has never been clear what this measure really means, due to key components of saving that are left out. Second, it is more important to know what is happening to wealth accumulation. Therefore, a low savings rate is not much of a concern when real and financial assets are appreciating; just as having a higher savings rate is of little comfort when asset prices are falling. Moreover, it may well be that a major reason that the savings rate is up is due to the effect of banks’ cutting credit lines and being more

cautious in issuing new credit cards. This is consistent with the latest data from the Federal Reserve’s *Senior Loan Officer Survey*, which shows that a net 59 percent of respondents reported tightening standards for credit cards. That means that nearly 80 percent reported tightening standards.

The personal savings rate, as a percentage of disposable personal income was 3.6 percent in December 2008, compared to 2.8 percent in November 2008. So we find households spending less at the height of the holiday season!

**INTERNATIONAL TRADE**

On February 11<sup>th</sup>, the Bureau of Economic Analysis (BEA) announced the U.S. international trade results for the month of December 2008. The data showed that the goods and services trade deficit for December was \$39.9 billion, down slightly from November’s \$41.1 billion. But the real story was a dramatic shrinkage of both imports and exports. Exports were \$133.8 billion in December, down \$8.5 billion from November’s \$142.3 billion. Imports, on the other hand, were \$173.7 billion in December, down \$10.2 billion from November’s level of \$183.9 billion. While, in dollar terms, imports shrunk more than exports, in percentage terms it’s a different story; exports contracted by 6.0 percent and imports by 5.5 percent. Additionally, while the sharp decline in the dollar value of imports was largely expected, due to the collapse of crude oil prices, the dramatic 6.0 percent decline in exports was not. These trade data underscore clearly that we are in a global slowdown.

**PERSONAL INCOME, SPENDING, AND PRICES**

Both personal income and personal spending declined in December. On February 2<sup>nd</sup>, the BEA announced that personal income fell -0.2 percent for December 2008; the consensus expectation had been -0.4 percent. At the same time, it announced that personal spending registered a reading of -1.0 percent, while the market had been expecting -0.8 percent. Thus, personal income declined less than expected, while



personal spending declined more than expected. The net result is that, in December 2008, the economy experienced a percentage decline in personal spending that was 5 times greater than the decline in personal income.

**The combined result of personal income declining less than expected and spending declining more than expected is an increase in personal savings.** This increase in the rate of savings is a symptom of negative conditions in the economy and growing pessimism with regard to the outlook. Consumers feeling less secure about their employment are spending less – saving for the rainy day. Those who might wish to borrow to make large purchases are finding it more difficult to obtain credit, because banks are less willing to lend. However, as consumers spend less, the demand for goods and services falls. This, in turn, increases business inventories unless businesses cut output by a similar or greater amount. An anticipated increase in inventories can only lead to manufacturing output cutbacks and layoffs, which, in turn lead to more pessimism, less spending and more savings. But an even bigger fear of this cycle of pessimism (more saving, less spending, less GDP, fewer jobs,, more saving, etc.) is that it could lead to a deflationary cycle. This increased personal saving and the unwinding of debt is at the core of the death spiral described by Irving Fisher as the “debt-deflation problem.”

**The general price level, meanwhile, continued to decline.** The Bureau of Labor Statistics reported a slight increase in the core Consumer Price Index (CPI) (excludes food and energy prices) from January 2008 to January 2009 of 1.7 percent. Meanwhile, the year-over-year results for whole sale prices, or the producer price index for the same period (not seasonally adjusted) are -1.0 percent for all finished goods, and 4.2 percent for all finished goods excluding food and energy.

**Why are falling prices so troubling?** As Irving Fisher pointed out in his classic 1933 *Econometrica* article on the *debt-deflation* cycle, during a speculative period (such as we recently experienced with housing)

people take on large amounts of debt to participate in the asset price appreciation. Then, when the prices of those assets start to fall, these same people try to unburden themselves of their debts (what we refer to today as de-leveraging). Unfortunately, the simultaneous unwinding of debt by a large number of individuals puts further downward pressure on the general price level. This, in turn, means that the de-leveraging becomes self-defeating, as the real value of the remaining debt may actually increase as its nominal value declines. Fisher called this the debt-deflation issue, and it was a very real problem in his day. Fisher advocated an aggressive monetary policy to restore the prior real values of debt contracts. And the fact that it was such a real problem in the 1930s goes a long way toward explaining why economists, in particular, those concerned with monetary policy, are so concerned about the potential problem of deflation today. The bottom line, however, is that the data are not giving us a clear answer on the question of whether we will or will not experience deflation.

Nevertheless, if we assume that the current rate of inflation is zero, and that the current rate of growth of GDP is -6.2 percent then a simple application of the so-called “Taylor Rule” suggests that the target Fed Funds rate should be somewhere in the neighborhood of -4 percent. The Taylor rule states that the target short-term interest rate is a function of the actual versus the desired rate of inflation, the actual versus the desired rate of growth of GDP and an assumed equilibrium interest rate. This result suggests that we are likely to see a zero Fed Funds rate for the foreseeable future.

David Malmquist, Financial Economist

## MARKET COMMENTARY

**Due largely to the Federal Reserve and Treasury’s recently implemented agency MBS programs, the agency market appears to be alive and doing well.** For 2008, total agency issuance was \$1.13 trillion, representing a volume on pace with that in 2007. Issuance volume of

agency (i.e., conforming) mortgage product is expected to be brisk in 2009, with gross agency issuance volume estimated to be approximately \$1.3 trillion. Issuance in 2009 will likely be dominated by 30- and 15-year fixed rate mortgage product and relatively little ARM product.

For 2008, total Government National Mortgage Association (GNMA) issuance was approximately \$270 billion, accounting for 24 percent of the total agency issuance, and surpassing the 21.4 percent and 21 percent shares for Fannie Mae and Freddie Mac, respectively. Like 2008, the GNMA will account for an increasing proportion of issuance, as the federal government continues to enhance existing and promulgate new Federal Housing Administration (FHA) loan-guarantee programs. GNMA MBS issuance has not surpassed Fannie Mae and Freddie Mac since the late 1980's and the aftermath of the Savings & Loan crisis where, like today, funding gaps for certain types of prime mortgages were evident. The Federal Home Loan Banks (FHLBs) had debt issuance volume of \$296 billion in 2008.

The growth in agency debt is driven by several factors. These factors include actions on the part of the Federal Reserve to keep rates low, thereby stimulating mortgage refinancing activity; the Federal Reserve's Term Asset-Backed Loan Facility (TALF), which is designed to foster increased market liquidity; and initiatives, such as loan modifications and foreclosure abatement, which are intended to temper a tepid housing market and motivate today's overly cautious mortgage market investors to purchase agency MBS.

**Since the collapse of the non-agency market, there have been few alternative financial products for mortgage market investors besides the agency market. One potential alternative is covered bonds.**

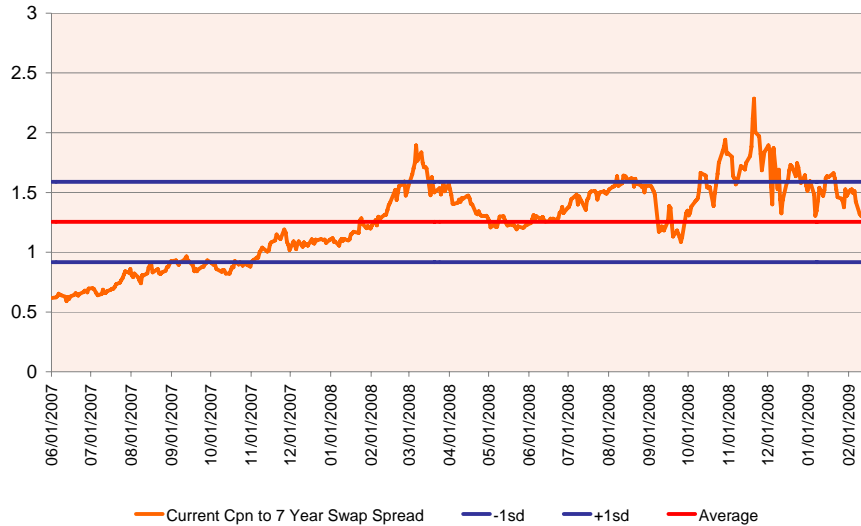
Covered bonds, like securitization via MBS, convert the mortgages on the bank balance sheets into a source of liquid funding for the bank. However, unlike the MBS case, in the case of the covered bond, the mortgages remain on the balance sheets of the bank, which requires the bank to hold capital against them and be responsible for any losses. As such, these bonds give the investor no exposure to the residential

mortgage market, since all payments on them are the responsibility of the bank. While these instruments are not new – they've had them in Europe for 200 years – they never gained popularity in the United States. One reason for this is the fact that it has never been clear whether the mortgages in the covered pool were beyond the reach of the FDIC in the event of failure resolution. The FDIC clarified this with its "Final Statement of Policy," issued July 15<sup>th</sup>, 2008, which stated, in effect, that the bonds in the pool, if they met certain criteria (such as having no negative amortization features, etc.), would be beyond the reach of the FDIC.

Despite the FDIC's clarification, an effort in July of last year by Treasury Secretary Paulson, representatives of other government agencies and market participants to kick-start a U.S. covered-bond market failed to go anywhere. One reason for this might be that the FDIC's Temporary Liquidity Guaranty Program (TLGP) has, at least for the moment, provided an unsecured source of funding that is more attractive than that offered by the terms of covered bonds today. However, the covered bond market will most likely receive renewed interest in the future when the TLGP expires.

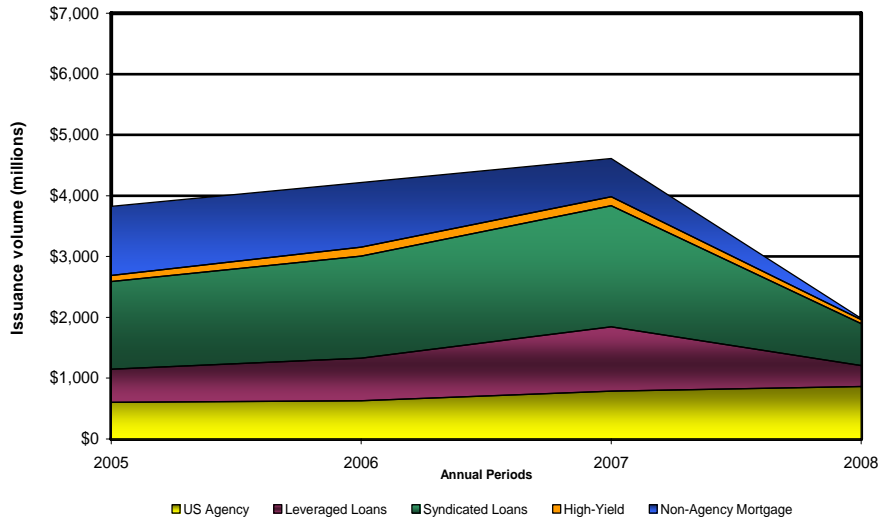
For those market participants looking for protection against the downside risk associated with home price depreciation, guaranteed agency debt continues to be an alternative due to the large mortgage basis relative to Treasury alternatives (see Chart 5). Other than the conventional agency market, activity in the credit markets is virtually non-existent (see Chart 6).

CURRENT MORTGAGE COUPON RELATIVE TO 7-YEAR SWAP (CHART 5)



SOURCE: BLOOMBERG, LP

TOTAL ISSUANCE VOLUME (CHART 6)



SOURCE: BLOOMBERG,

Over the period 2000 to 2004, agency MBS issuance dwarfed non-agency MBS. On average, agency issuance was 3.4 times greater during these years. However, during 2005 and 2006, as Fannie Mae and Freddie Mac were placed under greater capital constraints by OFHEO (its regulator at the time), non-agency issuance rose to almost two times the volume of agency paper. Much of the non-agency product (i.e., private label) consisted of “yield-enhancing” non-prime and prime-jumbo, as well as innovative “affordability” products such as Alt-A mortgages, option ARMs, and sub-prime mortgages, all packaged in monoline insurance wrappers. The non-agency market has essentially evaporated. There has also been a significant retrenchment in the leveraged, syndicated loan and high-yield debt markets. The funding gap of approximately \$2.6 trillion likely will remain an impediment to government efforts to re-start the credit markets, and is an indicator that the current crisis is not limited just to the mortgage market but impacts all credit markets.

**While many policies have recently been implemented in an attempt to stimulate the economy, the question remains as to whether these new policies will be effective..** One of the indicators of the health of the mortgage market is the delinquency rate on conforming fixed-rate 15-year mortgages, a rate that traditionally is low, fairly stable, and displays a seasonal pattern. Because the view is commonly held that conforming 15-year mortgages are used by relatively conservative borrowers with good credit histories, a noticeable increase in the delinquency rate for these mortgages would be cause for heightened concern.

In today’s market, there are several reasons why a borrower with a 15-year mortgage might have an incentive to refinance or roll into a new 30-year mortgage. On the surface, conditions appear to be quite favorable for increased mortgage refinancing activity and for new home purchases. Home prices have fallen by over 21 percent nationally since the peak period of 2005-2006, interest rates are low and there are lenders willing to make loans to credit-worthy borrowers. Moreover, the potential exists to lower monthly payments dramatically by switching from a 15-year to a 30-year mortgage, with virtually no cash outlay by the borrower.

However, today most homeowners, those with good and bad credit alike, face similar dilemmas: the inability to refinance due to dramatically lower home values, expected additional home price declines of over 10 percent and stricter underwriting standards.

The delinquency rate on conforming 15-year mortgages could be viewed as a leading indicator of emerging weakness in other sectors of the economy, and a red-flag that policy actions are not working and that fundamental weaknesses in the economy are broader and deeper than heretofore believed. Chart 7 shows that there was a substantial increase (approximately 60 bps) in the total delinquency rate on conforming 15-year mortgages between August and November of 2008. At this point, it is too early to draw any definitive conclusions about the implications of this increase. There is a seasonal rise in the delinquency rate for mortgages that occurs during the fall, although the seasonal increase in the delinquency rate for conforming 15-year mortgages in 2008 was much larger than has been the case historically.

We believe that even creditworthy mortgagors are beginning to feel the negative effects of the recession and that the delinquency rate on 15-year mortgages (typically a mortgage product with very low delinquency rates) may continue to be a good barometer of the success of policy actions. We expect to see a decline in the delinquency rate in the coming months, but believe that the spring and fall of 2009 will show significantly higher delinquency rates for both 15- and 30-year conforming and non-conforming mortgages.

The rise in the total delinquency rate on 15-year mortgages suggests that the recession is getting worse and that more forceful actions are needed with regard to employment, tax-relief, and economic stimulus. One idea that has been put forth is tax-loss carry-backs for mortgagors in particularly hard-hit areas, or even nationally. Tax-loss carry-backs would allow the borrowers to “claw-back” some of the taxes paid in previous years based on new appraisal values and could result in increased consumer spending.

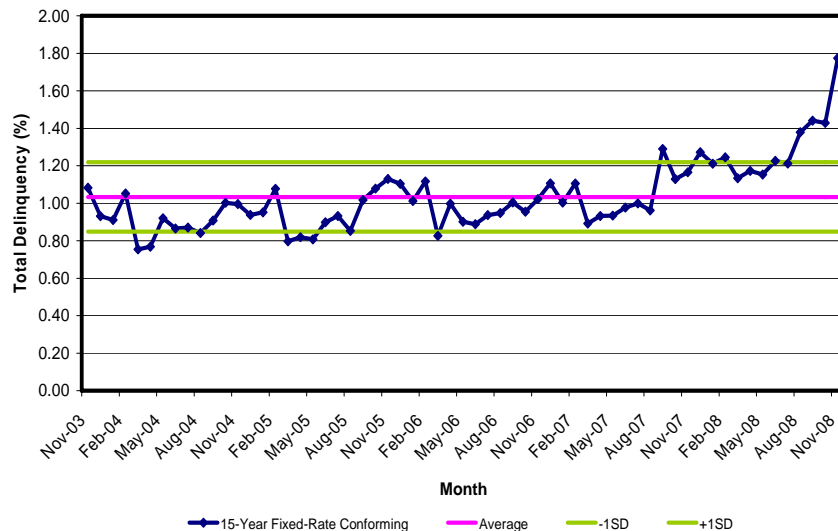
Tom Day, Managing Director, Risk Management

### REDEFAULT RATES OF SUBPRIME LOAN MODIFICATIONS

The analysis of subprime loan modifications and their post-modification performance is based on 125,984 securitized subprime loans modified in November 2006 through November 2008, as provided by First American Loan Performance and standardized by CPR/CDR Technologies Inc. The key findings are summarized as follows:

**Broadly defined, loan modifications have been utilized since November 2006, when traditional loan forbearances, or repayment plans, were offered to a relatively small number of borrowers.** These plans add the missed payments and other delinquency costs to borrowers’ principal balances and, in some cases, make minor adjustments to interest rates. Typically, the added costs equal 2.5-7.5 percent of the loan principal balances.

15-YEAR CONFORMING FIXED-RATE MORTGAGE (CHART 7)



SOURCE: LOAN PERFORMANCE

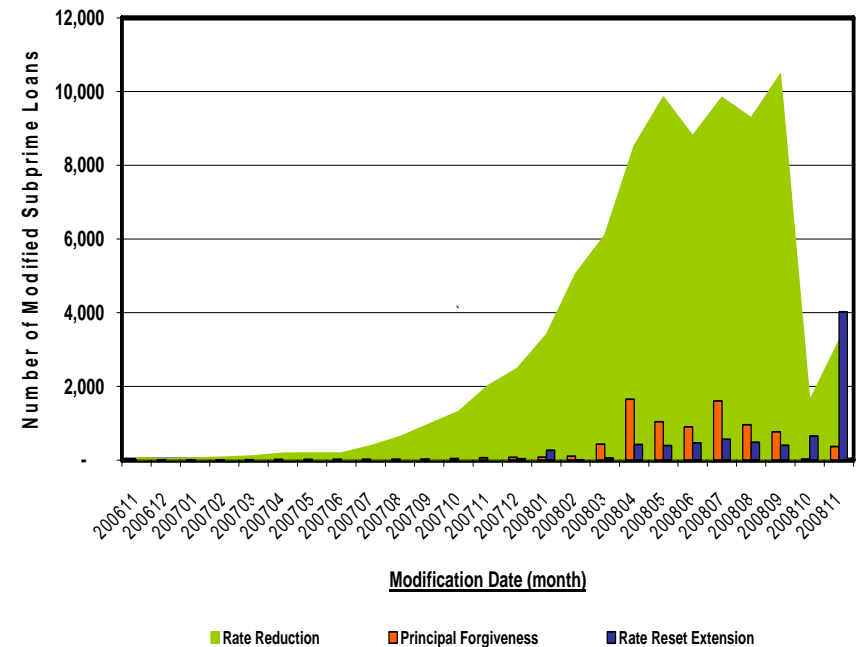
More aggressive modification approaches began appearing in increasing numbers after HOPE NOW<sup>1</sup> was introduced in late 2007. These modifications account for the vast majority of the modified loans in First American Loan Performance's survey. They include three main approaches being used. (Chart 8):

- **Interest Rate Reduction** accounts for 64 percent of the total modified loans. The interest rate reductions are concentrated in the range of 100 to 500 basis points, while the single largest group of borrowers received a 201-300 basis point reduction.
- **Principal Forgiveness** accounts for 6 percent of the total modified loans. The portion of principal balances forgiven varies widely from 1 to over 40 percent.
- **Rate Reset Extension** accounts for 6 percent of the total modified loans. The majority of the extensions of initial interest rate reset dates are 4 years.

The remaining 24 percent include repayment plans and actions not specified by lenders.

The risk profile of the modified loans is greater than that of the loans without modifications. The modification to non-modification comparatives are 611 vs. 625 in FICO, 83 percent vs. 81 percent in LTV, and 43 percent vs. 41 percent in debt-to-income back end ratio, respectively. Subprime loans modified with principal forgiveness have the highest LTV at origination at 86 percent.

GROWTH OF MODIFIED SUBPRIME LOANS BY MODIFICATION TYPE AS OF NOVEMBER 2008 (CHART 8)



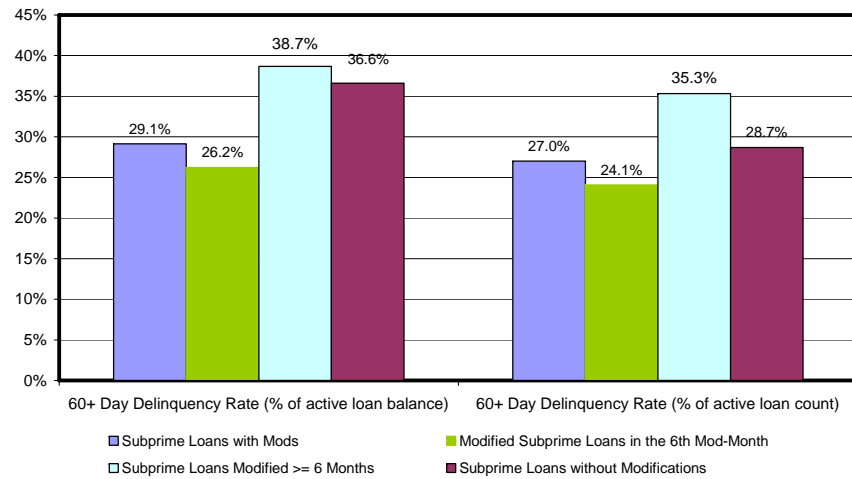
Source: Loan Performance

As measured by the serious delinquency rate<sup>2</sup>, the redefault rate on subprime loans with modifications is 27 percent (within the first six months of modification) (Chart 9). Six months after modification, the redefault rate on these loans rises to 35 percent. This compares to a serious delinquency rate of 29 percent for all subprime loans without modifications. However, it is important to note that most of the modified loans had delinquency problems prior to modification.

<sup>1</sup> HOPE NOW is an alliance between counselors, mortgage market participants, and mortgage servicers to create a unified, coordinated modification plan to reach and help as many homeowners in distress as possible. The alliance was formed in October 2007 with the encouragement of the Department of the Treasury and Department of Housing and Urban Development.

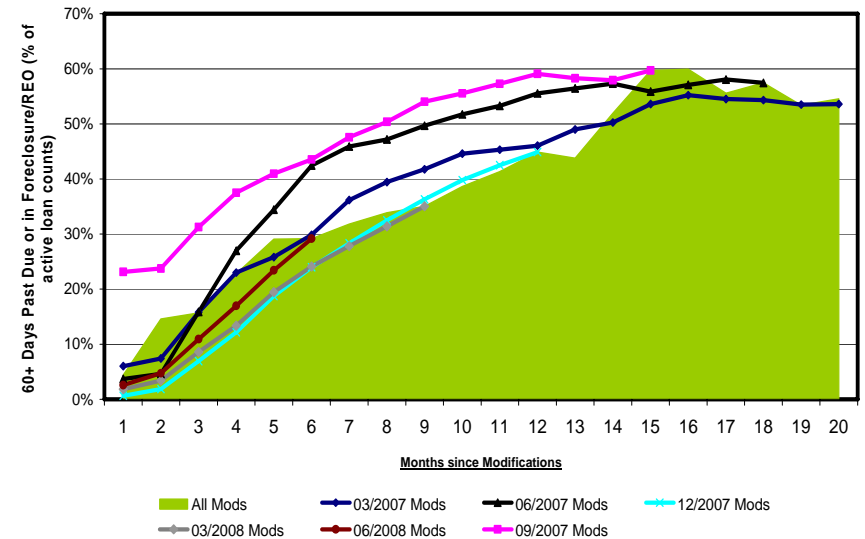
<sup>2</sup> The serious delinquency rate is defined as percent of loans that are at least 60 days past due or in foreclosure/REO.

SERIOUS DELINQUENCY RATES OF SUBPRIME LOANS WITH MODS VS. SUBPRIME LOANS WITHOUT MODS, AS OF NOVEMBER 2008 (CHART 9)



Source: Loan Performance

REDEFAULT RATE OF SUBPRIME MODIFICATIONS ADJUSTED FOR SEASONING EFFECT AS OF NOVEMBER 2008 (CHART 10)

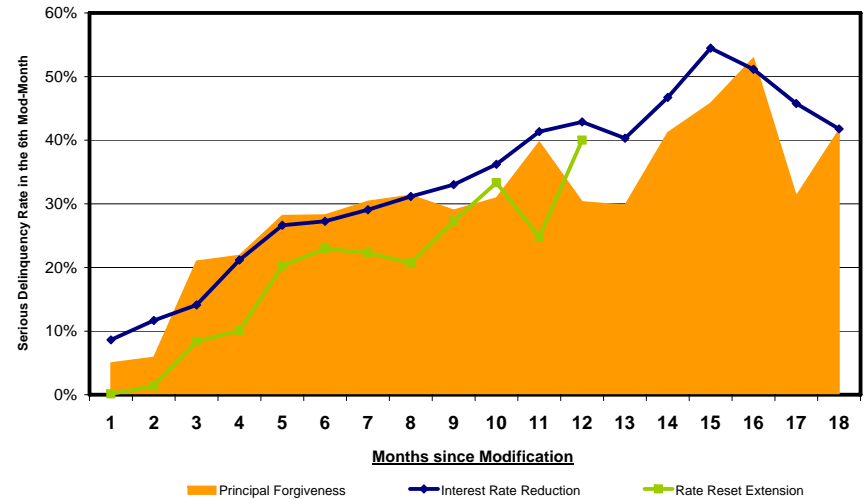


Source: Loan Performance

The redefault rates (as measured by serious delinquency rate) vary substantially by when the modification is completed and the size of the modification.

- The redefault rates of those loans modified (mainly through repayment plans in 2008) have outperformed those modified in 2007 — for every month they are seasoned (Chart 10).
- At six months, rate-reset-extension plans appear to have better post-modification performance than either principal-forgiveness plans or interest-rate-reduction plans. The redefault rates at month 6 after modifications for these plans are: 23 percent for rate reset extension, 28 percent for principal reduction, and 27 percent for interest rate reduction (Chart 11).
- A 100-basis-point reduction in the mortgage rate can lower the redefault rate of modified loans by about 2 percentage points. A 10-percent reduction in principal balances can reduce the redefault rate by approximately 5 percentage points (Charts 12 and 13).

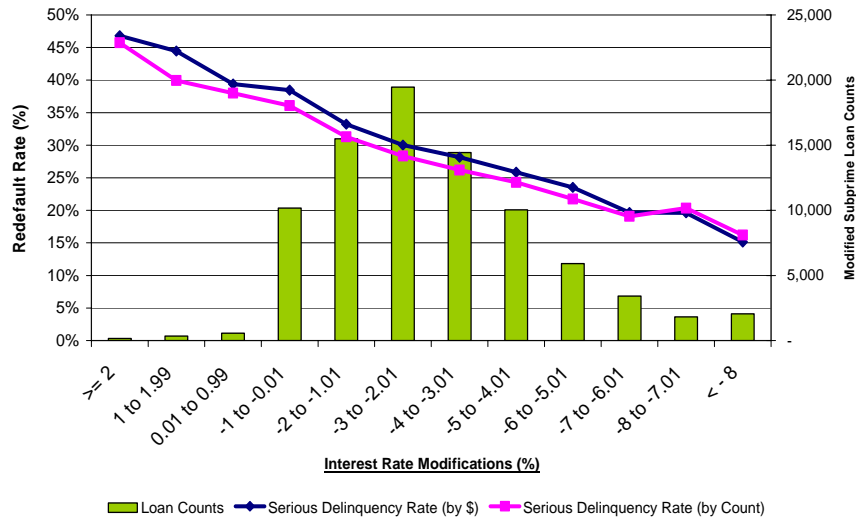
MAJOR MODIFICATION TYPES AND THEIR REDEFAULT RATES AS OF NOVEMBER 2008 (CHART 11)



Source: Loan Performance

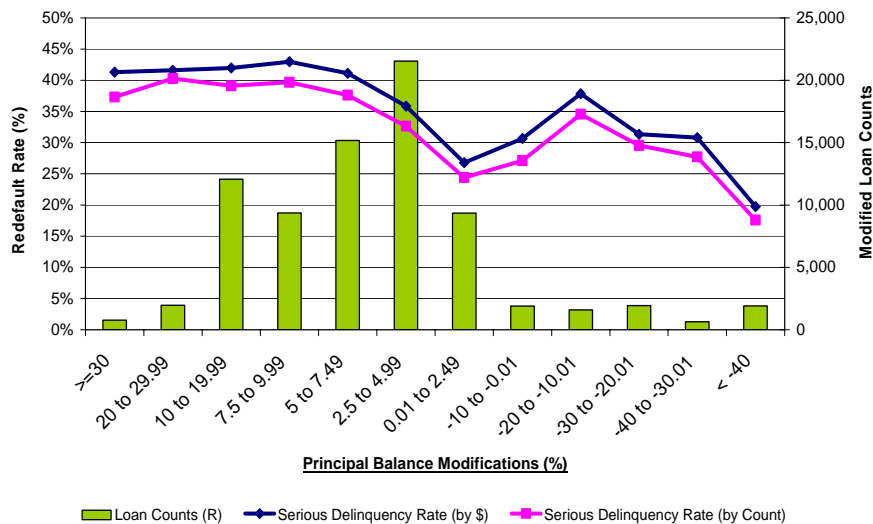


REDEFAULT RATE OF SUBPRIME LOANS WITH INTEREST RATE MODIFICATIONS AS OF NOVEMBER 2008 (CHART 12)



Source: Loan Performance

REDEFAULT RATE OF SUBPRIME LOANS WITH PRINCIPAL MODIFICATIONS AS OF NOVEMBER 2008 (CHART 13)

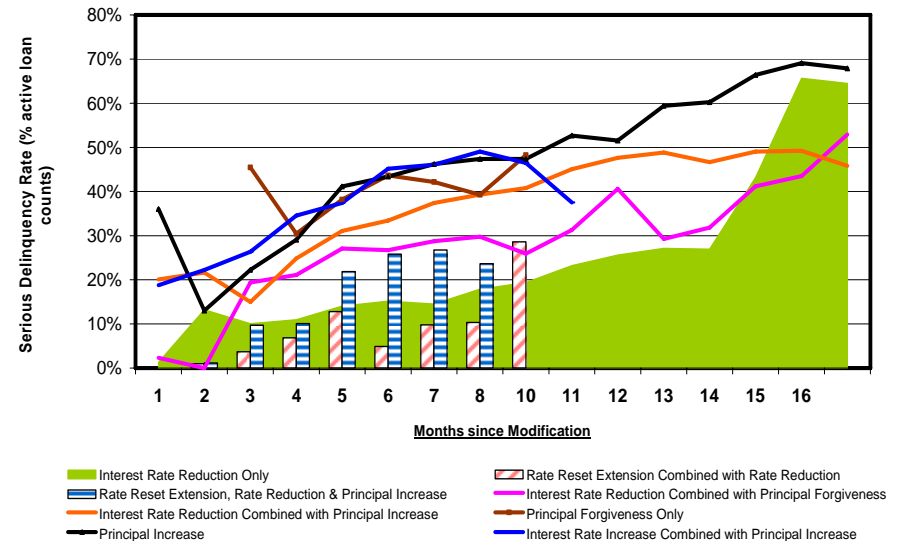


Source: Loan Performance

In practice, a subprime loan borrower may be offered a hybrid plan that combines various modification approaches (Chart 14). Presented below are some examples of various approaches and their respective shares of all loan modifications:

- 40 percent of all subprime modifications consist of interest rate reductions combined with a repayment plan (principal increase).
- Other types of practices include rate reduction only (17 percent), repayment plan or principal increase (11 percent), rate reduction combined with principal forgiveness (5 percent), rate reset extensions only (3 percent), rate reset extensions with various forms of combinations (2.7 percent) and principal forgiveness only (0.7 percent).
- The remaining 20.6 percent are mainly the loans flagged by banks as modifications but with specific modification actions unknown. These unspecified modifications may likely include modifications such as the extension of the maturity date for amortization.

DETAILED CLASSIFICATIONS OF SUBPRIME LOAN MODIFICATIONS AND THEIR REDEFAULT RATES, AS OF NOVEMBER 2008 (CHART 14)



Source: Loan Performance



**The more effective loan modification approaches (based on limited data)** are rate reset extension with rate reduction; interest rate reduction only; rate reset extension with rate reduction and principal increase; and rate reduction with partial principal forgiveness. For instance, at month six after modification, the redefault rates of the four approaches are 5 percent, 15 percent, 26 percent, and 27 percent, respectively (Chart 14).

**In contrast, the least effective modification approaches tend to be those associated with repayment plans.** Regardless of whether they are principal-balance-increase-only or principal-increase-with-rate-reduction, or rate-increase plans, repayment plans appear to demonstrate consistently higher redefault rates than the aforementioned more effective practices.

Zhong Yi Tong, Market Economist

## LOAN PERFORMANCE AND LOSS SEVERITY

This section provides an analysis of detailed and timely data on U.S. residential loan performance and loss severity, stratified by mortgage borrower types, product types, vintages and loan ages. The analysis is based on 41.8 million active loans from the First American Loan Performance Servicing database and 7.3 million active loans from First American Loan Performance Securities database as standardized by the CPR/CDR Technologies Inc.

Residential loan performance is measured by the serious delinquency rate, i.e., percent of active loan dollar balances that are at least 60 days past due or in foreclosure/REO in a given month. The mortgage loss severity refers to total losses as a result of liquidations in a given month, expressed as the percent of unpaid principal balances at default, or cents

on the dollar<sup>3</sup>. Data for both measures are calculated for first liens only. The key findings as of December 2008 are summarized as follows:

- **The rate of serious delinquencies has been steadily increasing since about the first quarter of 2007.** As illustrated in Charts 15 and 16, by December 2008, the serious delinquency rate reached 43.7 percent for subprime, 23.1 percent for Alt-A, and 5.7 percent for prime mortgages. The serious delinquency rate of 5.7 percent for prime represents a 0.5 percentage point increase from November 2008, and is the largest monthly increase for this category on record. By product type, serious delinquency rates were 31.9 percent for option ARMs, 15.5 percent for other ARMs, and 4.9 percent for fixed rate mortgages. These increases are 2.4, 1.1 and 0.4 percentage points, respectively, from November, and were each either the largest or second-largest monthly increase on record.
- **Loan performance varies substantially by vintage (when the loan was originated), with the 2007 vintage being the worst and the 2003 vintage the best.** Charts 17-20 depict serious delinquency rates by vintages and loan age for various loan types (jumbo, Alt-A, subprime and option ARMs) as of December 2008<sup>4</sup>. The findings indicate that the 2007 vintage has the worst performance, followed by the 2006, 2005 and 2004 vintages. The 2003 vintage appears to be the best performer regardless of loan type. For example, as of December 2008, the serious delinquency rates for option ARMs seasoned for 18 months are 0.4, 0.7, 2.7, 12.7 and 18.9 percent for the 2003-2007 vintages, respectively.

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<sup>3</sup> Delinquent interest and taxes, REO management costs, sales commissions and other costs, as well as MI recoveries from private mortgage insurance companies, are all included in the loss severity computations.

<sup>4</sup> The 2003-2007 vintages are examined in this analysis. The 2008 vintage is not included in this examination because of its small sample size as shown in the LP Securities database.

- **Chart 21 shows loss severity over time for jumbo, Alt-A, subprime and option ARM loans.** As of December 2008, subprime loans continued to exhibit the severest loss rate (64.7 cents on the dollar) among all types of loans examined, followed by option ARMs (53.7 cents on the dollar), Alt-A (52.8 cents on the dollar) and jumbo (38.6 cent on the dollar). As compared to a month earlier, the loss rates increased by 2.4, 2, 1.6, and 1.1 cents on the dollar, respectively.
- **The 2007 vintage has the highest loss severity rate among loans originated since 2003.** Charts 22-25 show the loss severity as of December 2008 for jumbo, Alt-A, subprime and option ARM loans by vintage and age of loan. Regardless of loan type, the 2007 vintage has lost the most in nearly every month of aging.<sup>5</sup> It is followed by the 2006 and 2005 vintages. The 2003 and 2004 vintages have lost the least among all vintages examined. For example, the findings indicate that the loss severity of Alt-A loans at an age of 18 months is 20.8, 18.7, 22, 44, and 52.7 cents on the dollar for the 2003-2007 vintages, respectively.

Zhong Yi Tong, Market Economist

## CONCLUSION

**In this issue of the Monthly Market Monitor, we covered three main areas:** We gave our interpretation of recent news on the macro economy, including developments in gross domestic product and other aspects of the national income and product accounts, labor markets, prices at the producer and consumer level and international trade. We also covered developments in the credit markets, especially those aspects connected to mortgage finance. Finally, we looked at data related to the mortgage loan performance and loss severity, as well as the redefault rates on subprime mortgage modifications. The effectiveness of various loan

modification approaches are identified and discussed based on the data we have obtained thus far.

The GDP data were dismal, and the more we probed into the causes, the gloomier the outlook. In the credit markets, there are a few positives, including the revival of the agency MBS market due to the Fed's efforts to keep rates low and to the TALF. A serious negative is that the private-label MBS market is still moribund. Another negative factor is that subprime mortgage modifications do not appear to be very successful.

SOURCE FOR CHARTS 15-25: FIRST AMERICAN LOAN PERFORMANCE AND CPR/CDR TECHNOLOGIES INC.

NOTE: DATA USES ACTIVE LOAN DOLLAR BALANCES OF FIRST LIENS ON A MONTHLY BASIS; DATA FOLLOWS THE MBA DEFINITION OF DELINQUENCY.

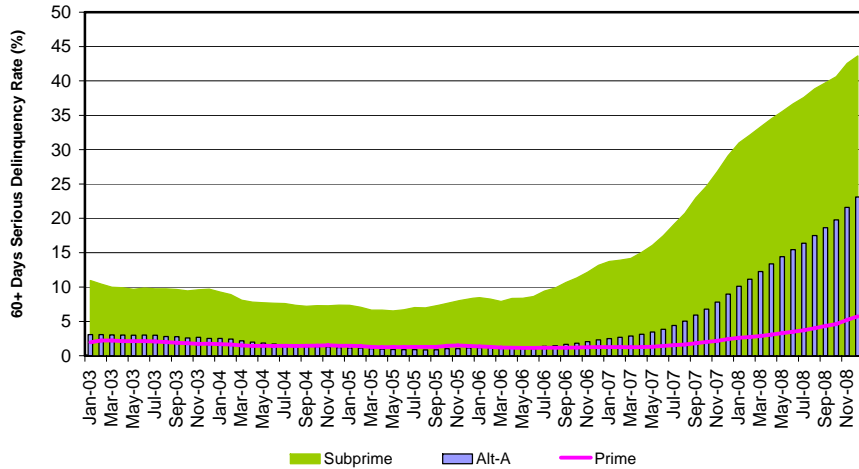
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<sup>5</sup> These charts also show a few spikes of loss severity at the beginning or end of the loan age series. These spikes are caused by a very small number of losses that occurred and therefore should be treated as outliers to be ignored.



SERIOUS DELINQUENCY RATES BY INTEREST RATE & BORROWER TYPES

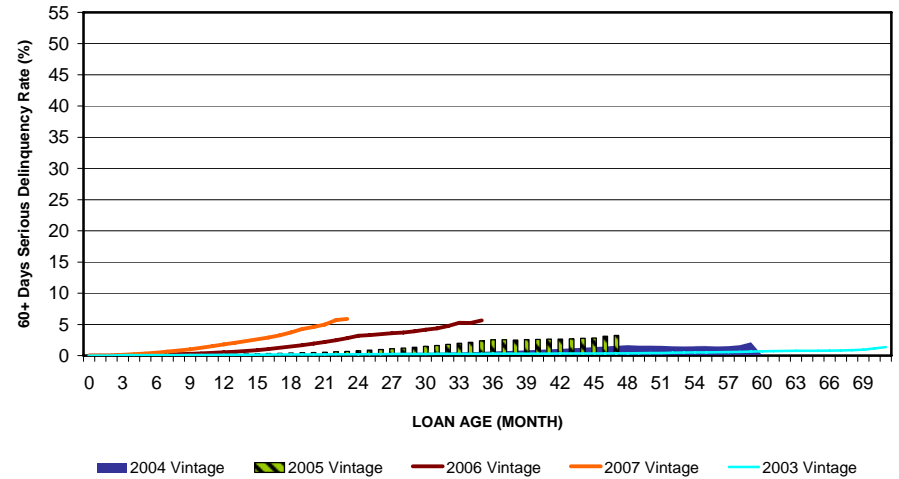
MORTGAGE LOAN PERFORMANCE BY BORROWER TYPE  
AS OF DECEMBER 2008 (CHART 15)



SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

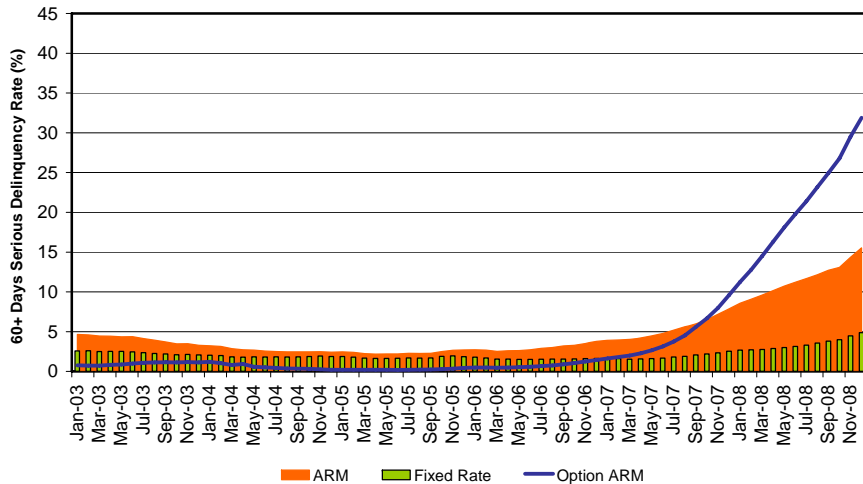
NATIONAL SERIOUS DELINQUENCY RATES BY VINTAGE

LOAN PERFORMANCE BY VINTAGE AND LOAN AGE: JUMBO  
AS OF DECEMBER 2008 (CHART 17)



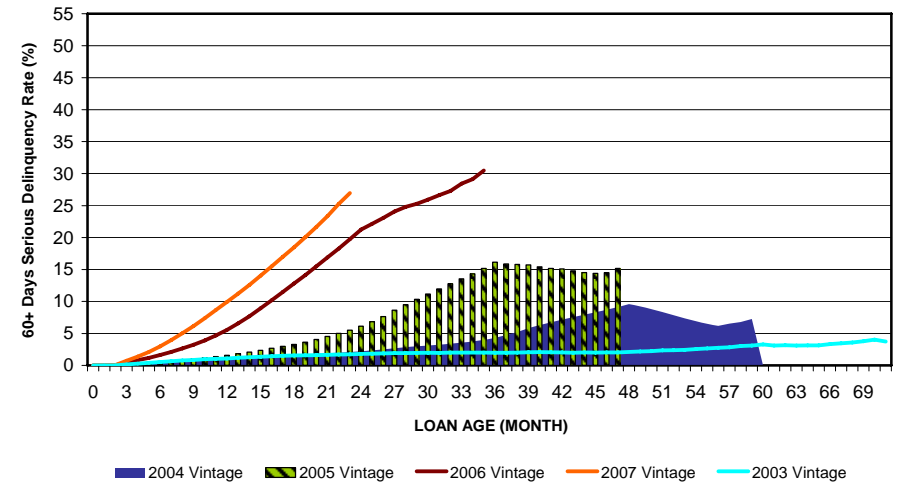
SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

MORTGAGE LOAN PERFORMANCE BY PRODUCT TYPE  
AS OF DECEMBER 2008 (CHART 16)



SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

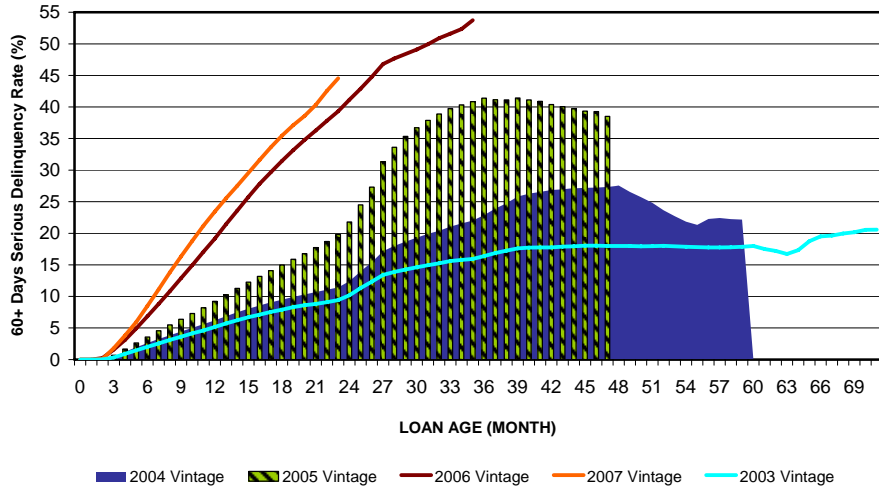
LOAN PERFORMANCE BY VINTAGE AND LOAN AGE: ALT-A  
AS OF DECEMBER 2008 (CHART 18)



SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR



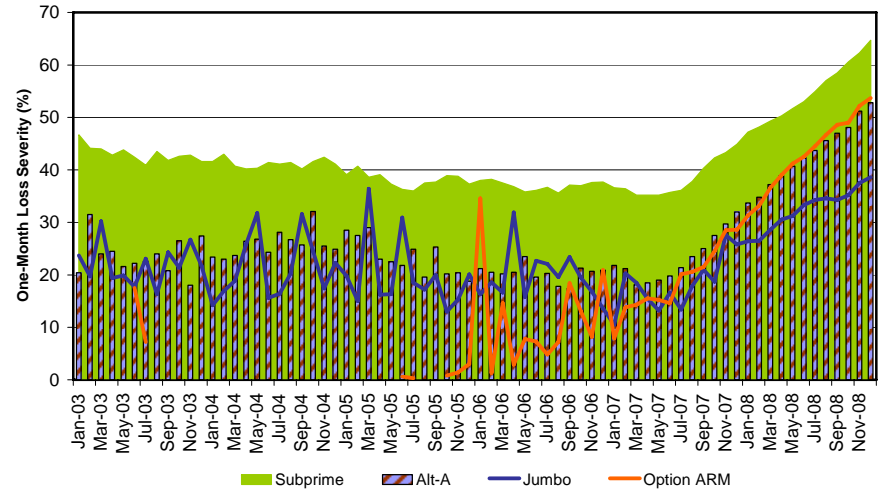
LOAN PERFORMANCE BY VINTAGE AND LOAN AGE: SUBPRIME  
AS OF DECEMBER 2008 (CHART 19)



SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

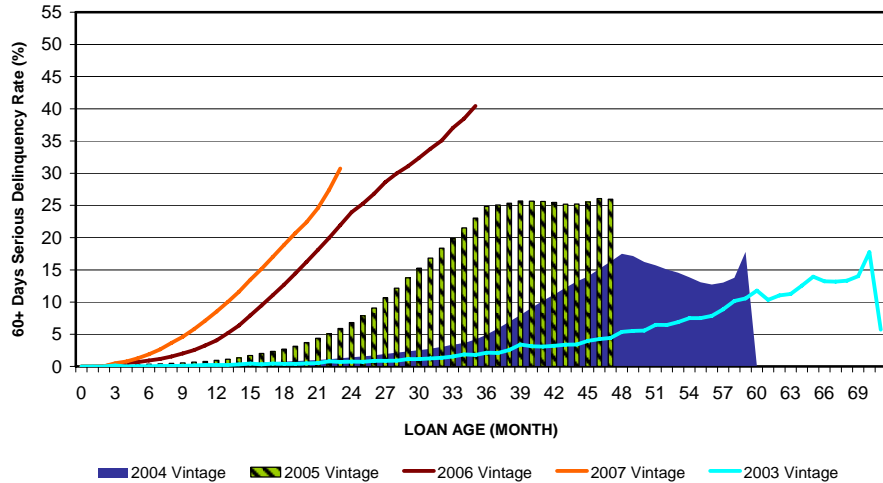
NATIONAL LOSS SEVERITY BY LOAN TYPE AND VINTAGE

LOSS SEVERITY BY LOAN TYPE, AS OF DECEMBER 2008 (CHART 21)



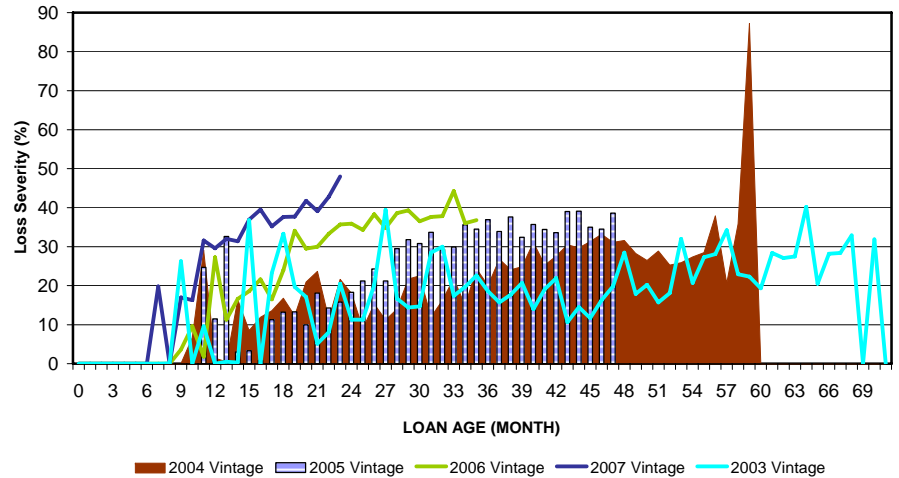
SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

LOAN PERFORMANCE BY VINTAGE AND LOAN AGE: OPTION ARM  
AS OF DECEMBER 2008 (CHART 20)



SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

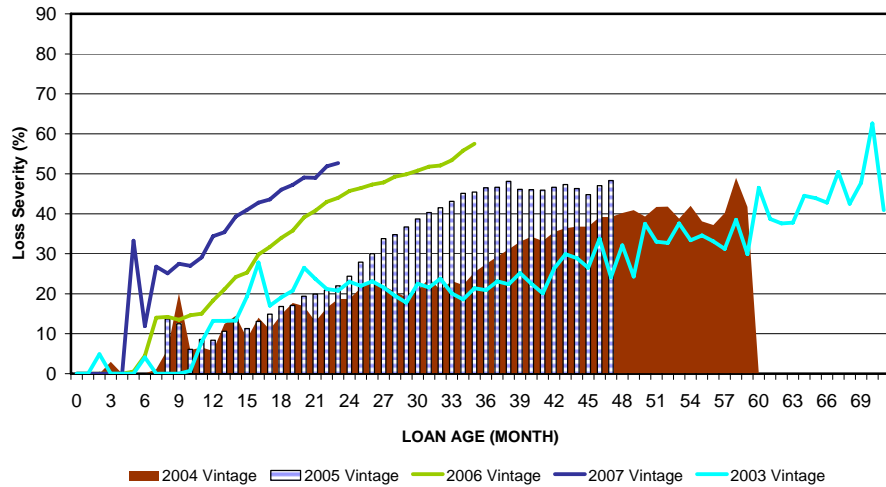
LOSS SEVERITY BY VINTAGE AND LOAN AGE: JUMBO  
AS OF DECEMBER 2008 (CHART 22)



SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

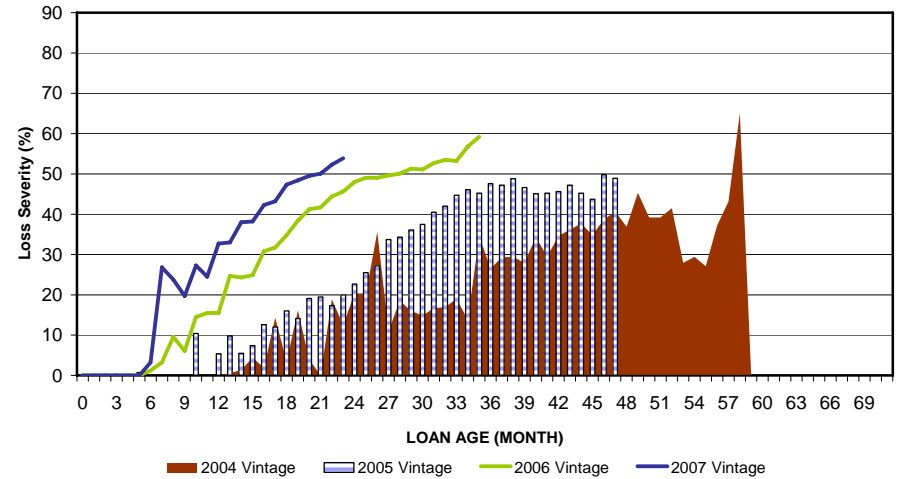


LOSS SEVERITY BY VINTAGE AND LOAN AGE: ALT-A  
AS OF DECEMBER 2008 (CHART 23)



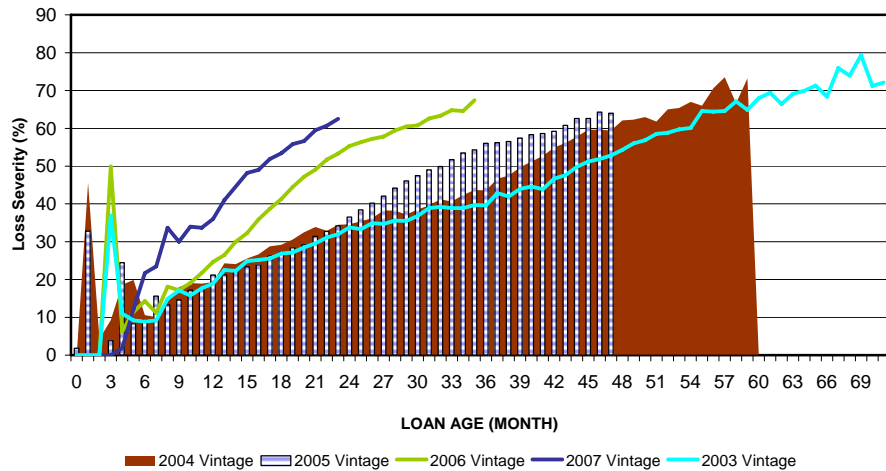
SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

LOSS SEVERITY BY VINTAGE AND LOAN AGE: OPTION ARM  
AS OF DECEMBER 2008 (CHART 25)



SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

LOSS SEVERITY BY VINTAGE AND LOAN AGE: SUBPRIME  
AS OF DECEMBER 2008 (CHART 24)



SOURCE: FIRST AMERICAN LOAN PERFORMANCE & CPR/CDR

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