

Mortgage Servicing Rights: The Right Time to Acquire GNMA Servicing

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Summary of Acquisition Opportunity

- Create an annuity income stream with a stable 5 year time horizon
- Own an asset that generates positive operating cash from day one
- Take advantage of acquisition prices that are well below economic values
- Minimize the risk of rising operating costs with new production underwritten to high credit quality standards
- Counterparty risk more easily controlled through the flexibility to be selective
- Origination REPS and Warrants do not transfer to the new servicer
- Base Case Scenario:
 - Achieve an estimated gross operating margin of approximately **79%**
 - Under 5 year acquisition strategy, achieve an estimated after-tax Annual IRR of **39%**

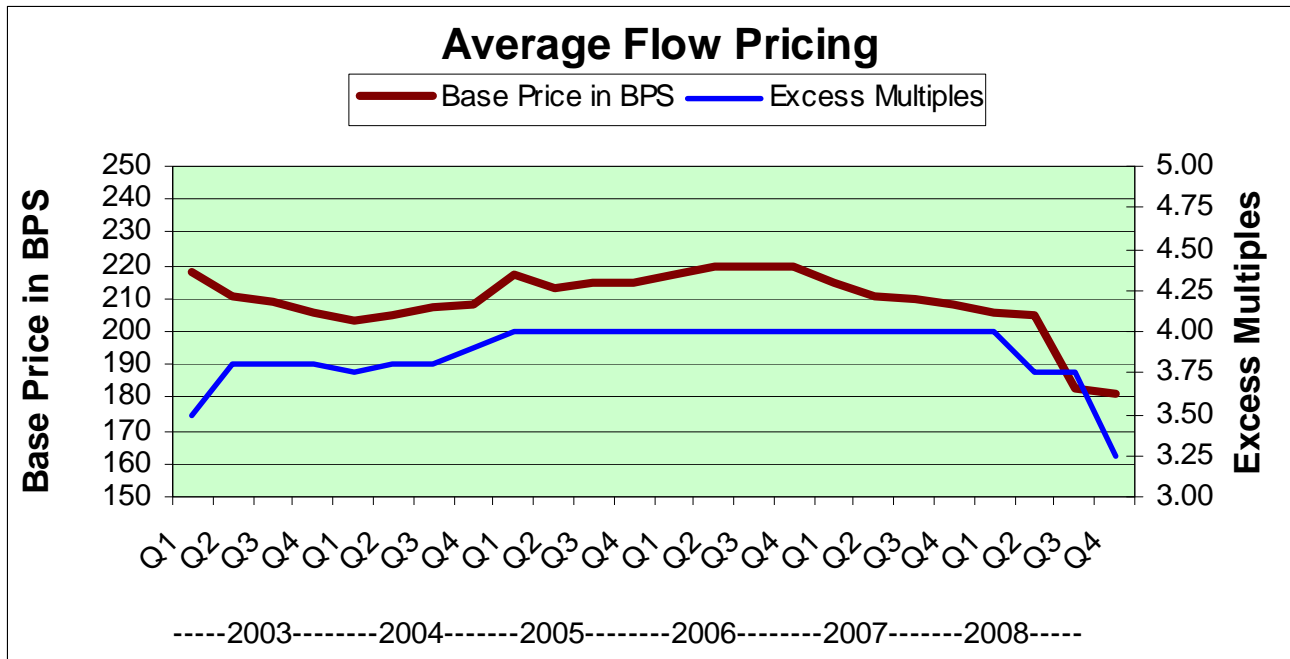
MSR Market Update

**Historical Market Prices: Co-Issue/Forward Bulk
MSR Price Deterioration
Historical Delinquency and Foreclosure Rates: FHA/VA
Market vs Economic Value Disparity**

MSR Market Update

Historical Market Prices ~ Co-Issue/Forward Bulk

- Pricing for new, par-rate base servicing was relatively stable from 2003-2007 with an average price of 212bps. (Prices below are approximate, based on a wide range of production profiles)
- Excess servicing multiples were more volatile during the same time period, ranging from a low of 3.5:1 to a high of 4.0:1
- Both base and excess prices plunged sharply in the last two quarters of 2008. By December 2008 base values declined nearly 14% to near a 1.81% while excess multiples had fallen close to 20% to a 3.25:1 multiple



MSR Market Update

MSR Price Deterioration

Values have continued to decline in the first two months of 2009. MSRs that were trading at a base multiple between 4.50 and 5.00 six months ago are now priced between a 2.50 and 3.00 multiple in 1st Qtr 2009. This represents a 50% overall price drop from early to mid 2008. This drop in price was due to traditional buyers exiting the Co-Issue/Forward Bulk market and leaving only AOT/Best Efforts or Mandatory selling methods available. Over the same time frame, par interest rates have dropped approximately 150bps, from a range of 6.25% - 6.50% to 4.75% - 5.25%.

Factors contributing to this price deterioration include:

- Internal competition for capital
- Lack of liquidity as the number of buyers have declined
- Uncertainty regarding government legislation
- Counterparty risk uncertainty
- Volatility in credit markets
- Increased concern of VA No Bids
- Increased concern of rising foreclosure rates

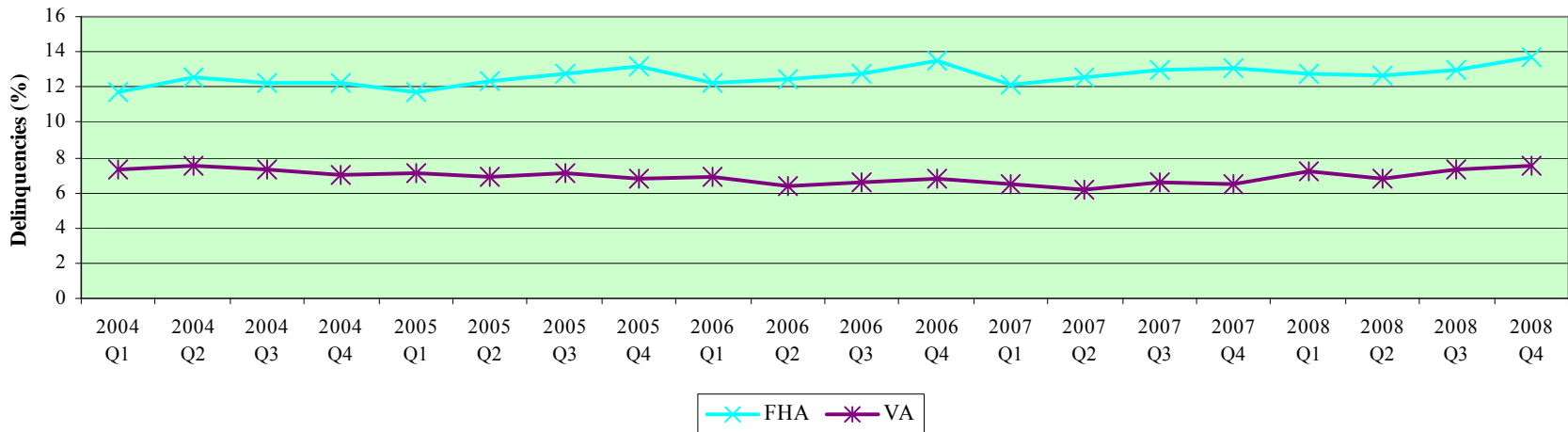
MSR Market Update

Historical Delinquency and Foreclosure Rates: FHA/VA

Historically, FHA loans have had 30-40% higher delinquency rates than VA loans.

According to Mortgage Banking Association (“MBA”), GNMA FHA/VA delinquencies (30/60/90+) rates have stayed relatively steady throughout the years but have slightly increased in 2008. FHA loans have shown a more visible spike so far.

Seasonally Adjusted Delinquency Numbers



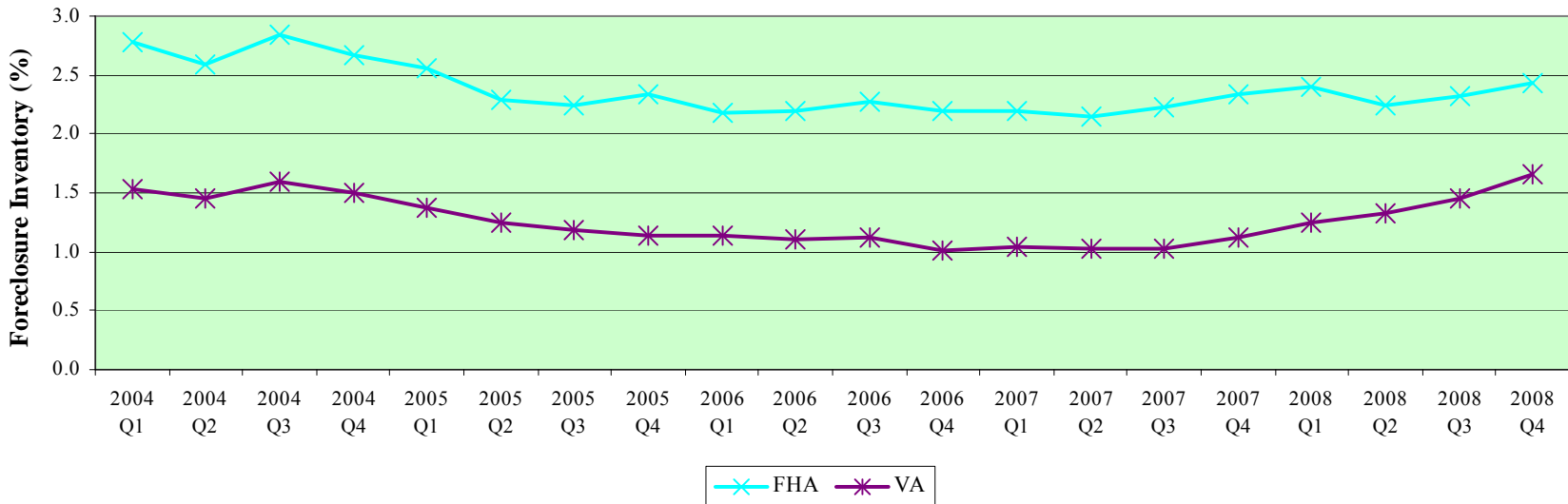
Source: MBA

MSR Market Update

Historical Delinquency and Foreclosure rates: FHA/VA

Similar to delinquency rates, FHA foreclosure percentages have historically been higher than VA. However, VA foreclosure rates have been climbing since the 4th quarter of 2007 and narrowing the gap. Adjustable Rate Mortgages (“ARMs”) are currently about 50% worse than Fixed Rate loans for 90+ delinquencies and foreclosures.

Foreclosure Inventory



Source: MBA

MSR Market Update

Market vs Economic Value Disparity

Despite current market prices, the economic value of newly originated mortgage servicing rights are very strong today due to:

- Historically low interest rates and related prepayment risk
- Imbalance between supply and demand for servicing rights
- Transaction costs to the borrower on refinances today are higher than 12 months ago

New Production Profile

Reduced Prepayment Risk

New Production Profile

Reduced Prepayment Risk:

Reduced prepayment risk is being influenced by several underlying factors:

- Historically low interest rate environment
- Increased closing costs to the borrower due to MBS price compression and higher loan level pricing adjustors
- A significantly reduced wholesale presence in the origination market
- The demise of over 300 lending entities nationwide

Subprime vs. GNMA Production

Subprime vs. GNMA production

With the collapse of the Subprime Market concerns have been raised regarding the quality of future GNMA originations and them becoming “the new subprime.” However, we feel this is a largely inaccurate assumption due to several factors:

GNMA
100% Full Documentation at the time of origination
99% Owner Occupied
Stop advancing stop at FC
WAVG Fico 680
FHA underwriters are monitored and scored to FHA standards
100% Escrowed
DTI Ratios: FHA Standard
95% Fixed Rate
100% First Lien

Subprime
Majority Partial or No Documentation at the time of origination
10% Second or Investment Properties
Advance through REO
WAVG Fico 600
No monitoring of underwriters
40% Escrowed
Verbal or no verification of income/assets
80% ARMs
Both 1st and 2nd Liens

PCI Return Analysis

MSR Return Profile
Modeling Assumptions
5yr Returns: 5yr Acquisition Strategy, \$1B/Quarter

PCI Return Analysis

Mortgage Servicing Rights Investment Returns

	Acquisition @ 2.5 multiple			Acquisition @ 2.75 Multiple		
	Scenario 1	Scenario 2	Scenario 3	Scenario 4 (Base Case)	Scenario 5	Scenario 6
Acquisition Price	1.10%	1.10%	1.10%	1.21%	1.21%	1.21%
Fair Value - Beginning	1.32%	1.32%	1.32%	1.32%	1.32%	1.32%
Quarterly Fair Value Change	-0.015%	-0.015%	-0.015%	-0.015%	-0.015%	-0.015%
Acquisition Price Incremental Yearly Increase (Capped at Capitalization Rate)	0.05%	0.05%	0.05%	0.05%	0.05%	0.05%
% of Expense from Foreclosure/Delinquency	100%	150%	200%	100%	150%	200%
Sale Price Multiple (of 5th yr Fair Value)	100%	95%	90%	100%	95%	90%
Exit Value as a % of UPB	1.18%	1.12%	1.06%	1.18%	1.12%	1.06%
Gross Sales Amount	181,309,608	172,244,128	163,178,648	181,309,608	172,244,128	163,178,648
Sales Expense	17,802,000	26,703,000	35,604,000	17,802,000	26,703,000	35,604,000
Net Sales Amount	163,507,608	145,541,128	127,574,648	163,507,608	145,541,128	127,574,648
Cost of Debt	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%
Interest Rate earned on Cash	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
Minimum Cash Balance	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Max Debt % of Fair Value	60%	60%	60%	60%	60%	60%
Tax Rate	40%	40%	40%	40%	40%	40%
Annual Return after Tax	51.95%	44.42%	35.64%	39.51%	31.93%	23.08%

	Acquisition @ 3.00 multiple		
	Scenario 7	Scenario 8	Scenario 9
Acquisition Price	1.32%	1.32%	1.32%
Fair Value - Beginning	1.32%	1.32%	1.32%
Quarterly Fair Value Change	-0.015%	-0.015%	-0.015%
Acquisition Price Incremental Yearly Increase (Capped at Capitalization Rate)	0.05%	0.05%	0.05%
% of Expense from Foreclosure/Delinquency	100%	150%	200%
Sale Price Multiple (of 5th yr Fair Value)	100%	95%	90%
Exit Value as a % of UPB	1.18%	1.12%	1.06%
Gross Sales Amount	181,309,608	172,244,128	163,178,648
Sales Expense	17,802,000	26,703,000	35,604,000
Net Sales Amount	163,507,608	145,541,128	127,574,648
Cost of Debt	5.50%	5.50%	5.50%
Interest Rate earned on Cash	2.50%	2.50%	2.50%
Minimum Cash Balance	1,000,000	1,000,000	1,000,000
Debt % of Fair Value	60%	60%	60%
Tax Rate	40%	40%	40%
Annual Return after Tax	33.10%	25.95%	17.57%

PCI Return Analysis – Base Case Scenario

Return Modeling Assumptions

PCI has modeled the opportunity to buy new servicing rights using the following assumptions:

- All product is assumed to be GNMA I/GNMA II Fixed 30yr, current-rate, new production with 44bps of servicing fee
- Purchase price in Year 1 is 121bps (2.75 mult)
- Ongoing quarterly acquisitions of \$1B for 5 years. The purchase price for acquisitions after Year 1 was increased by 5bps per year to reflect the eventual convergence of market vs economic value
- Fair Market Value = 132bps (3 mult)
- Decline in Market Value = 1.5bps/quarter
- Rate Environment = Static
- Debt/Equity % was capped at 60/40 of fair market value net of positive operating earnings reinvested to reduce debt
- 11% Total CPR
 - 8% Voluntary
 - 3% Involuntary
- Base Cost to service = \$80

PCI Return Analysis – Base Case Scenario

Return Modeling Assumptions

- Cost to service delinquent loans
 - 30 Days = \$50 per loan
 - 60 Days = \$150 per loan
 - 90 Days = \$250 per loan
 - Foreclosure Cost/Loss = \$3,000 per loan
 - Lifetime Foreclosure Rate = 3% with it peaking at over 4%
- FHA/VA = 80%/20%
- Average balance at purchase = \$175,000
- Cost of debt = 5.50%
- Earnings rate of cash balance = 2.50%
- Tax rate = 40%
- Hedging Costs are NOT included
- Accounting Methodology = Fair Value

PCI believes these to be conservative assumptions and they can be altered upon request.

PCI Return Analysis – Base Case Scenario

Pro Forma Income Statement: Quarterly \$1 Billion Acquisitions

<u>Income Statement</u>		Year 1	Year 2	Year 3	Year 4	Year 5
Revenues						
Servicing Revenue		12,705,256	32,366,980	49,893,574	65,333,643	78,888,543
Interest Earned on Cash		25,000	25,000	25,000	25,000	31,250
Total Revenue		12,730,256	32,391,980	49,918,574	65,358,643	78,919,793
Expenses						
Servicing Expense		(1,066,601)	(2,847,167)	(4,535,926)	(6,095,824)	(7,523,674)
Borrowing Cost		(1,040,674)	(2,533,588)	(3,787,899)	(4,772,866)	(5,318,819)
Expense of Delinquency/Foreclosure		(143,638)	(909,166)	(2,185,498)	(3,737,548)	(5,428,734)
Total Expenses		(2,250,913)	(6,289,921)	(10,509,323)	(14,606,238)	(18,271,227)
Operating Margin		10,479,343	26,102,059	39,409,251	50,752,405	60,648,566
Change in FMV		(3,145,601)	(10,382,467)	(17,305,496)	(23,310,427)	(28,546,400)
Net Income before Gain on Acquisition		7,333,741	15,719,592	22,103,755	27,441,978	32,102,166
Other Income						
Unrealized Gain (Loss) on MSR Asset		4,400,000	2,400,000	400,000	-	-
Realized Gain (Loss) on MSR Asset						-
MSR Liquidation Expense						(17,802,000)
Net Income (Before Taxes)		11,733,741	18,119,592	22,503,755	27,441,978	14,300,166
Taxes		4,693,497	7,247,837	9,001,502	10,976,791	5,720,067
Net Income (After Taxes)		7,040,245	10,871,755	13,502,253	16,465,187	8,580,100

Purchase Price = 121bps +5bps/yr ♦ Debt Ratio = 60% ♦ Capitalization = 132bps ♦ Cost of Debt = 5.50% ♦ Earnings Rate = 2.50%



PCI Return Analysis – Base Case Scenario

Pro Forma Balance Sheet Statement: Quarterly \$1 Billion Acquisitions

Balance Sheet	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Assets						
Cash	5,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Mortgage Servicing Rights (MSR)	-	49,654,399	92,071,931	127,566,435	157,056,008	-
Excess Cash		2,625,797	5,798,175	8,525,263	10,745,415	84,597,123
Total Assets	5,000,000	53,280,196	98,870,106	137,091,698	168,801,423	85,597,123
Liabilities						
Loan Payable						
Total Liabilities	-	29,792,639	55,243,159	76,539,861	91,784,400	-
Equity						
Beginning Equity	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000
Net Income	-	2,311,903	3,096,230	3,686,010	4,384,561	(5,626,070)
Retained Earnings		4,728,342	14,815,769	27,728,242	43,494,878	62,085,609
Total Contributions		11,447,312	20,714,948	24,137,584	24,137,584	24,137,584
Total Equity	5,000,000	23,487,557	43,626,948	60,551,837	77,017,023	85,597,123
Total Liabilities + Equity	5,000,000	53,280,196	98,870,106	137,091,698	168,801,423	85,597,123

Purchase Price = 121bps +5bps/yr ♦ Debt Ratio = 60% ♦ Capitalization = 132bps ♦ Cost of Debt = 5.50% ♦ Earnings Rate = 2.50%

PCI Return Analysis – Base Case Scenario

Pro Forma Cash Flow Statement: Quarterly \$1 Billion Acquisitions

Statement of Cash Flows

	12 Months Ended Year 0	12 Months Ended Year 1	12 Months Ended Year 2	12 Months Ended Year 3	12 Months Ended Year 4	12 Months Ended Year 5
Operating Cash Flow						
Net Income	5,000,000	7,040,245	10,871,755	13,502,253	16,465,187	8,580,100
Change in FMV	-	3,145,601	10,382,467	17,305,496	23,310,427	28,546,400
Unrealized (Gain) Loss on MSR Investment	-	(4,400,000)	(2,400,000)	(400,000)	-	-
Realized (Gain) Loss on MSR Investment	-	-	-	-	-	-
Total Cash Flow from Operations	5,000,000	5,785,846	18,854,222	30,407,749	39,775,614	37,126,500
Investing Cash Flow						
Purchase of MSR Asset	-	(48,400,000)	(50,400,000)	(52,400,000)	(52,800,000)	(52,800,000)
Sale of MSR Asset	-	-	-	-	-	181,309,608
Total Cash Flow from Investment	-	(48,400,000)	(50,400,000)	(52,400,000)	(52,800,000)	128,509,608
Financing Cash Flow						
Debt Financing	-	29,792,639	25,450,520	21,296,702	15,244,538	6,900,137
Equity Financing	-	11,447,312	9,267,636	3,422,636	-	-
Debt Repayment	-	-	-	-	-	(98,684,536)
Total Cash Flow From Financing	-	41,239,951	34,718,155	24,719,339	15,244,538	(91,784,400)
Net Cash Flow	5,000,000	(1,374,203)	3,172,378	2,727,088	2,220,152	73,851,709
Change in Cash & Excess Cash	5,000,000	(1,374,203)	3,172,378	2,727,088	2,220,152	73,851,709

Purchase Price = 121bps +5bps/yr ♦ Debt Ratio = 60% ♦ Capitalization = 132bps ♦ Cost of Debt = 5.50% ♦ Earnings Rate = 2.50%

PCI Return Analysis – Base Case Scenario

Pro Forma Financial Ratios: Quarterly \$1 Billion Acquisitions

Ratios	Year 1	Year 2	Year 3	Year 4	Year 5 Beg.	Year 5
Gross Margin %	82.3%	80.6%	78.9%	77.7%		76.8%
Net Margin %	91.6%	33.6%	27.0%	25.2%		10.9%
Debt/Equity	126.8%	126.6%	126.4%	119.2%	107.1%	0%
Debt/ Assets	55.9%	55.9%	55.8%	54.4%	51.7%	0%
Debt to MSR Market Value	60.0%	60.0%	60.0%	58.4%	55.6%	0%

Purchase Price = 100bps +5bps/yr ♦ Debt Ratio = 60% ♦ Capitalization = 120bps ♦ Cost of Debt = 5.50% ♦ Earnings Rate = 2.50%

Other Considerations

Selling Expenses
Risks to Assumptions and Servicer
Barriers to Entry

Other Considerations

Selling Expenses

Several key selling expenses are noticeable higher on a GNMA transfer as compared to FNMA or FHLMC servicing. For example:

- \$250 per pool transfer cost
- Excluded loans (typically 60+ dq and foreclosures) will receive no purchase price and a loan level transfer cost will be applied which varies from buyer to buyer. In our modeling assumptions we used an average transfer cost of \$3,000 per loan.
 - You may buy GNMA loans out of a pool once that loan reaches 90 days delinquent which can eliminate some of the cost above
- Pools must be transferred in entirety (no loans may be pulled due to delinquency status, etc)

Other Considerations

Risks to Assumptions and Servicer

Rising unemployment and further declines in property values

- May cause increased delinquency, foreclosure and VA No Bids
- With new production this risk will be far less than seasoned servicing, since only future deterioration will impact current production

Illiquidity dissipates faster than economic return assumptions

- Model assumes that market vs economic disparity becomes neutral over 4 years

Scenario Analysis

- To reflect potential increase in delinquencies beyond our base case scenario we raised the delinquencies/foreclosure cost to 150% and 200%. Even with this increase in cost the returns are still excellent
- Hedging costs are not accounted for

Uncertainty Around New Legislation

- Foreclosure suspensions, cram-downs, required modification programs should have limited impact on new production

Other Considerations

Barriers to Entry

Knowledge, Logistics & Licensing

- PCI provides value to new servicing owners by conveying our knowledge of agency servicing requirements, subservicing costs and terms and the distinctions between various in house and subservicing options.
- The knowledge and relationships PCI maintains are beneficial whether a new servicer needs to obtain a new platform, build a scalable platform or outsource some or all of the servicing functions.

Volatility of the Asset

- Historically, servicing rights are volatile assets. They will continue to be in the future, but the current interest rate provides for less negative convexity than we have seen in recent years.

Accounting Implications

- PCI is uniquely poised to utilize our market knowledge to your benefit. We can assist you by fully outsourcing all FAS 156 reporting. Our hands-on trade information puts us in the best position to assess fair value.

Competing Opportunities to Deploy Capital

- As with any investment decision, the asset needs to fit strategically within your organization's goals as well as garner an acceptable return. We are happy to adjust our analysis to facilitate your specific economics as well as discuss how MSR acquisitions could help achieve your mission.