

## Homeloans (No. 2) PLC, Multi Class Mortgage Backed FRNs

UK-MBS

### TRANSACTION IN BRIEF

	<i>Class A1</i>	<i>Class A2</i>	<i>Mezzanine</i>
Rating:	<b>Aaa</b>	<b>Aaa</b>	<b>Baa2</b>
Amount:	£70,000,000	£141,250,000	£31,250,000
Coupon:	Libor + 6.25bp	Libor + 14bp	Libor + 70bp
Step Up Date:	Aug 1998	Aug 2002	Aug 2002
Step Up Margin:	Libor+ 20bp	Libor+ 45bp	Libor+ 150 bp
Final Maturity:	May 2028	May 2028	May 2028
Interest Payment			
Dates:	August, November, February, May.		
Issuer:	Homeloans (No. 2) PLC		
Originator:	The National Home Loans Corporation plc, and affiliated entities		
Servicer:	The National Home Loans Corporation plc		
Servicer of Last Resort:	Barclays Bank PLC ( <b>Aa2</b> )		
Trustee:	Morgan Guaranty Trust Company of New York ( <b>Aa1</b> )		
Lead Manager:	JP Morgan Securities Ltd.		
Asset Characteristics:	First residential mortgages in England and Wales.		

### Summary of Initial Pool

Count:	5,334 residential loans		
Prin. Amt:	£253,375,626		
LTV:	Avg: 72%	Max 100+%	(3.2%)
Loan Size:	Avg: £47,502	Max £250,000+	(1.20%)
Performance:	Current: (inc <=1 month arrears). 65.50%		
	Arrears: 1-3 months 12.1%, 3-6 months 8.8%, 6-12 months 7.4%, 12+ months 6.04%		
Origination:	HLDL 15%. Other 85%.		
Product Type:	Potential Self Certification 71 %		
	Stabilised Rate Loans 9.2%		
Loan Usage:	Purchase 42%		
	Remortgage 58%		
Interest Rate:	Administered Variable Rate 96.6%, Libor linked 2.1%		
	Fixed Rate (that reverts to variable) 1.3%		
Concentration:	36% SE, 14% Ldn, 2.4% North, 8.4% SW, 3.9% E Anglia, 8.1% E Mid, 9.8% W Mid, 3.8% Wales, 3.7% NW, 8.7% Yorks 5.6%		
Seasoning:	86 1%, 87 3%, 88 6.%, 89 11%, 90 35%, 91 28%, 95 7%, 96 8%		
Mtg Indem. Ins:	Sun Alliance and London Insurance plc ( <b>Aa3</b> ), Legal and General Assurance Society Limited ( <b>Aa1</b> ). C.E. Heath (LLoyd's of London).		
Structure:	Senior/ Mezzanine/ Subordinated Loan/ Loan Stock, Mortgage Backed Notes.		
Credit Support:	First Loss Fund ( £5,000,000 funded on the first day), Mortgage Overcollateralisation (of 3% of the final pool on the first day and thereafter up to £8,500,000) £31,250,000 Class B notes, and Spread.		
Launch Date:	June 20, 1996		



## **OPINION**

Moody's has assigned long term credit ratings of **Aaa** to the Class A Notes and **Baa2** to the Mezzanine Notes (together "the ratings").

The rating of the Class A Notes is based upon an analysis of the characteristics of the mortgage pool backing the notes, the protection the notes receive from credit enhancement against defaults and arrears in the mortgage pool, and the legal and structural integrity of the issue.

The rating of the Mezzanine Notes is based on the above factors, and on an assessment of the Mezzanine Notes' subordinate position in relation to the Class A Notes.

The ratings of the Notes address the timely payment of interest, and ultimate payment of principal.

## **RATING SUMMARY**

### **Structure**

The issuer is a special purpose vehicle incorporated in England ultimately owned by The National Home Loans Holdings PLC.

The assets backing the structure are first mortgages secured on residential properties in England or Wales that have been sold by NHL and Home Loans Direct Limited (HLDL). The Issuer funds the purchase price of the loans by issuing the Class A Notes, Mezzanine Notes and Loan Stock.

Start up expenses of the issuer are funded by HLDL. These costs are repayable by the issuer though such payments are subordinated to payments of both interest and principal to the Class A and Mezzanine noteholders. NHL has also advanced a separate Subordinated Loan to the issuer to fund the initial First Loss Fund of £5,000,000.

The First Loss Fund also acts as a source of liquidity for the structure and assists the payment of interest in event that income from the mortgages is insufficient to pay Class A and Mezzanine Note interest and various costs. Proceeds from the sale of possessed properties are treated first as income and then principal and this also enhances liquidity. Finally replenishment of the First Loss Fund is senior to the reduction in the Principal Deficiency Ledger, until Class A Notes are no longer outstanding.

The structure does not possess a Reserve Fund to fund mandatory further advances on the mortgage portfolio or the potential for the deferral of interest on the stabilised rate mortgages. Moody's believes that the liquidity provided by the First Loss Fund and by the structure of the transaction, is consistent with the ratings assigned to the notes.

No purchases of new mortgages with redemption moneys is permitted, though the Issuer may, subject to various conditions, utilise principal receipts to make discretionary further advances on existing mortgages of up to £40,000,000.

### **Interest Rate Risk**

The issuer receives either an administered or an externally set variable mortgage rate or a temporarily fixed rate on its mortgage assets while paying Libor plus a margin on the notes.

The Servicer is obliged to set a mortgage rate on the administered variable rate mortgages within the portfolio so as to charge an "Average Margin" on the whole pool of at least 150bp pa over 3 Month Libor.

The structure does not contain the Threshold Rate Mechanism found in previous NHL securitisations, and thus there is a small risk that the interest rate charged on the mortgage portfolio may be less than that payable on the Notes, plus various expenses. The servicer is however, obliged to set a minimum Average margin of at least 200bp after the step up date on the Class A2 Notes, and the residual risk is consistent with the overall level of credit enhancement within the transaction, and the credit ratings assigned to the Notes.

There may be a small element of direct interest rate exposure within the transaction due to the presence of certain mortgage products such as fixed rate loans which may be

unhedged. This is consistent with the prospective ratings due to the small proportion of the pool affected (1.3%), the limited remaining time before reversion to variable rate (between 1 and 34 months), the Average Margin mechanism, and the overall credit enhancement within the transaction.

The Servicer may also agree to convert fixed rate into floating rate mortgages and vice versa, and may also alter the repayment method between repayment, endowment and pension linked. There is no requirement to hedge such further interest rate exposure, unless the then current rating of the notes would be adversely affected.

A Shortfall Fund, may be established by the Servicer to enable it to set an Average Margin on the mortgage pool below the minimum level, to the extent that the fund is able to make good the difference.

### **Credit Enhancement**

The first layer of protection is *spread* in the transaction, which is the difference between (1) the income received from the mortgages and other investments, and (2) the coupon on the notes plus various ongoing costs. The value of this spread was assessed under a variety of adverse conditions which would minimise its effectiveness, including high prepayment speeds, and back-ended losses. Excess spread leaves the transaction to the extent that it is not required to meet ongoing or past losses or to add to one of the various funds.

The existence of mortgages that are currently in arrears with their payments within a structure, may increase the protection provided by excess spread, as losses are more likely to occur early in the life of the structure, when excess spread may otherwise leave the transaction.

The second layer of protection for investors is the *overcollateralisation* of the Notes, as approximately £250 million of mortgage assets (or principal redemption funds), support £242.5 million of Notes. This was funded through the sale of some of the mortgages at a discount to their principal amount outstanding, and through the issuance of Loan Stock.

The third layer of protection for investors is the *First Loss Fund*, which is £5,000,747 or 2% of the initial balance of the initial mortgage pool. Excess spread is also used to replenish any drawings from the First Loss Fund in prior periods, throughout the life of the transaction.

The balance of the First Loss Fund may amortise in line with the mortgage collateral, subject to certain severe triggers, to the extent that the remaining balance equals 4% of the outstanding mortgage pool.

The final layer of protection for the Class A Notes are the *Mezzanine Notes*.

On each payment date on the Notes, interest on the Class A Notes is paid in priority to payment of interest to the Mezzanine Notes.

If outstanding principal losses and any interest arrears on the notes, after the effect of spread, exceed the first loss fund plus the Mezzanine note balance, then the payment of Mezzanine note interest is subordinated to the rebuilding of the first loss fund and to the reduction of the principal deficiency ledger. Mezzanine interest is therefore effectively subordinate to A Note interest and principal but not Mezzanine principal.

No principal is paid to the Mezzanine Noteholders until the Mezzanine Notes represent approximately 25% of the total Class A and Mezzanine Notes. Thereafter, and subject to certain triggers, prepayments are allocated so as to restore the 25% ratio. The Mezzanine Notes are subject to a minimum balance of £2,000,000 while any Class A Notes remain outstanding.

### **Collateral**

The notes are backed by residential first mortgage loans on properties in England or Wales. Approximately 85% of the pool is comprised of loans originated by NHL prior to December 1991. The remainder had been granted by Homeloans Direct Limited "HLDL", (an entity within the NHL group), since September 1994.

The pool credit quality was affected favourably by:

1. the conservative underwriting criteria employed by HLDL, and
2. the substantial seasoning (averaging over 6 years) of the loans originated by NHL.

Negative characteristics included:

1. the inclusion of mortgages currently in arrears with their payments (approximately 35% of the portfolio). This is partially offset by the fact that borrowers representing 25% of the arrears balances (approximately 8.5% of the portfolio) have, on average, paid more than their current monthly obligations over the past 6 months,
2. the retention by NHL of the right to receive up to £7,297,682 of overdue interest that was accrued on the above loans prior to the sale of the portfolio to Homeloans (No. 2) plc. Payments received on these individual loan accounts (including property sale proceeds), are allocated to the overdue interest claim retained by NHL, before being passed through to the structure,
3. the 24% of the pool which have been in arrears within the last 12 months, even though they are now current,
4. the high proportion (potentially 71%) of Self Certified loans in the pool. Self Certified mortgages allowed little or no formal verification of a borrower's declared income level provided that certain other criteria, (such as a low LTV) were met,
5. the inclusion of certain mortgages where NHL's normal underwriting practices or record keeping was not followed, and
6. the £2.6m of loans in the portfolio that represent shared ownership mortgages originated by HLDL.

Almost all of the loans originated by HLDL with a LTV in excess of 70% have the benefit of Mortgage Indemnity policies provided by Lloyd's of London. A substantial element of this policy is re-insured on a cut through basis by highly rated entities.

Many of the older loans originated by other entities within the NHL group at LTV's in excess of 75%, benefit from Mortgage Indemnity contracts from one of Sun Alliance and London Insurance Limited (**Aa3**) or Legal and General Assurance Society Limited (**Aa1**).

### **Servicer**

NHL is the servicer for the transaction. NHL currently employs approximately 300 staff in administering a mortgage portfolio of approximately £1.3bn for the NHL group and associated securitisation vehicles. Barclays Bank plc is the servicer of last resort.

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