RMBS Commentary:

Q3 2013 Morningstar RMBS Distressed Inventory Index:

Months to Clear Inventories in Judicial States Improving in Last Two Quarters While Inventories Continue to Grow Nationally

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Overview

Morningstar Credit Ratings, LLC ("Morningstar") forecasts that, given current market dynamics, it will take 49 months to clear national distressed inventories. This forecast is five months higher than our forecast in the second quarter of 2013 and is increased by eleven months from our forecast one year ago. The current trend is similar to that presented in the previous quarter; however, a notable improvement has been observed in the judicial states over the past two quarters.

Morningstar defines distressed inventory as first lien mortgages that are 90+ days delinquent, in foreclosure ("FCL"), or are real estate owned ("REO"). Also included are 50% of the first lien mortgages that are currently designated as "cured/modified" from a 90+ days delinquency status within the past 12 months. We include these cured loans because they are more likely to re-default in the future than loans that have always performed. The number of months to clear the distressed inventory (months of inventory) is measured by the total volume of distressed loans divided by the six-month moving average number of liquidations. All data is sourced from CoreLogic's loan-level, non-agency residential mortgage-backed securities ("RMBS") database. Please note that commencing with this quarter's forecast, distressed inventory will be based solely on deals which have full loss reporting and with underlying collateral (residential properties) located in the fifty states of the United States, plus the District of Columbia.

The most recent data available indicates that the overall distressed inventory has decreased by 20% from one year ago, while the number of liquidations declined a significant 39%. Our principal observations of RMBS distressed inventories are as follows:

- Increasing months of inventory in non-judicial states and decreasing months in judicial states;
- Short sales continue to decline;
- Sustained loan modifications activities;
- Slower liquidation rates; and
- Total distressed liquidation as a percentage of total paid-off continues to decline.

Distressed Inventory Continues to Decline

Unsurprisingly, distressed inventories continue to decline. The number of distressed properties at the end of September 2013 was approximately 891,000 units, down 5% from three months prior and down 20% from a year prior. See Chart 1 below. The distressed inventory in judicial states accounts for approximately 57% of the total distressed inventory, compared to 43% since the beginning of 2008. See Chart 2 for a breakdown of distressed inventory by state.

Chart 1

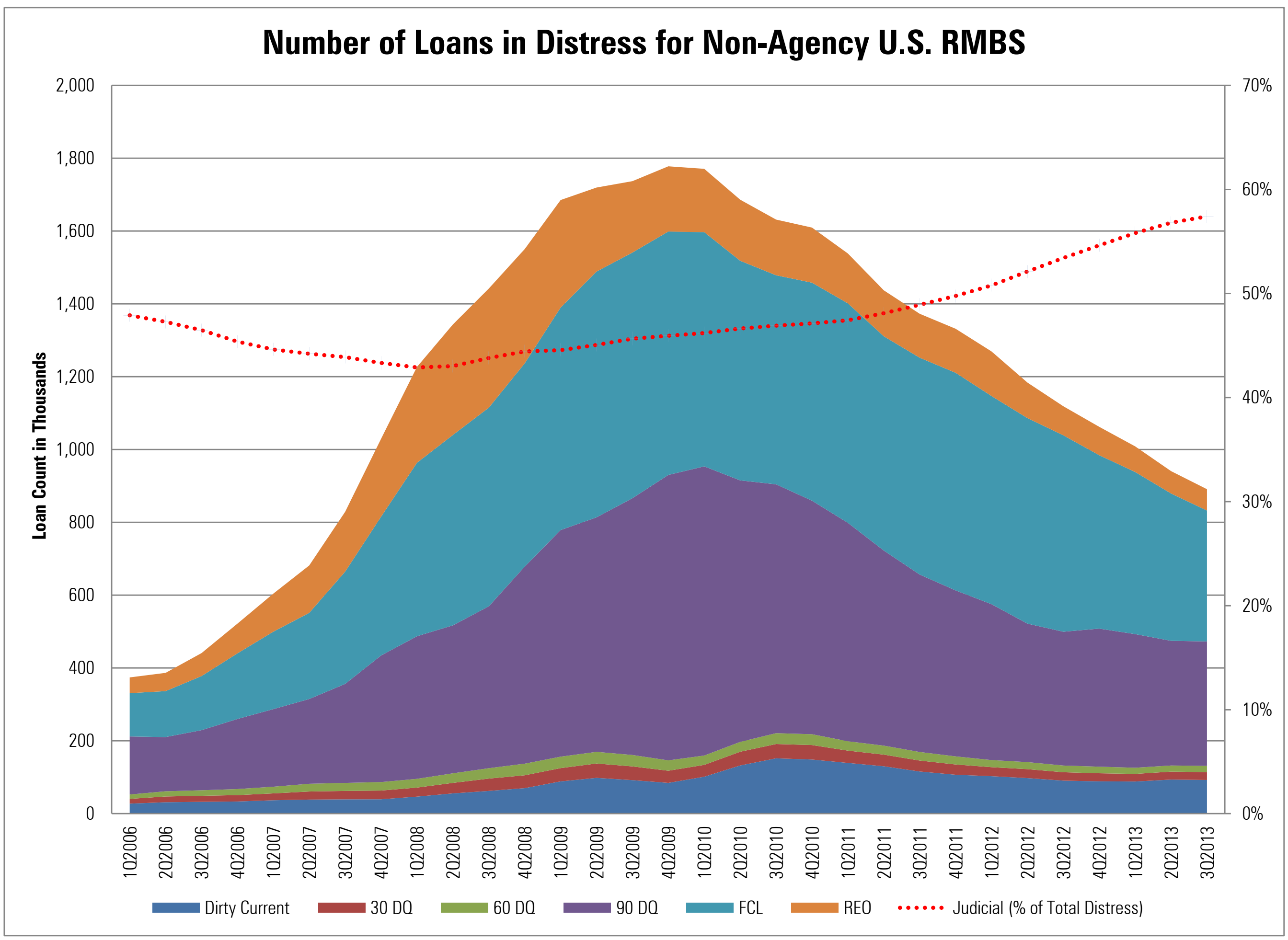
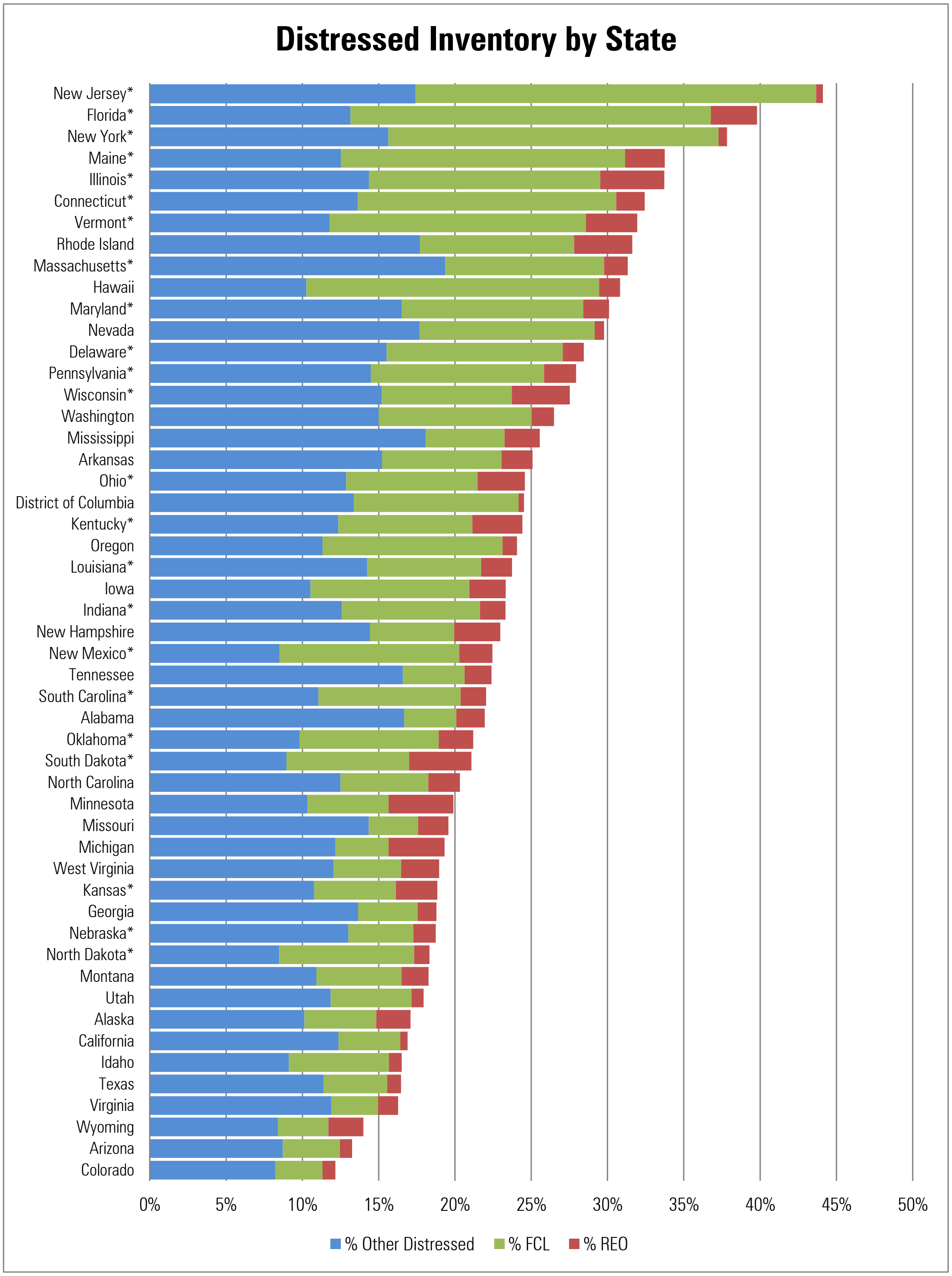


Chart 2



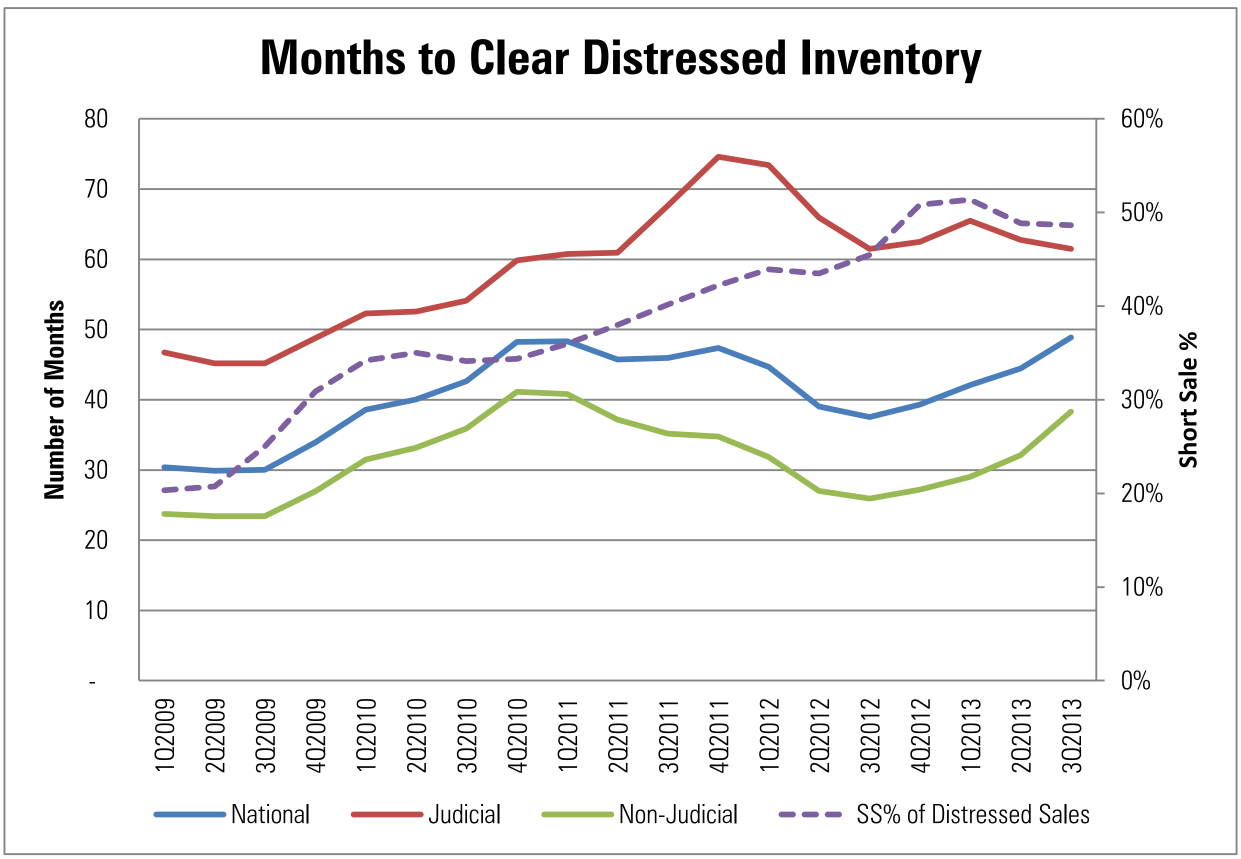
States with an asterisk (*) denote judicial states.

Liquidation Trend

Nationally, as of September 2013, the average number of months to clear distressed inventory is 49 months compared to 38 months as of September 2012. Compared to last quarter, the number of months of inventory is five months longer at 44 months.

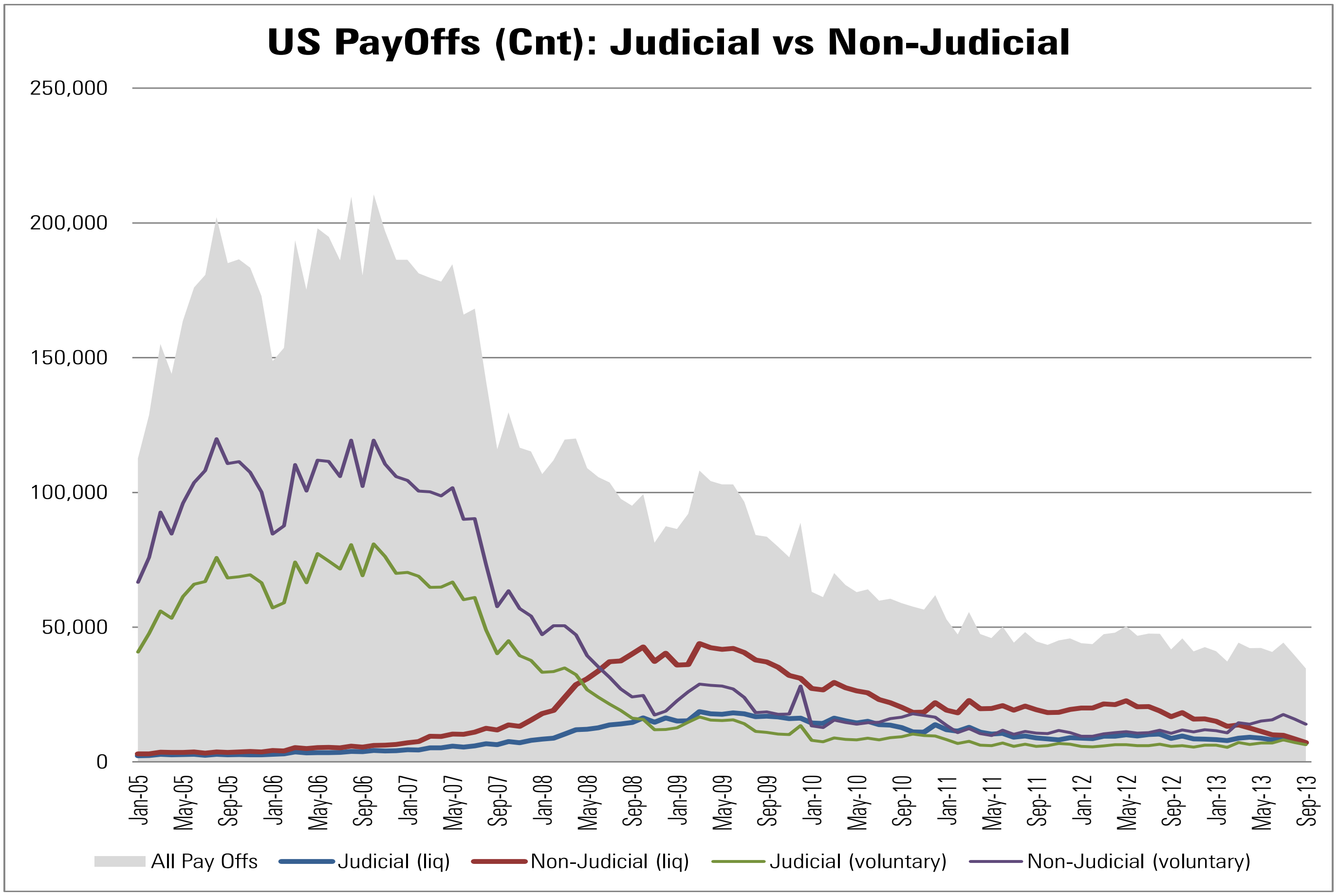
During the same one-year period, short sales as a percentage of total distressed sales increased from 45% to 49%, although it has recently remained unchanged from last quarter and down 2% since December 2012. Loan modifications remain active. Close to $93 billion in unpaid principal balance of the distressed inventory had been modified as of September 2013. See Chart 3 for a time series display of the months taken to clear the distressed inventory. Liquidation rates vary considerably across states. As of September 2013, Morningstar's estimate for the months to clear the distressed inventory is 61 in judicial states and 38 in non-judicial states; a decline from our previous quarter's estimate of 63 months in judicial states and an increase from 32 months in non-judicial states.

Chart 3



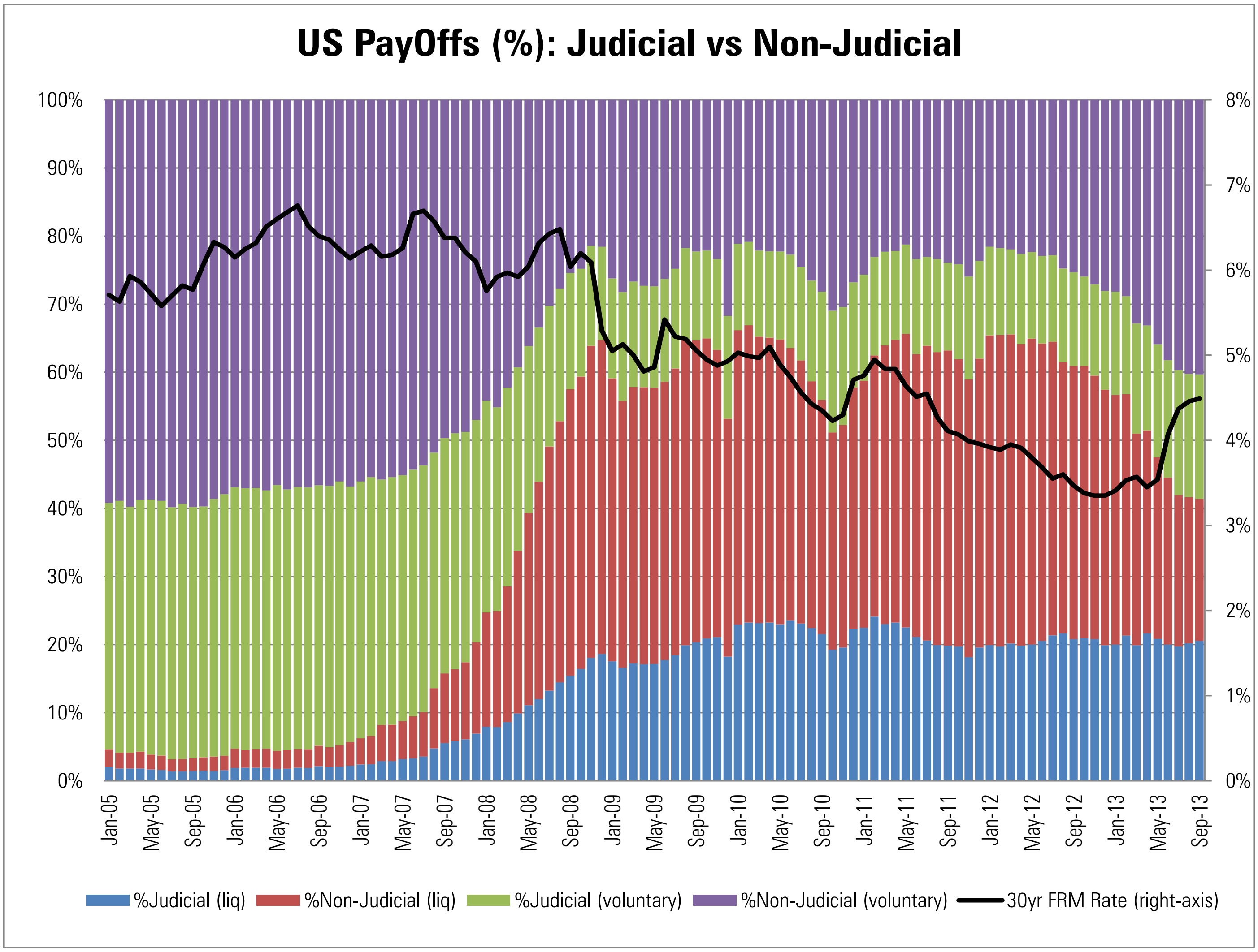
Overall, the number of loans being paid off either via distressed liquidation or voluntary prepayment is declining. But a clear divergence has emerged in payoffs between judicial and non-judicial states. See Chart 4.

Chart 4



For this analysis, total U.S. payoffs are divided into four categories: liquidated loans in judicial and non-judicial states, and voluntarily prepaid loans in judicial and non-judicial states. For the purpose of this analysis, generally loans paid off without losses are counted as voluntary prepayments. See Chart 5. Approximately 40% of all paid off loans are voluntary prepayments in the non-judicial states in September 2013, whereas in September 2012 this category accounted for only 25%. The picture is almost the exact opposite of a year ago: 40% of all paid off loans were liquidations in the non-judicial states, which now accounts for only 21%. We believe that due to improving market conditions - continued national house price appreciation coupled with an affordable interest rate environment and efforts made by the government and servicers to provide modification and/or refinancing alternatives to underwater home owners, the market in 2013 has been dominated by voluntary prepayment via refinancing and modifications. The right axis in Chart 5 presents the historical monthly Primary Mortgage Market Survey ("PMMS") data on the Freddie Mac 30-year fixed rates.

Chart 5



Higher Months of Distressed Inventory across Top 20 MSAs

The average number of months to clear the distressed inventory for the top 20 Metropolitan Statistical Areas ("MSA") as of September 2013 is 55 months ranging from 20 months in Phoenix to 230 months in New York. For the top 20 MSAs, this is an increase of eight months of inventory from a year ago. Excluding the New York MSA, which is in a judicial foreclosure state and has an unusually low percentage of distressed sales, the average months to clear inventory is 45 months, compared to 41 months estimated three months ago. On average, the percentage of short sales in the top 20 MSAs remains flat at 56%, and on the national level it dropped by 0.1% from 48.8% over the past three months.

Table 1

Distressed Inventory - Top 20 MSAs											
	3Q 2013	3Q 2013	3Q 2013	2Q 2013	1Q 2013	4Q 2012	3Q 2012	2Q 2012	1Q 2012	Change in Inventory	
MSA	**Shadow Inventory Units**	**SS% (6-mos avg)**	# of Mos of Inventory							**Since 2Q 2013**	**Since 3Q 2012**
Atlanta	16,340	58%	36	30	25	23	22	25	33	6	13
Boston	8,786	53%	120	101	88	77	68	71	84	19	52
Charlotte	4,953	36%	48	43	43	45	48	55	65	5	(0)
Chicago	37,840	33%	41	43	47	48	52	62	67	(2)	(12)
Cleveland	6,727	42%	40	42	47	45	42	42	47	(2)	(1)
Dallas	9,199	41%	56	44	41	41	36	39	52	12	20
Denver	4,702	50%	35	27	25	24	24	26	29	8	10
Detroit	9,100	42%	22	22	20	19	20	21	24	0	2
Las Vegas	15,325	83%	32	30	26	23	20	17	19	2	13
Los Angeles	33,844	70%	44	35	30	28	29	32	39	9	15
Miami	30,436	51%	53	57	61	61	62	66	75	(4)	(9)
Minneapolis	6,824	24%	24	25	28	29	28	30	33	(1)	(4)
New York	31,608	80%	230	235	240	231	233	242	239	(5)	(3)
Phoenix	7,710	71%	20	16	14	13	13	13	13	4	7
Portland	7,061	72%	63	57	52	44	37	39	51	6	26
San Diego	9,480	77%	32	24	20	19	20	22	27	8	12
San Francisco	3,290	61%	46	35	31	28	27	28	35	11	19
Seattle	10,010	66%	40	39	44	48	48	49	53	0	(8)
Tampa	23,681	48%	46	48	51	47	49	56	64	(2)	(2)
Washington DC	24,774	62%	63	58	60	58	53	52	58	5	11
Top 20 MSA	**301,686**	**56%**	**55**	**51**	**50**	**48**	**47**	**49**	**55**	**4**	**8**
Total U.S. Market	**891,177**	**49%**	**49**	**44**	**42**	**39**	**38**	**39**	**45**	**4**	**11**

Credit Profile

Origination credit profiles, including FICO score and original combined-loan-to-value ("CLTV"), for both distressed and non-distressed inventories remain very similar to what we observed in the previous quarter. However, the data shows decreasing current CLTV and steady modification rates among all delinquency buckets. Overall, current CLTV ratios, which are adjusted based on the current CoreLogic HPI, are 6% lower than previously observed on the distressed population and 11% lower on the non-distressed inventory. See Tables 2a and 2b below.

Table 2a

Distressed Inventory							
MBA Stat	**Total**	**Dirty Current***	**30 DQ****	**60 DQ*****	**90 DQ**	**FCL**	**REO**
Active Loan Cnt	**891,177**	92,622	21,706	17,062	341,622	359,555	58,611
Orig Amt ($)	**229,312,228,446**	24,328,899,336	4,716,274,135	3,643,544,059	87,484,265,649	96,429,987,842	12,709,257,425
Curr Inv Bal ($)	**218,200,963,410**	20,361,773,152	4,237,755,155	3,340,574,619	84,316,329,314	93,530,915,102	12,413,616,068
Orig FICO	**658**	656	635	635	657	660	660
Orig CLTV (%)	**82.7**	81.6	82.1	82.4	82.9	82.5	84.5
Curr CLTV (%)	**102.7**	89.0	92.7	93.7	102.6	105.9	107.3
Mod Pct Bal (%)	**42.5**	86.4	75.2	69.5	43.9	31.4	26.1

* Loans in the current status, but which were in the 90+ days delinquent, FCL, or REO statuses in the past 12 months.
** Loans in the 30-59 days delinquent status, but which were in the 90+ days, FCL, or REO statuses in the past 12 months.
*** Loans in the 60-89 days delinquent status, but which were in the 90+ days, FCL, or REO statuses in the past 12 months.

Table 2b

Non-Distressed Inventory				
MBA Stat	**Total**	**Clean Current**	**30 DQ**	**60 DQ**
Active Loan Cnt	**2,547,866**	2,299,992	180,177	67,697
Orig Amt ($)	**640,938,265,716**	590,493,025,728	36,335,425,721	14,109,814,267
Curr Inv Bal ($)	**566,486,357,989**	520,415,798,466	33,099,376,207	12,971,183,316
Orig FICO	**696**	700	647	644
Orig CLTV (%)	**78.4**	78.1	81.5	82.2
Curr CLTV (%)	**83.6**	82.8	91.2	93.7
Mod Pct Bal (%)	**27.6**	25.3	51.3	58.0

Conclusion

Distressed inventory nationwide dropped by 20% year-over-year and decreased by 5% in the past three months. At the current pace of liquidation, it will take 61 and 38 months to clear the distressed inventory in the judicial and non-judicial states, respectively. In comparison to the previous quarter, the number of months of inventory decreased in judicial states from 63 months and increased in non-judicial states from 32 months. Total distressed liquidation as a percentage of the total paid off continues to decline while voluntary prepayments increased.

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