

European Residential Mortgage Securities Reports
(Summary only)

RMBS/UK
Performance Report

Residential Mortgage Securities (“RMS”): Performance Review

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■ Summary

Throughout 2005, delinquencies in the UK non-conforming sector have been rising at a much faster pace than previously, particularly in the RMS transactions.

Two of the RMS transactions launched by Kensington Mortgages (“KM”) recently drew on their reserve funds; this report highlights the reasons for these drawings and outlines the potential future impact of this action. When Fitch affirmed all the ratings of the RMS transactions on 18 March 2005 it warned of the potential problems that ultimately led to the drawings. Following the reserve fund draws, the agency affirmed the majority of the outstanding tranches again on 22 July 2005, upgrading the Class B notes of RMS 11.

■ Background

KM was established in November 1994 to provide mortgages to UK borrowers who are systematically refused credit by traditional lenders owing either to previous credit problems or the non-standard nature of the loan sought. Given its non-deposit-taking status, Kensington is reliant on short-term revolving facilities that are refinanced through the RMS securitisation programme. The first mortgage was granted in December 1995 and the first RMS securitisation (RMS1) was issued 12 months later.

Since then, a further 19 RMS deals have been launched, the first 10 of which have been redeemed in full, leaving RMS 11-RMS 20 currently outstanding.

With the exception of RMS 7, all deals prior to RMS 15 performed according to a similar pattern: total arrears of over 3 months plus possessions and cumulative losses climbed during the first 18-24 months of the transaction’s life and stabilised at around 12%-14% of the total outstanding loan balance thereafter.

The arrears performance of RMS 7 followed a markedly steeper curve, with arrears exceeding 20% after a year-and-a-half. The interest rates charged by KM are based on three-month sterling LIBOR and, as with RMS 15 and RMS 16, the loans in the RMS 7 portfolio were originated when interest rates were at historically low levels – namely mid- to late 1999. The transaction therefore suffered the impact of subsequent rises when LIBOR climbed from a low of around 5.10% in June 1999 to around 6.10% by the end of the year, remaining stable throughout 2000, before falling steadily from the beginning of 2001 and then resuming its climb from late 2003. This repeated pattern of an increase in rates from an historical low has also adversely affected the later transactions. However, the credit enhancement available to all tranches of RMS 7 continued to build as a result of the rate of note pay-down and the ratings of the ‘AAA’ tranche were affirmed throughout the remaining life of the transaction, while the ratings of the Class M

Summary of and Introduction to: Moody's Approach to Rating Italian Residential Mortgage-Backed Securities

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SUMMARY

Moody's modelling approach in rating Italian residential mortgage-backed securities ("RMBS") is based on our rating methodology, which is a combination of **Moody's Individual Loan Analysis ("MILAN")** and **Moody's Analyser of Residential Cash Flows ("MARCO")**. Previously Italian RMBS transactions have been analysed by means of a lognormal approach, in which assumptions and results have been adjusted qualitatively based on the characteristics of the securitised portfolio. Moody's new approach makes it possible for portfolio characteristics to be assessed in a consistent quantitative manner.

The report focuses primarily on MILAN, which has only recently been introduced as a tool for the Italian market. MILAN is the result of an in-depth analysis and comparison of major European RMBS markets, which Moody's has recently undertaken, especially with regard to historical performance and other available market data. MILAN is, in conjunction with other tools, used for rating RMBS transactions in Europe, Africa and the Middle East ("EMEA") and helps determine the **Aaa CE** credit enhancement levels ("**Aaa CE**") required for a given pool. Although they are standardised models, each version of MILAN is nonetheless designed to address specific features for each country.

The **Aaa CE** derived from MILAN is an important input in the MARCO cash flow model which will help assess the tranching and related ratings on the notes. MILAN allows for the quantification of the impact of certain *portfolio characteristics* on enhancement levels. MARCO, on the other hand, allows for the quantification of the impact of transactions' *structural features* on enhancement levels. Rating committees then make further qualitative and quantitative adjustments to validate the results. MILAN and MARCO are designed to enhance the consistency of Moody's ratings on RMBS across Europe and facilitate the process for investors in comparing RMBS transactions across multiple jurisdictions. This will in turn also assist Moody's in analysing pan-European RMBS transactions more easily.



MOODY'S EXPECTED LOSS APPROACH

Moody's structured finance ratings address the expected loss that investors in the bonds potentially face. The **Expected Loss Approach** assesses the combination of the probability of default of a portfolio of bonds and the expected severity of credit losses facing investors in such bonds upon default.

In the context of RMBS, the **Expected Loss Approach** is assessed through our MARCO cash flow model, which includes all structural elements of a given transaction. Within the cash flow model, the loss and average life of each class is calculated across each loss scenario. For each class, the particular losses in each scenario are weighted by the probability that this level of loss will occur. The rating of each class of notes can be ultimately derived by comparing the expected loss and the weighted average life of a class to Moody's Idealised Expected Loss Table.

Hence, a specified loss distribution is the crucial input parameter for MARCO. For granular portfolios such as residential mortgage pools, Moody's assumes losses to be lognormally distributed. Moody's uses three parameters to determine the lognormal loss distribution: (a) the expected default and loss of the portfolio, (b) the **Adjusted MILAN Aaa CE** combined with (c) the weighted average life of the most securitised portfolio. In this context, the mean of the lognormal distribution is mainly calculated on the basis of static historical performance data. The standard deviation is computed by assuming that the expected loss of the lognormal curve calculated on the scenarios past the **Adjusted MILAN Aaa CE** is equal to the expected loss of a Aaa tranche on a time horizon matching the portfolio's weighed average life. The standard deviation will be compared with any available historical data on the portfolio (in particular in static cohorts) to complete the analysis.

MOODY'S INDIVIDUAL LOAN ANALYSIS ("MILAN")

MILAN works similarly to a scoring model. Each loan is compared and scored against a country-specific benchmark loan, which is an average loan usually granted by mortgage originators in Italy. Firstly, the benchmark loan is defined. Then, based on certain assumptions, the **Aaa** credit enhancement necessary for this benchmark loan can be determined. The comparison of each loan with the benchmark loan leads to adjustments regarding the **Aaa** credit enhancement of the benchmark loan and results in the **Aaa CE for each loan**.

After each loan has been scored, the given portfolio is compared with the Italian benchmark RMBS portfolio. This comparison again leads to certain adjustments to the credit enhancement for the benchmark portfolio and results ultimately in the **MILAN Aaa CE for the total portfolio**. The results are then discussed by a committee to get to the **Adjusted MILAN Aaa CE**.

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■ Introduction

In this report, Fitch Ratings presents the delinquency index it has developed to give an overview of the performance of the German residential mortgage-backed security (“RMBS”) transactions for which it maintains a rating.

Fitch currently maintains ratings on 33 transactions backed by residential mortgage loans secured on property in Germany. It has always been difficult to compare the performance of these transactions because of the differences between the features and reporting standards of each individual deal. However, since the transactions are so numerous, and the sector is seasoned enough for the development of objective performance measures, Fitch has developed an index to benchmark the performance of the mortgage loan delinquency rates. The aim is to provide investors with an insight into sector trends as well as a means of easily identifying performance that is better or worse than average via comparison to an index.

The Fitch German RMBS index measures the average rate of loan delinquency, normalised, as far as possible, for any differences in measurement. For example, although delinquency data is most commonly broken down in 30-60, 60-90 and 90+ days in arrears, some servicer reports use a different breakdown of arrears buckets. The index is based on loans in arrears by 30+ days (inclusive of credit events and defaulted reference claims) including losses. These are weighted according to the total rated mortgage balance at closing and are adjusted for deal seasoning. All transactions included in this index have 12 or more months’ seasoning.

■ Performance Overview

The performance of German RMBS transactions varies greatly across the 33 deals rated by Fitch. Those greater than 90 days in arrears, range from a low of 0.07% in the Provide Domicile 2003-1 deal to a high of 10% in the Provide Gems 2002-1 transaction. Given the growing concern about delinquencies, these are closely monitored, as reflected in the surveillance analysis of all outstanding transactions.

When comparing delinquencies, it is also important to consider other factors that influence higher-than-average levels.

Pool characteristics will have an obvious impact on delinquency levels. In particular, a given transaction may have more aggressive collateral features than others. Deals that are over-exposed to loans secured on properties in eastern Germany have shown above-average arrears levels, as have those where a substantial proportion of loans are secured on investment properties – particularly multi-family units. Other factors that have a negative impact on arrears levels are high WA LTVs and a high proportion of second-ranking loans. As a consequence, transactions with these features display arrears levels that exceed the overall Fitch Index.

CDOs/Spain
Special Report

Spanish Securitisation Market – CDOs: Outlook 2005

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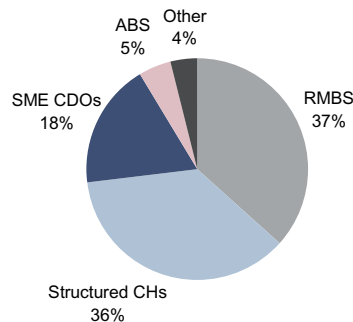
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■ Summary

In 2004, for the second consecutive year, Spain ranked second in the European funded securitisation market, with an estimated share of issuance volume of 20% to 23%. This represents total issuance volumes of EUR51.6 billion for the year¹. As in previous years, the main asset classes backing the issuance of structured bonds were residential mortgages, *cédulas hipotecarias* (“CHs”)² and loans to small and medium enterprises (“SMEs”), which represented 37%, 36% and 18%, respectively, of total issuance volumes in 2004.

Spanish Securitisation 2004 by Collateral Type



Source: Fitch

The potential for continued growth lies mainly in the positive momentum of mortgage lending activity. Although this is expected to slow in 2005, to an annual growth rate of 12% to 15%, compared with 25.1% and 21.6% in 2004 and 2003, respectively³, the sector outlook remains dynamic and positive. Because the Spanish securitisation market has been driven by mortgage lending activity to date – mainly owing to low interest rates, higher property prices and first-time buyer demand – RMBS and structured CHs have jointly accounted for c.73%-78% of total issuance in recent years.

Turning to SME CDOs and the FTPYME programme, Article 52 of the Spanish budget law for 2005 (“LEY 2/2004, *Presupuestos Generales del Estado*) stipulates that the Spanish Treasury will make a maximum guarantee of EUR600 million available to Spanish SME CDO transactions in 2005.

¹ Source: ESF Securitisation Data Report Autumn 2004 and Fitch.

² CHs are mortgage covered bonds issued by Spanish financial institutions. For more information on their main characteristics please refer to “*Rating Spanish Financial Institutions' Cédulas Hipotecarias and Cédulas Territoriales*”, dated 7 July 2003, and available at www.fitchratings.com.

³ Source: Asociación Hipotecaria Española. The 2004 figure is the annual growth rate as of October 2004.