



Freddie Mac and Fannie Mae Announce the Purchase of Seriously Delinquent Loans – Effects within BondEdge

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Background

In February, Freddie Mac announced that it would “purchase substantially all 120 days or more delinquent mortgage loans from the company’s related fixed-rate and adjustable-rate (ARM) mortgage Participation Certificate (PC) securities”.¹ The purchases took place in early March with corresponding principal payments to pass through to investors on March 15 and April 15, 2010.

According to information released by Freddie Mac,² as of December 31, 2009, the unpaid balance for delinquent fixed rate loans is \$49.824 billion. This represents a 120+ day delinquency rate³ of 2.46%. Fixed rate pools issued in 2007 with 6.0% and 5.5% net coupon rates are the most affected. For adjustable rate mortgages, the unpaid balance for delinquent loans is \$19.147 billion, representing a 120+ day delinquency rate of 12.54%. Initial interest adjustable rate pools issued in 2007 and 2006 with net coupons of 6.0% and 5.5% are the most affected.

Similarly, Fannie Mae announced their plans to purchase 120 day or more delinquent loans.⁴ As of December 31, 2009, the unpaid outstanding balance of 120+ days Fannie Mae pools was approximately \$127 billion. Of that, approximately \$82 billion were 30-year fixed rate pools (with the CL prefix). According to its announcement, Fannie Mae anticipates purchasing approximately 150,000–200,000 loans from MBS trusts in the month of March and expect that they will continue purchasing loans in each of the subsequent few months until they have substantially reduced the current population of loans that are four or more months delinquent.

Furthermore, Fannie Mae will prioritize their purchases based on mandatory purchases (such as modified loans and loans that become 24 months delinquent), loans in MBS having the highest MBS pass-through rates, loans backing CL or CI prefixes, and lastly, loans having the highest unpaid principal balances. CL pools issued in 2007 with 5.5% to 7.0% net coupon rates will be the most affected.

Effects within BondEdge[®]

For investors in Freddie Mac and Fannie Mae pools with 120+ day delinquent loans, the purchase of delinquent loans may result in a short term spike in prepayments. This will automatically be reflected within BondEdge when new factor, balance and weighted loan characteristics are updated by these Government Sponsored Enterprises (GSEs). Consequently, BondEdge risk measures and analytic reporting, including Performance Attribution, will incorporate the actions taken by the GSEs.

However, at this time there will be no modifications to the BondEdge prepayment model as a result of the decision made by Freddie Mac and Fannie Mae to purchase severely delinquent loans. There are two main reasons for this decision. First, the GSEs do not currently publish delinquency rates at a pool level and therefore, the affected pools cannot be identified. Second, the action announced by the GSEs is temporary in nature and is anticipated to last for a short period of time.

As a result of the GSEs’ decision described above, short term prepayment projections within Dynamic Asset Cash Flow could be slower than actual prepayments for affected pools. In addition, the projected prepayment speeds (both lifetime and 12-month) within BondEdge will temporarily be slower than actual prepayments for affected pools based on the purchasing activity of the GSEs. This may also temporarily impact the risk measures, such as option adjusted duration, for affected pools since they may not be based on a short term spike in actual prepayments.

¹ See Freddie Mac’s announcement as of February 10, 2010 – www.freddiemac.com/news/archives/mbs/2010/20100210_pc_securities.html

² See www.FreddieMac.com/mbs/docs/delinquencyrates_021010.pdf

³ The delinquency rate is calculated as the number of delinquent loans divided by the total number of loans in the relevant PC category.

⁴ Refer to Fannie Mae’s announcement on March 1, 2010 – www.fanniemae.com/newsreleases/2010/4960.jhtml?p=Media&s=News+Releases

In Summary

As stated above, the purchases by Freddie Mac should be completed by April 2010. The Fannie Mae purchases also began in March and likely persist for several months. At this time, our prepayment model may not reflect the agency purchases of 120+ day delinquent loans, and this may lead to a short term underestimation of actual prepayment for affected pools. However, pools without 120+ day delinquent loans will continue to benefit from the consistency in analytical treatment of projected prepayments.

Please note that clients are free to update the BondEdge prepayment assumptions in a variety of ways – such as through the Prepayment Matrix, User Scaling of the prepayment model, or through the Security Calculator on a single security basis. However, please be aware that such modifications affect the lifetime prepayment assumption, and not only the short term spike in prepayments that may occur as a result of GSEs purchases of severely delinquent loans.

Finally, we are considering the activation of additional prepayment model functionality that would allow the specification by clients of default or prepayment vectors.

Please feel free to contact your Analytic Consultant, Client Services or email me directly at william.burns@interactivedata.com if you have any comments, questions or concerns.

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