

Phoenix Capital, Inc.: Hold vs Sell Analysis

May 2009



Prices paid for current production MSR's have fallen drastically since the middle of 2008. From 2003-2007, prices were relatively stable averaging about 5.6x for FNMA MBS 30yr product with 25bps of net service fee. This number has been plunging since the second half of 2008; MSR's have lost about 30% of their value and are currently reaping less than a 4x on average. Several factors have contributed to the demise in pricing including: lack of liquidity and capital constraints, uncertainty regarding the impact of new and future legislation, and volatility in credit markets. This has caused many originators to consider holding servicing rights. Additionally, the annuity stream earned from servicing income has traditionally acted as a built-in hedge for low production cycles.

Hold/Sell Analysis

Our hold/sell analysis compares the economics of selling loans and servicing rights today through best efforts, mandatory, direct trade or assignment of trade loan deliveries on a released basis versus selling loans to FNMA, FHLMC or GNMA (typically in a MBS format) and retaining the MSR asset for a period of time. The analysis models holding the servicing rights over the assets' lifetime or until interest rates and the buying environment become more favorable, creating a reasonable level to sell. PCI incorporates internal servicing costs or costs of standard sub-servicing contracts to customize a client's economics and explores servicing values under varying interest rate scenarios to highlight risks.

Key Business Considerations

- Benefits of agency relationship
- Cash requirements and breakeven analysis versus released execution
- Capitalization & Accounting options
- MSR volatility
- Deciding which product to sell versus which product to hold

Key Economic Assumptions

- Prepayment speeds
- Late fee and ancillary opportunities
- Discount rate
- Servicing cost
- Earnings rates
- Cost of funds

Recent Findings

Despite current market pricing, the economic value of newly originated mortgage servicing rights appears to be quite strong. Factors contributing to the attractive economic value include:

- Historically low interest rates and related prepayment risk
- Imbalance between supply and demand for servicing rights
- Lower expectations of default on new production from higher credit standards
- Transaction costs to the borrower today are higher than 12 months ago

PCI has performed many hold/sell analyses in 2009. To date, every analysis has found the economics of holding servicing to be superior to selling released in today's market.



Phoenix Capital, Inc.: Hold vs Sell Analysis (cont.)

Sample Report: Economics of Holding

Today's value from selling MSR in the future at economic value

Current value of MSR asset

Point in time when cash forgone by holding MSR is completely recouped

Monthly cash flow from holding the MSR

Accounting Income after costs (including sub-service costs) are incurred

Hold Servicing (Economics) - Flat Rate								
Net Economic Value:		1.000%						
Starting Basis:		172,217						
Discount Rate:		11						
Total Discounted Cash Flow from Bulk Sale in 3 Years:						\$ 205,674		
Equivalent Cash Collected in Month:						Jul-10		
Total Discounted Cash Flow						174,364		
Servicing Cash Flow	Amort Rate	Amort Expense	Cost Basis	Cost Basis %	Mkt /Econ. Value	Mkt /Econ. Value - %	(Impairment) / Recovery	Net Income
(910)	-	-	172,217	1.000%	174,365	1.012%	-	174,365
3,386	1.1467%	(1,975)	170,242	0.990%	172,586	1.004%	-	1,411
3,388	1.1607%	(1,976)	168,266	0.981%	170,788	0.995%	-	1,412
3,383	1.1729%	(1,974)	166,292	0.972%	168,979	0.987%	-	1,410
3,380	1.1855%	(1,971)	164,321	0.963%	167,156	0.980%	-	1,408
3,377	1.1989%	(1,970)	162,351	0.956%	165,320	0.973%	-	1,407
3,368	1.2101%	(1,965)	160,386	0.949%	163,475	0.967%	-	1,403
3,365	1.2238%	(1,963)	158,423	0.943%	161,617	0.962%	-	1,402
3,345	1.2316%	(1,951)	156,472	0.937%	159,762	0.957%	-	1,394
3,327	1.2401%	(1,940)	154,532	0.932%	157,908	0.952%	-	1,386
3,303	1.2470%	(1,927)	152,605	0.927%	156,061	0.948%	-	1,377
3,282	1.2545%	(1,914)	150,690	0.922%	154,218	0.944%	-	1,368
3,248	1.2572%	(1,895)	148,796	0.916%	152,392	0.939%	-	1,353
295,240								298,365

Sample Report: Implied Value of Released Servicing

	RELEASED						RETAINED			
	WANR	Investor 1		Investor 2		Investor 3		PAS Economic		Opportunity
	%	%	Multiple	%	Multiple	%	Multiple	%	Multiple	
Premium	5.5000%	0.200	0.80x	0.165	0.66x	0.155	0.62x	0.85	3.40x	0.650
Par	5.0000%	0.400	1.60x	0.350	1.40x	0.340	1.36x	1.000	4.00x	0.600
Discount	4.5000%	0.800	3.20x	0.720	2.88x	0.760	3.04x	1.120	4.48x	0.320

Shock to client originations

Implied SRP paid by Investor 1

The gain over time by holding an MSR verses releasing it to the best execution

Other Services

If the analysis proves that the optimal strategy is to retain servicing, PCI can help manage the MSR asset from a valuation and accounting standpoint. Additional services offered include:

- Third party valuation services
- Full outsourcing of MSR accounting
- Assistance in choosing the appropriate sub-servicer
- Managing the subsequent MSR sale transaction when appropriate

If you decide to sell servicing, PCI can run best execution models to help you maximize profits by analyzing various flow structures including co-issue/forward bulk, direct trade/assignment of trade and mandatory/best efforts sales. The best execution model provides loan level detail on each execution alternative.