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A CLOSER LOOK AT LIQUIDATING TRUST SECURITIZATIONS

As the performance of residential mortgages continues to deteriorate, lenders and servicers maintain large portfolios of seriously delinquent loans on their balance sheets. To obtain financing, some have considered issuing notes backed by the liquidation proceeds of these non-performing mortgage assets through a liquidating trust structure. As covered in our January 22, 2008, [U.S. Structured Finance Newsletter](#), DBRS discussed the practicality of liquidating trust securitizations. In this newsletter, we provide a closer look at the methodology DBRS uses to analyze these structures.

In a liquidating trust securitization, noteholders are primarily dependent on proceeds from the liquidation of mortgaged properties as opposed to a traditional securitization in which cash comes from the monthly receipt of borrower remittances. The notes may assume a senior-subordinate structure and have forms of credit enhancement that include, but are not limited to, overcollateralization, subordination and a reserve fund.

The analysis of liquidating trust securitizations is an extension of the standard DBRS rating methodology available at www.dbrs.com. This includes a review of collateral quality through a default frequency and loss severity analysis, cash flow modeling, operational risk assessment and legal structure.

Default Frequencies

For liquidating trusts, DBRS uses the maximum of (1) the RMBS model-calculated default frequencies (based on FICO score, combined loan-to-value (CLTV) and other standard default frequency drivers) or (2) various expected liquidation rates based on the delinquency status of the mortgage. For example, real estate owned (REO) loans have an expected liquidation rate of 100%; foreclosures, 90%; 60-day delinquent loans, 50%, etc.

Loss Severities

In addition to our standard loss severity calculation, DBRS has made related enhancements specific to non-performing assets. These include extended state-by-state foreclosure timelines for calculating interest carrying costs, the inclusion of outstanding arrearages (if any), consideration of servicing advances, market loss by property price tier and REO disposition costs.

Cash Flow Analysis

The expected cash flow for liquidating trusts will be the liquidation proceeds from the sale of the mortgaged property. DBRS formulates conservative transaction-specific assumptions for the expected timing of liquidation proceeds and adjusts these timelines based on the review of the servicer's capability and experience, as well as on the observation of recent market trends. For example, liquidation proceeds can be distributed in the following sequence: REOs from month 7 to 24, foreclosures and bankruptcies from month 13 to 36 and 90+ day delinquencies from month 19 to 42, since mortgage loans in varying stages of delinquency proceed through the liquidation process in succession.

Operational Risk Assessment

DBRS's standard operational risk review procedures are designed to evaluate the quality of a servicer's (1) company and management, (2) loan administration, (3) customer service, (4) investor reporting and (5) collections, bankruptcy, foreclosure and REO processes. For liquidating trust structures, the review focuses on the servicer's strategy for handling various types of delinquent loans and its success rate in getting these loans to re-perform, either through foreclosure or by being sold through the REO process as quickly as possible.

DBRS has recently assigned investment-grade ratings to several liquidating trust securitizations. For more information on the process used by DBRS to analyze liquidating trust securitizations, please contact Quincy Tang at qtang@dbrs.com, Sagar Kongettira at skongettira@dbrs.com or Bernard Maas at bmaas@dbrs.com.