

Structured Finance Newsletter

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A SYNOPSIS OF NEW PRIME JUMBO POOLS

The U.S. prime jumbo market was significantly shaken by the financial crisis. Despite the fact that prime mortgages are still considered the cleanest loans, securitizations backed by such assets have been disrupted for nearly a year and a half. According to Inside Mortgage Finance, Lehman Mortgage Trust 2008-6 in August 2008 was the last prime jumbo transaction issued.

As the RMBS sector today is largely dominated by ReREMICs (with a handful of core securitizations backed by seasoned legacy subprime/Alt-A loans), many industry participants agree that these non-traditional transactions are not sustainable in the long run. It is becoming increasingly urgent that the market has to find a way to revitalize the prime jumbo issuance soon.

Since late last year, DBRS has been receiving a growing number of prime jumbo pools for review. These pools share a few common characteristics. First and foremost, the mortgages are newly originated, seasoned no more than two to three months. Although the low seasoning ensures that the properties have experienced minimum home price declines as compared to many seasoned loans from 2005-2006, the borrowers' payment behaviors are also not yet tested. One could argue that a home owner of a perfect pay history of three years brings a lot more comfort in terms of likelihood of default, than a brand new borrower, despite that the latter may have better loan characteristics. These pools also typically have high FICO scores of 750 and above, and relatively low original loan-to-value ratios (LTV) of 65-70%. Investor properties rarely exceed 5%, and loans are underwritten to mostly full documentation standards. Second liens are out of the question for obvious reasons.

While many prime jumbo pools DBRS reviewed are indeed of high quality, others may only appear attractive on the surface. First, some pools contain small percentages of adverse attributes such as interest only loans, piggybacks and stated documentation, essentially risk layers that many may believe have become obsolete in this credit environment. Other characteristics such as condo/co-op or 5/1 ARMs are also not uncommon in these prime jumbo loans. Second, some pools may be significantly bar-belled when it comes to distribution of attributes. For example, a pool may have a weighted average debt-to-income ratio (DTI) of 30%, but when DBRS took a closer look, its distribution is heavily skewed towards the 40-50% range, compensated by the 5-10% DTIs on the low end of the distribution curve. Last but not least, more than half of the prime jumbo pools are usually refinance loans where there are no bona-fide purchase prices between the buyer and the seller. Although the appraisal process has improved compared to years ago, the real value of LTV is sometimes questionable depending on the origination quality.

These adverse characteristics, coupled with rating agencies' conservative home price and other default assumptions, generally mean that credit enhancements are going to be quite high for prime jumbo pools for the time being. This will of course change when the market starts to experience stabilization in both historical performance trends as well as home prices.

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