

Dynamic Credit Partners

Dutch Mortgage Market

January 2012



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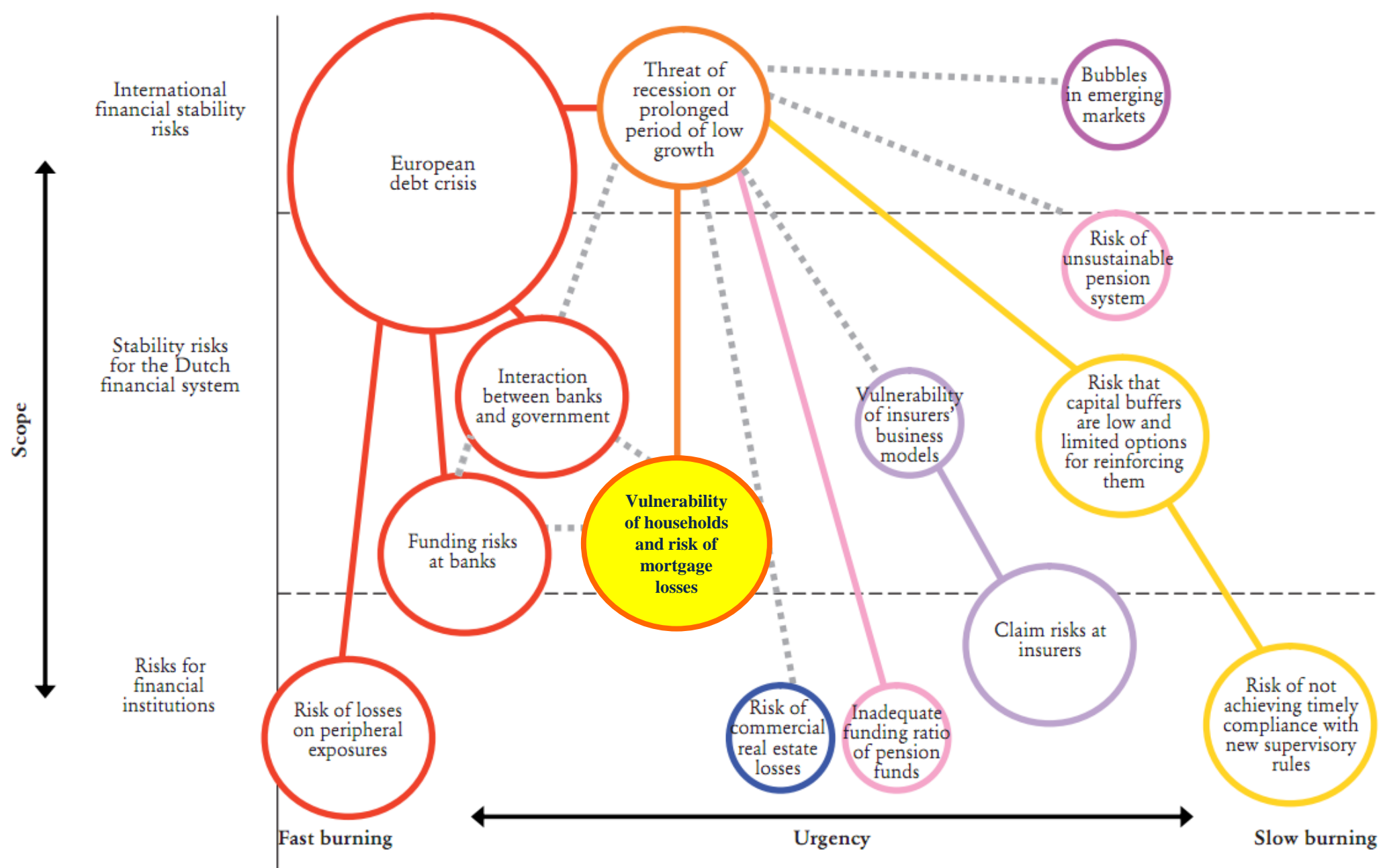
Overview

Part 1:

- Dutch mortgage market overview
- Drivers of mortgage default

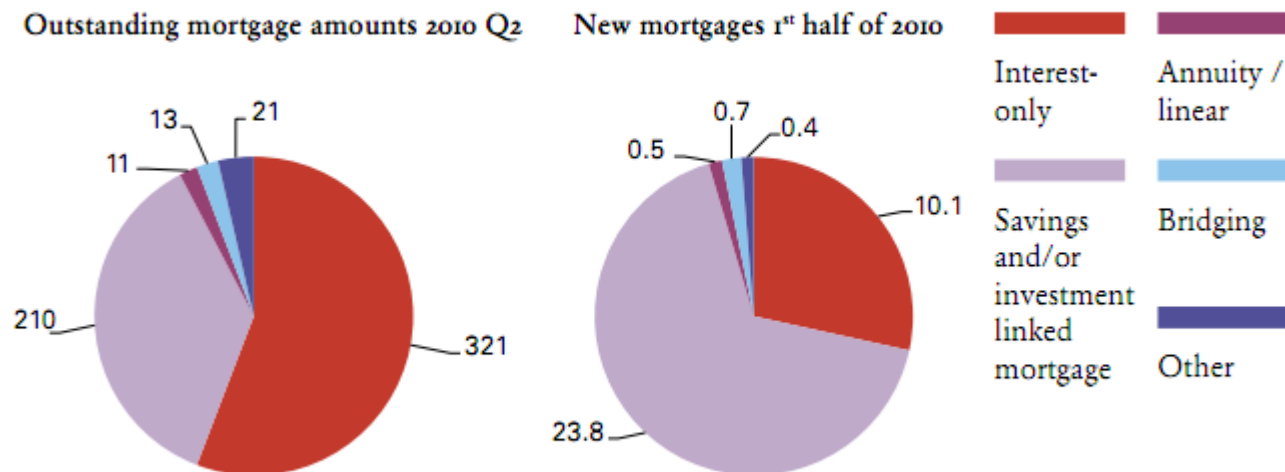
Part 2:

- Alternative Funding Solutions for Banks



Types of Mortgages

EUR billion.



Source: DNB.

Interest Only Mortgages

- Borrower is obliged to pay only interest during the term of the loan and principal is due upon maturity

Annuity/ Linear Mortgages

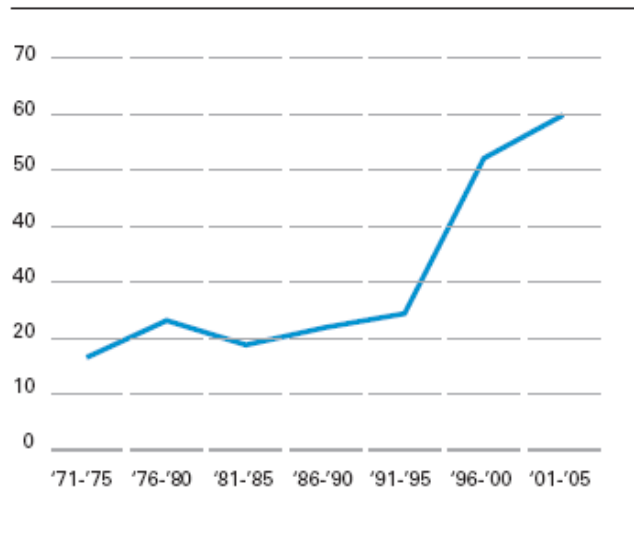
- Borrower pays a constant total amount consisting of decreasing (increasing) portions of interest (principal), or a fixed principal amount on each installment with each payment date to amortize the mortgage

Savings/ Insurance Linked Mortgages

- (Beleggingshypotheek/ Levenhypotheek/ Spaarhypotheek/ Bankspaarhypotheek) Instead of amounts towards redemption, the borrower invests an agreed minimum amount in certain investment funds, takes out an insurance policy consisting of risk insurance and capital insurance, or saves at a fixed rate to repay the mortgage at the end of the mortgage term.

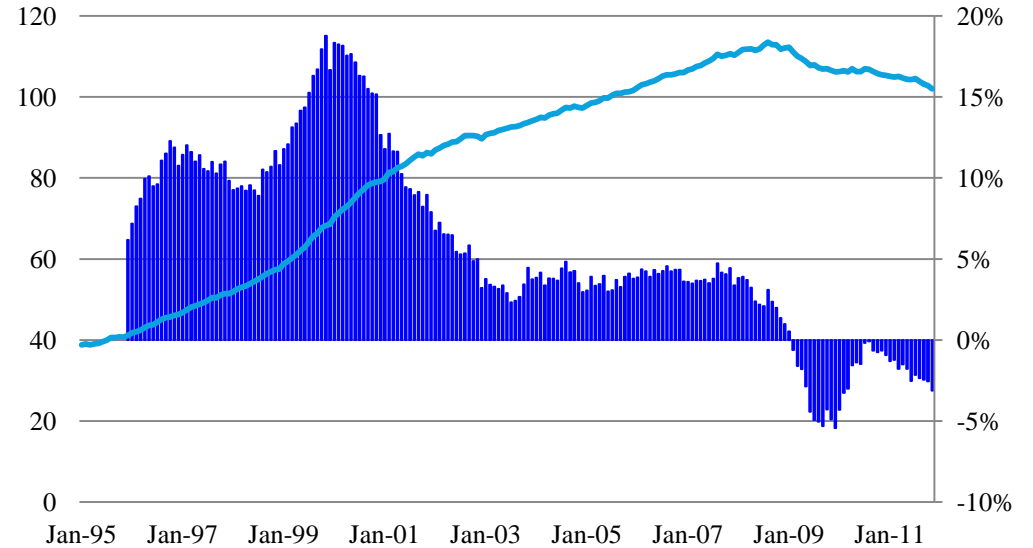
High LTVs started in the late 90s, because of large house price increases

Percent of New Mtges with LTV > 100%



From: DNB Household survey 2005.

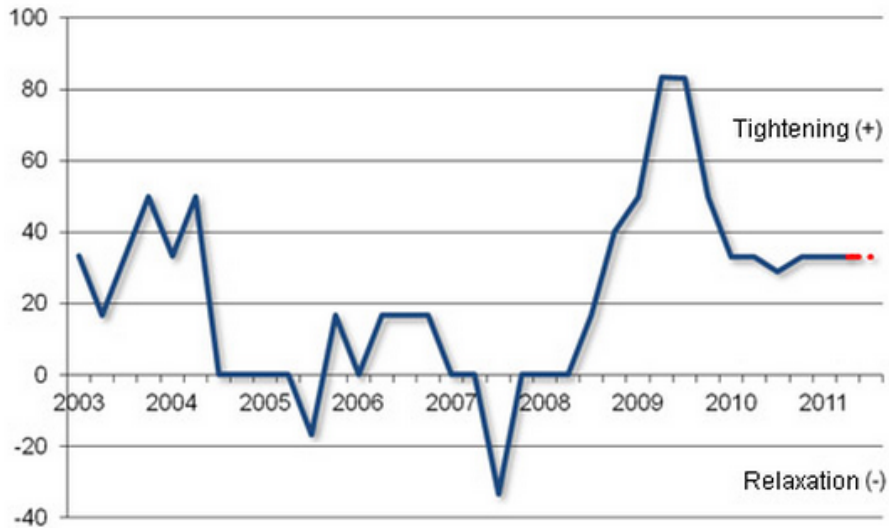
Housing Price Appreciation



Source: CBS ■ Annualized Change (%) — Housing Price Index (2005 = 100)

Change in Funding Environment Means Less Available Credit

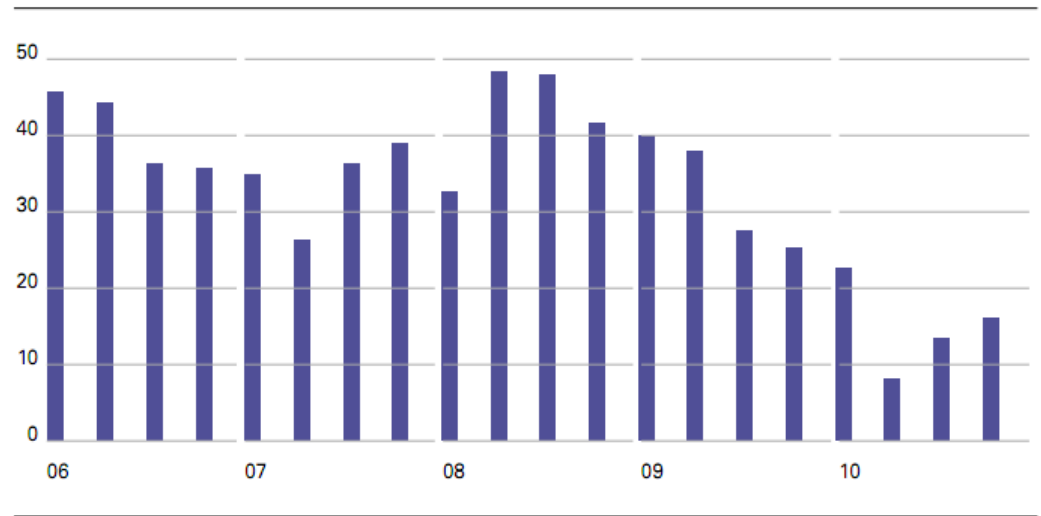
Tightening of Residential Mortgage Lending Criteria



Net percentage is the balance of the number of banks indicating that they have tightened the standards, minus the number of banks that have indicated to have relaxed the standards. Banks that did not change their policy have not been considered.

Slow-Down in Lending is Evident by Lower Y-o-Y Change in Households' Mortgage Debt

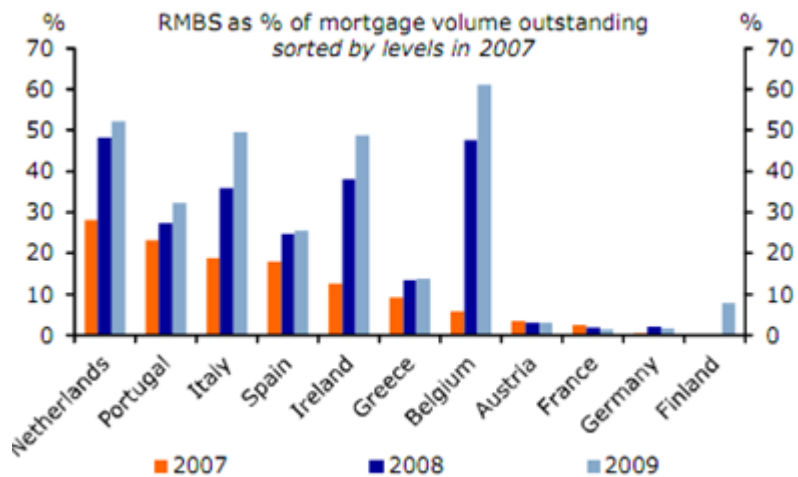
EUR billion.



Source: DNB.

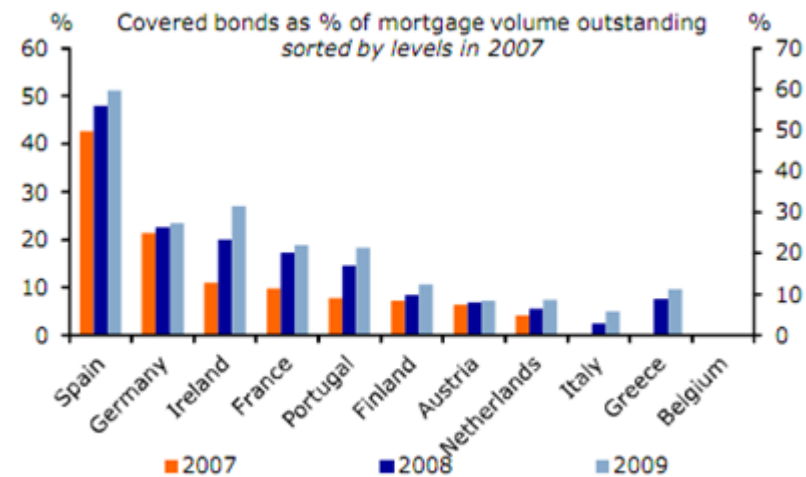
Banks Rely on Securitisation to Fund Mortgage Lending

Dutch Mortgage Lending Relies on Securitisation



Source: European Securitisation Forum (ESF), ECB

...Not so much on Covered Bonds



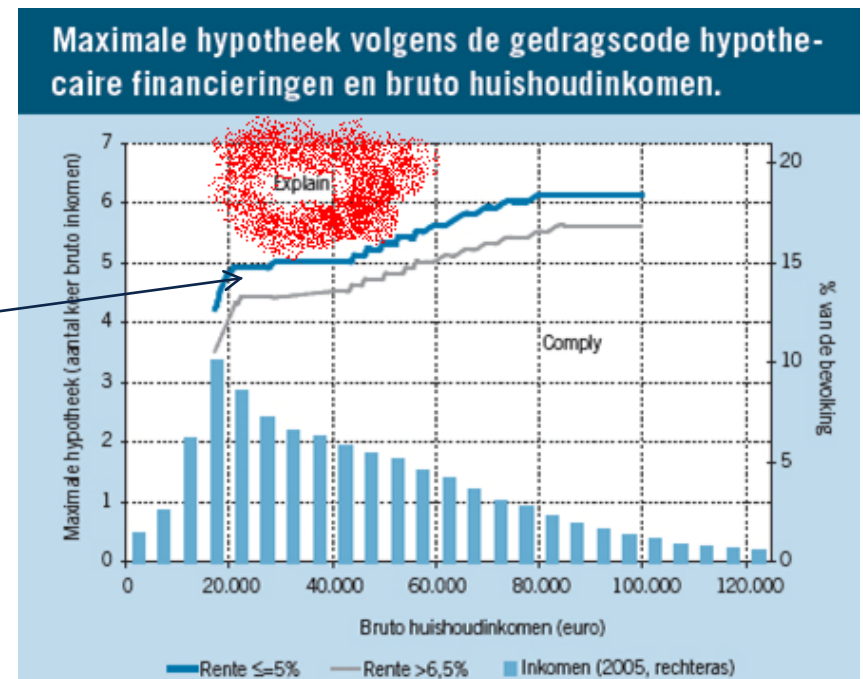
Source: European Covered Bond Council (ECBC), ECB

We all now understand the risk of mortgage innovation...

Underestimated effect of many years of **mortgage innovation** on mortgage risk:

- According to the AFM (Dutch financial markets regulator) analysis, 25% of the mortgages of previous years did not comply with the mortgage-code-of-conduct. Of those 'explanations', 80-90% is considered 'not prudent' by the AFM.

According to the 'code-of-conduct':
low income households are allowed to borrow up to 5 times their income (when rates are <5%), with NO further explanation



We all now understand the risk of mortgage innovation...

Underestimated effect of many years of **mortgage innovation** on mortgage risk:

- Mortgage innovation was allowed to get out of control because mortgage industry regulation was weak and relied on weak self-regulation:
 - Loose ‘code of conduct’ with high LTVs and high LTIs
 - ‘Comply-or-explain’, with this loose code of conduct, and originators were allowed to give weak explanations (also see next page)
 - Large number of financial illiterate borrowers
- Mortgage innovation in The Netherlands was comparable to the US (including the vicious cycle of: higher house prices leading to more affordability products which lead to higher house prices, also fueled by excessive liquidity)

Risky mortgage innovation is more likely to grow in a weak regulatory environment

Housing prices are likely to fall from the pre-crisis peak

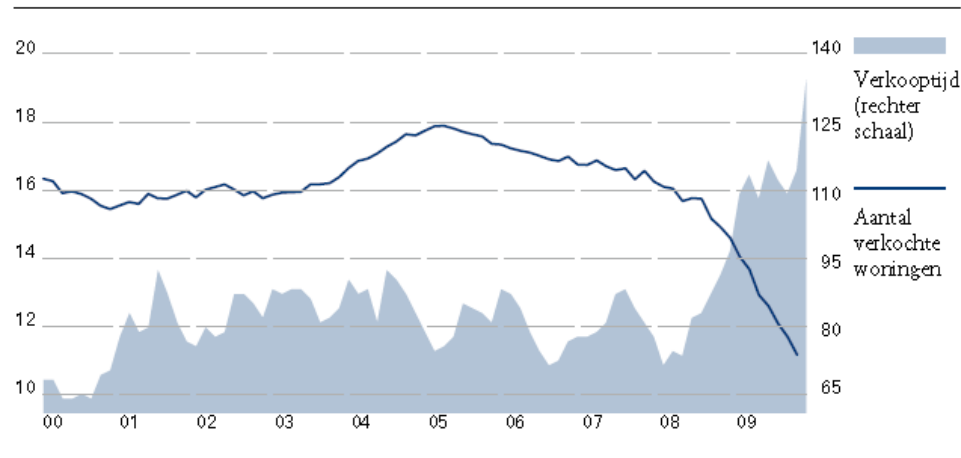
House price bubble has yet to fully disappear

- in the 12 years before the house price peak:
 - Consumer price inflation: +33%
 - Income growth: +55%
 - House price increase: +160%

US house prices increased by only 135% in the 12 years before their housing peak...

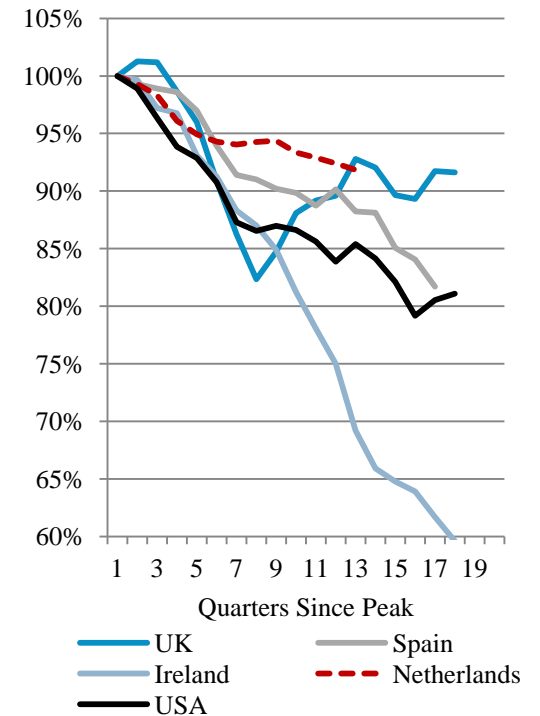
Grafiek 10 Woningverkoop

Aantal verkochte woningen; twaalfmaands voortschrijdend gemiddelde, x 1.000; verkooptijd, in dagen



Bron: CBS/Kadaster & NVM.

HPA From Pre-Crisis Peak



Source: ECB Residential Property Price Index Statistics, FHFA, Nationwide

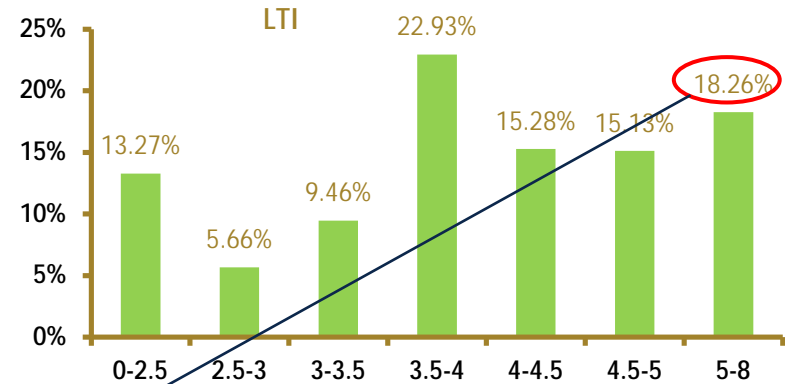
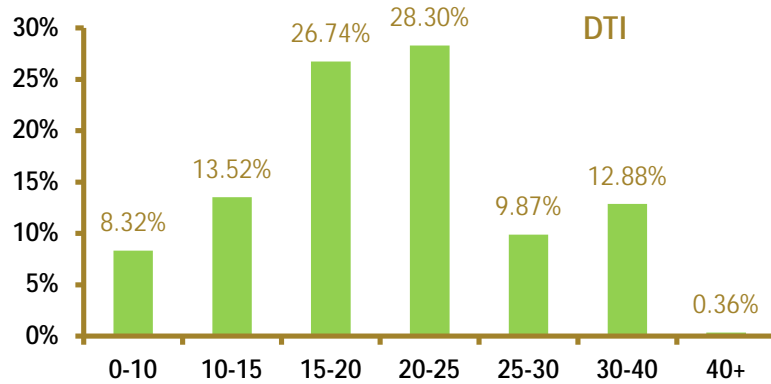
Drivers of mortgage default

- **Ability**-to-pay, due to
 - Income decline
 - Expenses increase

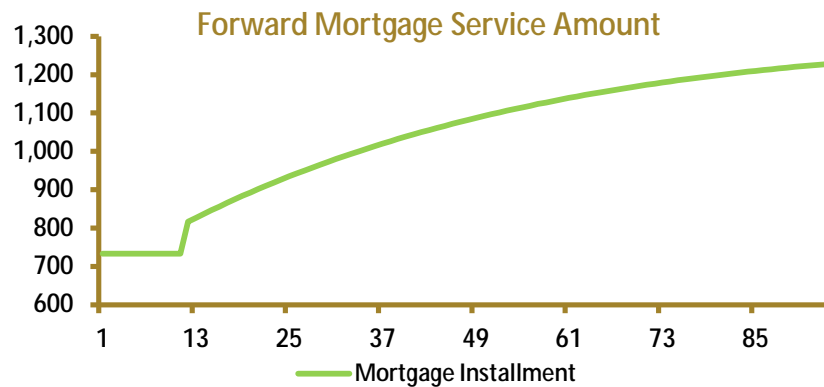
- **Willingness**-to-pay
 - Strategic default option could get a positive value at some point

Drivers of mortgage default

Sample Dutch Mortgage Portfolio



Sample Loan (>100 Current LTFV, <25 DTI, >5 LTI, Current Rate 4%)



* Assuming at reset the interest rate switches to variable, Forward Mortgage Rates are implied based on current market data

Drivers of mortgage default

Indicator	Sample Loan 1	Sample Loan 2
Current Balance	180.000	250.000
Foreclosure Value	156.521	217.391
Interest Rate	4.5%	6.5%
Remaining Fixed Period (years)	3	20
Current LTFV	115%	115%
DTI	23,1%	19,1%
Income	35.000	85.000
Borrower Age	26	46
LTI	5,14	2,94

→ **which one is riskier ?**

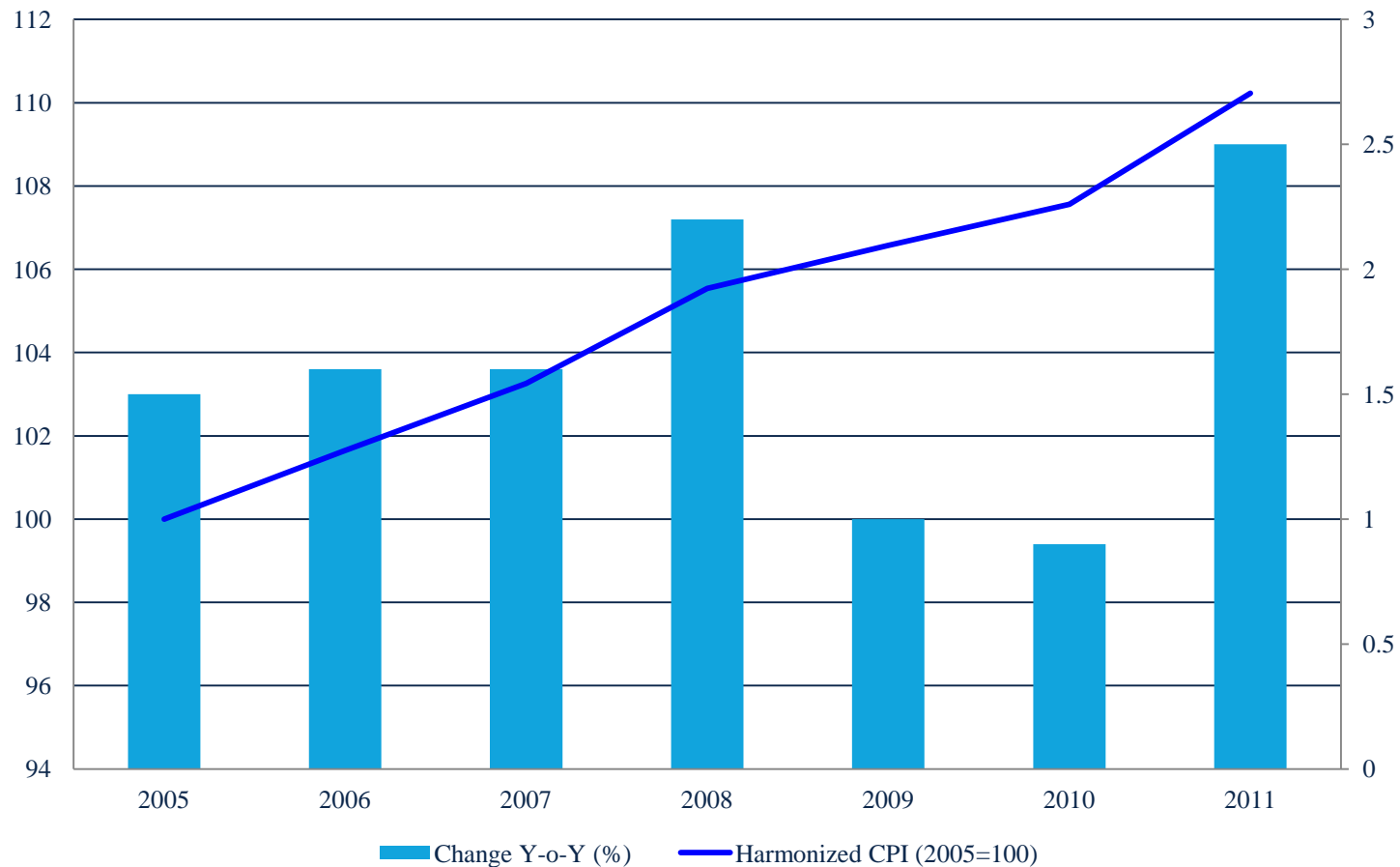


How much “room” does this borrower have for:

- Ø1. Income decline (unemployment, less hours worked, lower wages, less government subsidies, etc)
- Ø2. Expenses increase (interest rate shocks, inflationary periods, life events (children, divorce, etc)

Dutch Consumer Price Index

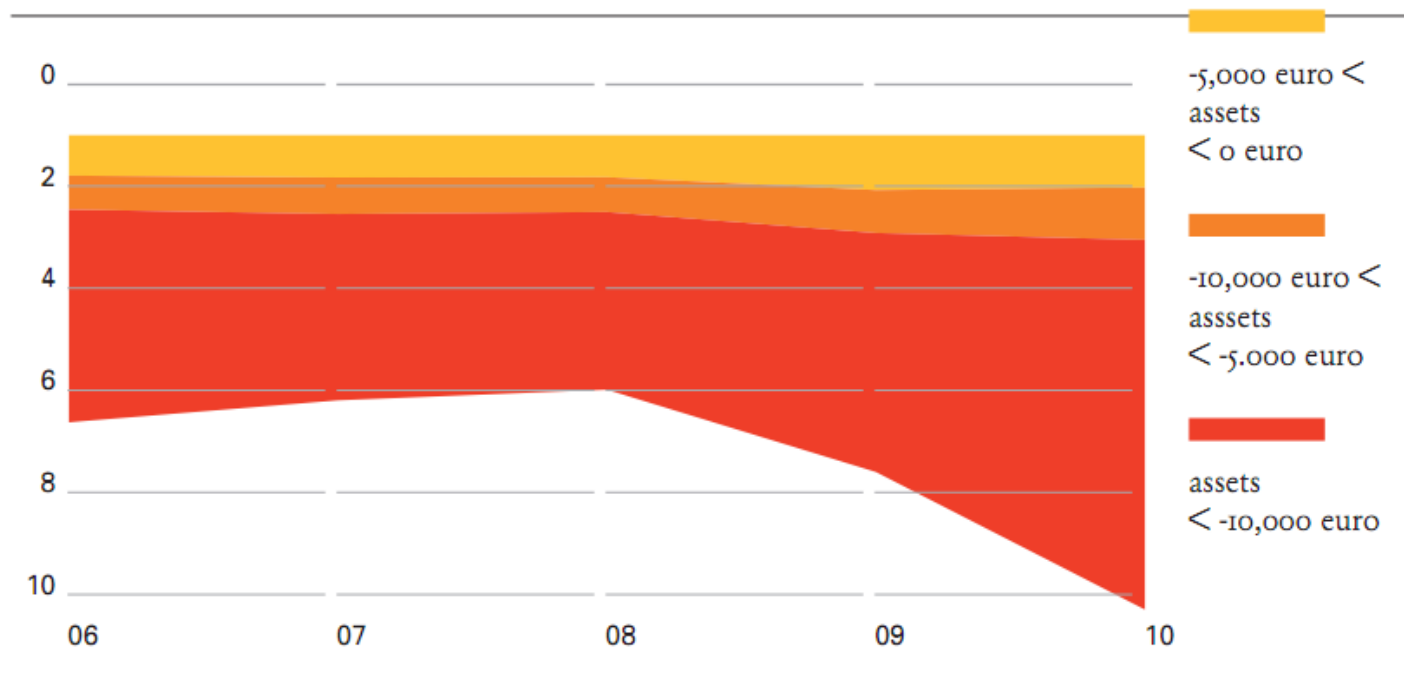
Inflation (2005-2011)



Source: CBS

Increase in Households with Negative Net Assets

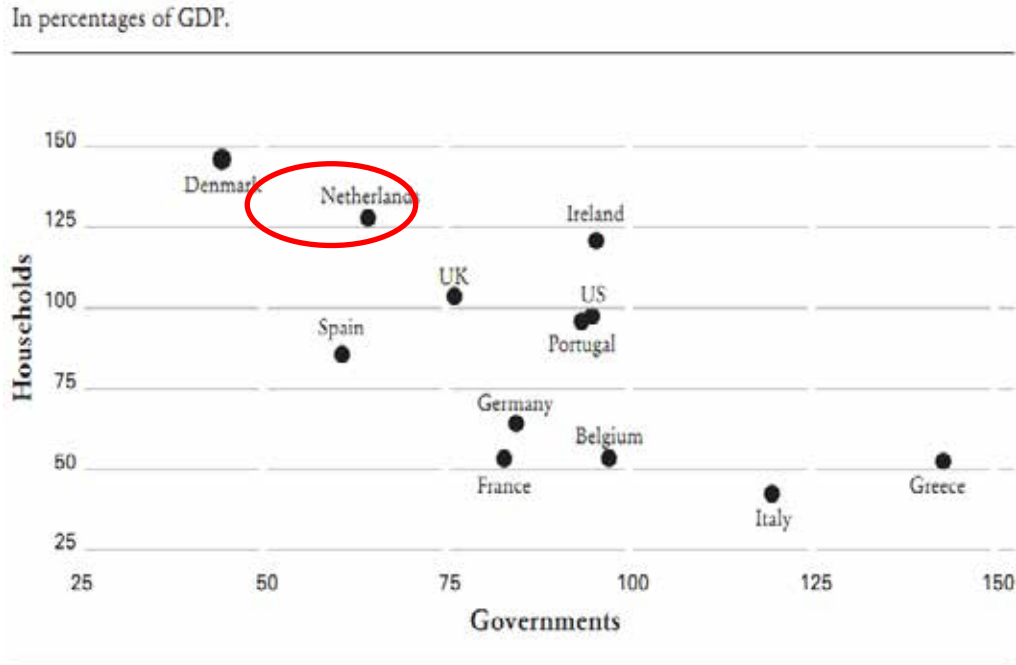
In percentages of total number of households, as at 1 January.



Source: Statistical Netherlands.

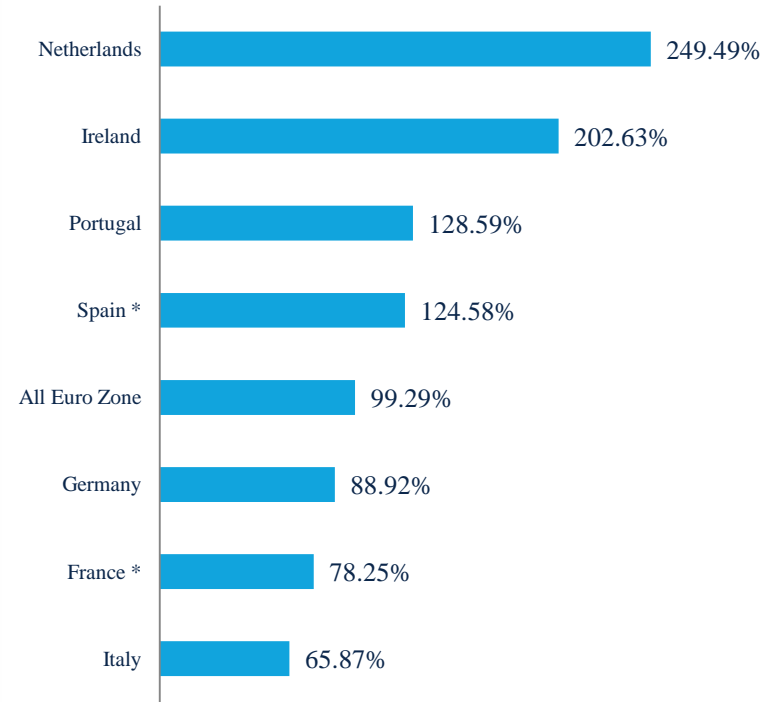
Dutch Household Suffer from Heavy Debt Burdens

Household Debt vs. Sovereign Debt



Households relate to data at 2009, sovereigns at 2010.
Source: OECD and IMF.

Household Debt to Disposable Income

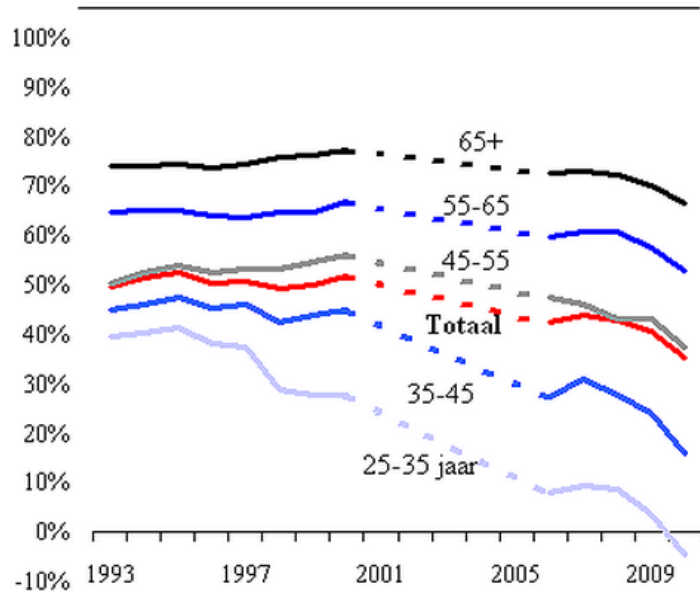


Source: Eurostat

Young Homeowners are Most Vulnerable

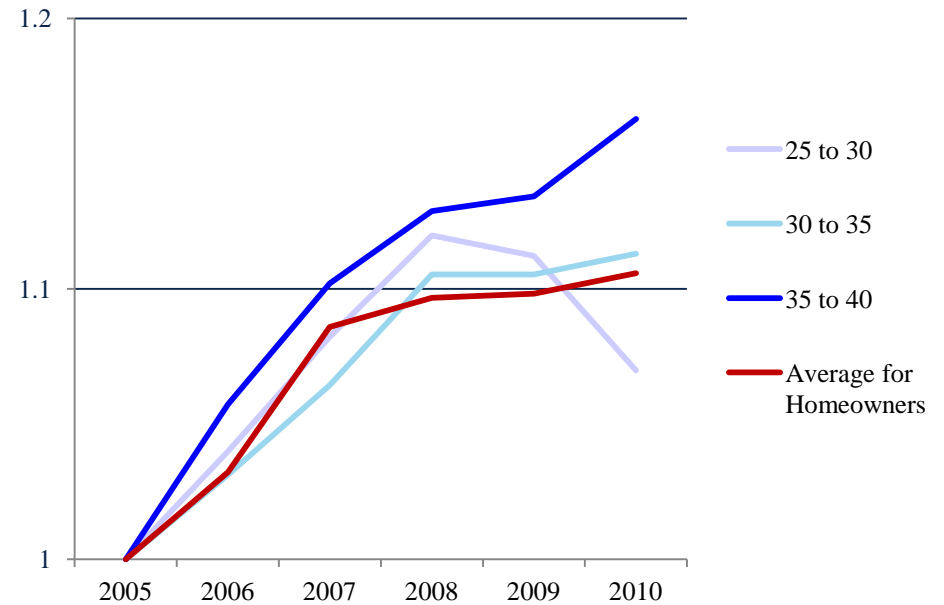
Home Equity by Age Cohort

Average home equity held by mortgage borrowers as a percentage of the average house price; no data are available for the 2001–2005 period.



Source: CBS

Income Growth By Age Cohort (Indexed)



Source: CBS

Historical Mortgage Rates

Figure 1a: Mortgage rate, fixed up to 1yr

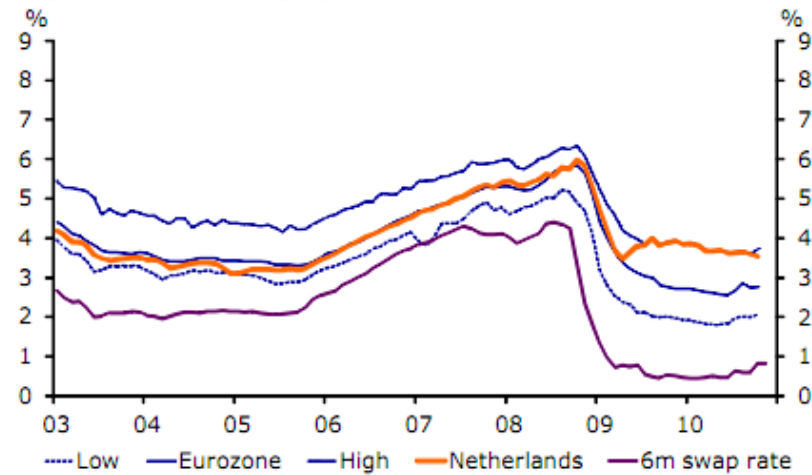


Figure 1b: Mortgage rate, fixed 1-5yrs

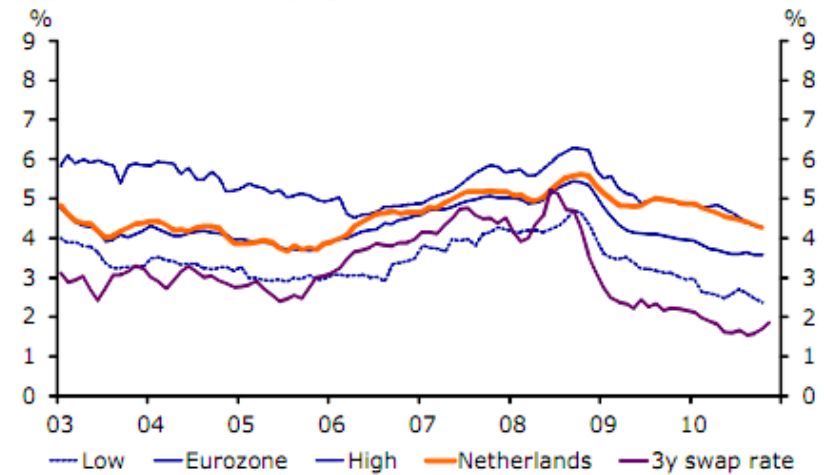


Figure 1c: Mortgage rate, fixed 5-10yrs

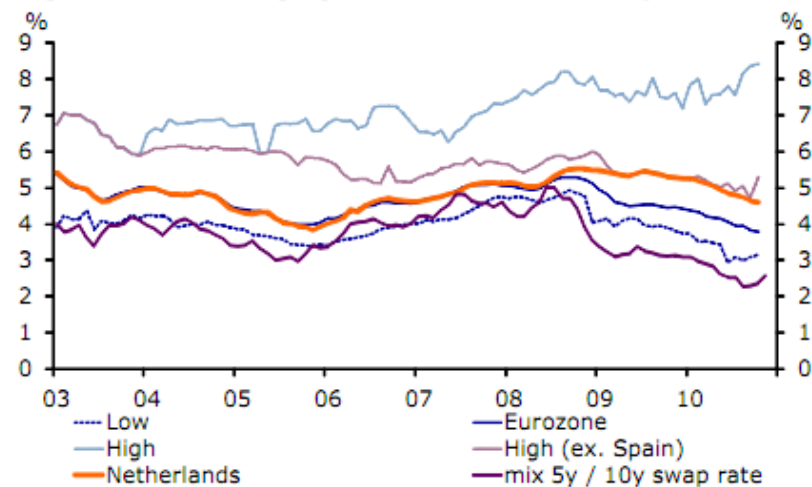
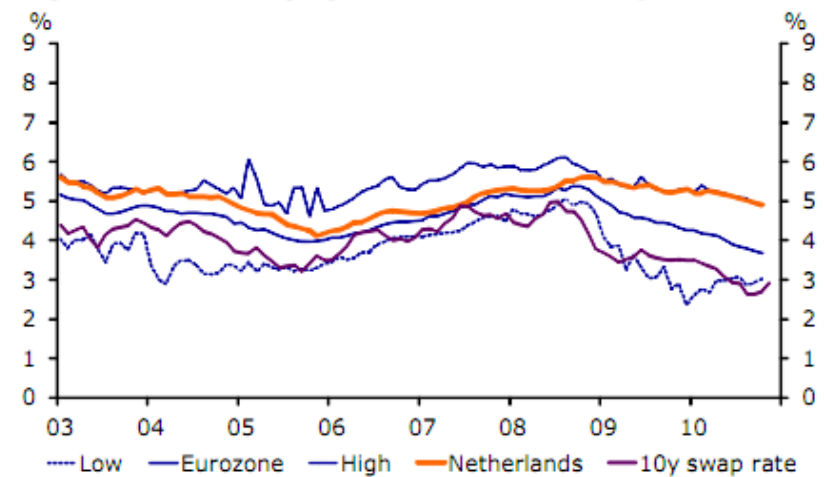


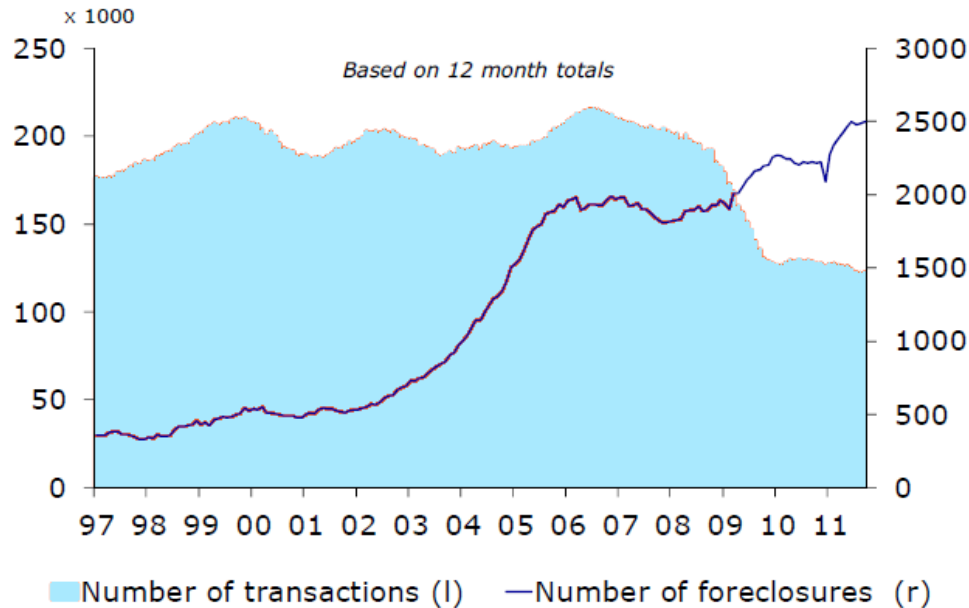
Figure 1d: Mortgage rate, fixed 10+yrs



Source: European Central Bank (ECB)

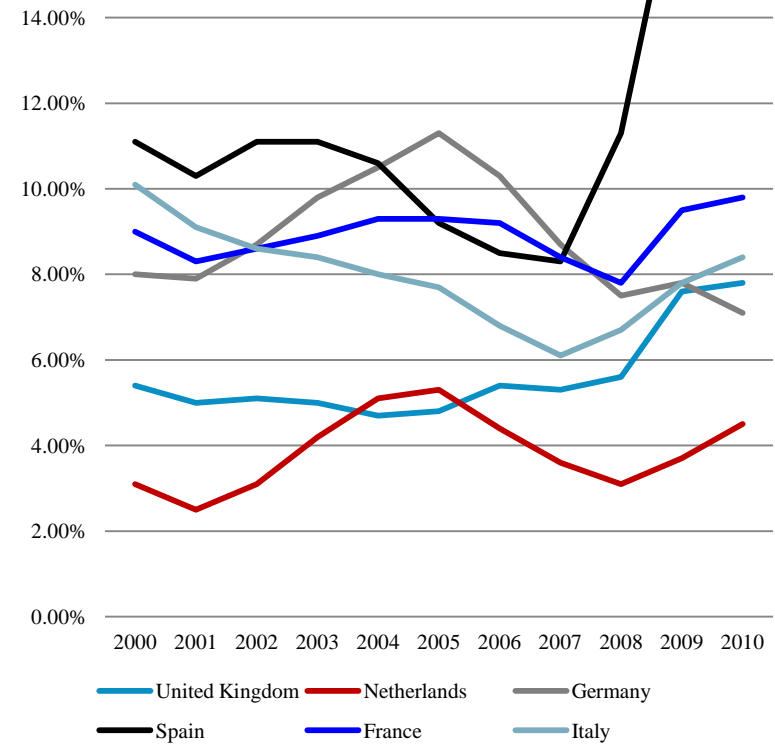
Mortgage Performance Weakens as Unemployment Rises

House Sale Transactions vs. Foreclosures



Source: Statistics Netherlands/Land Registry

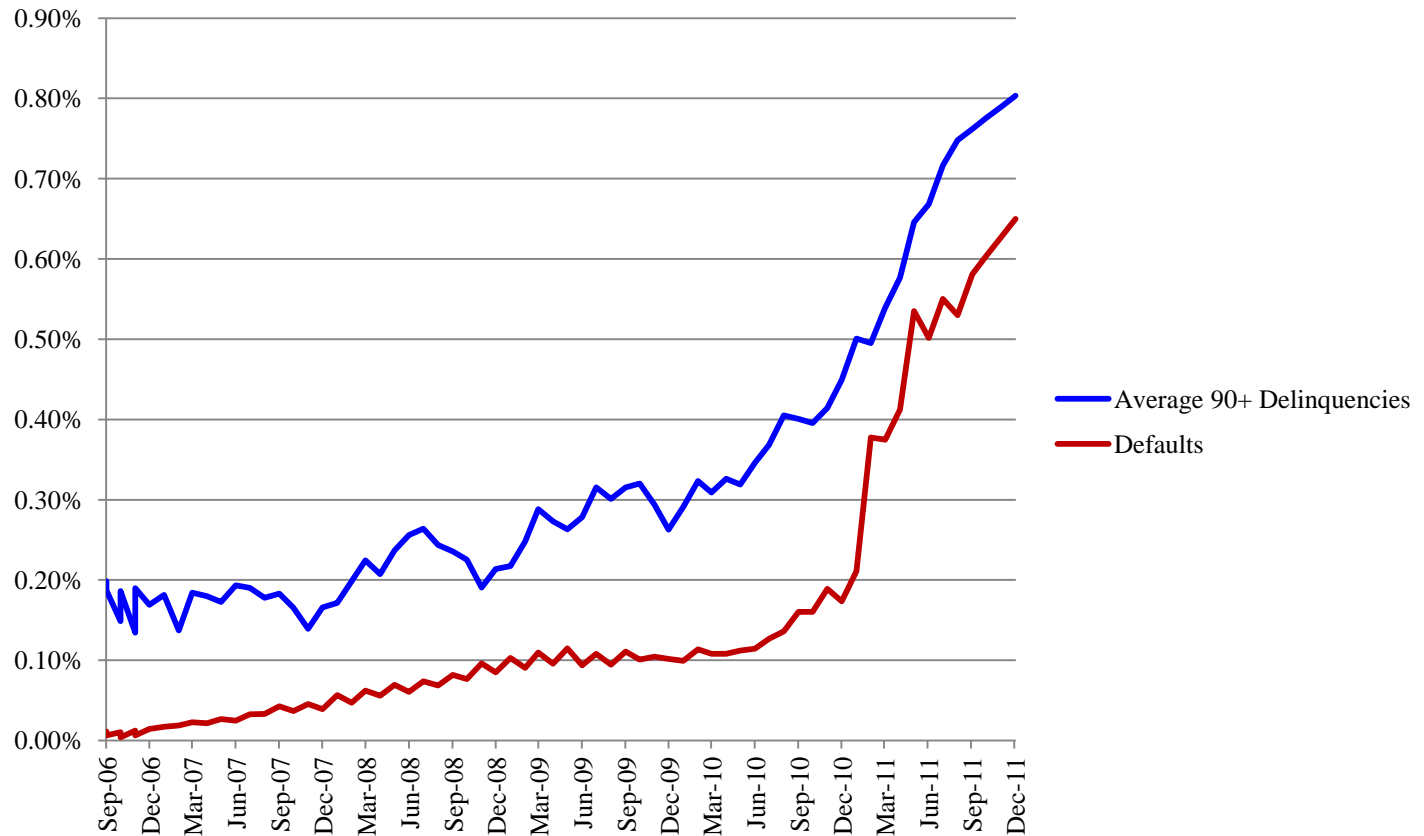
Unemployment Show an Upward Trend



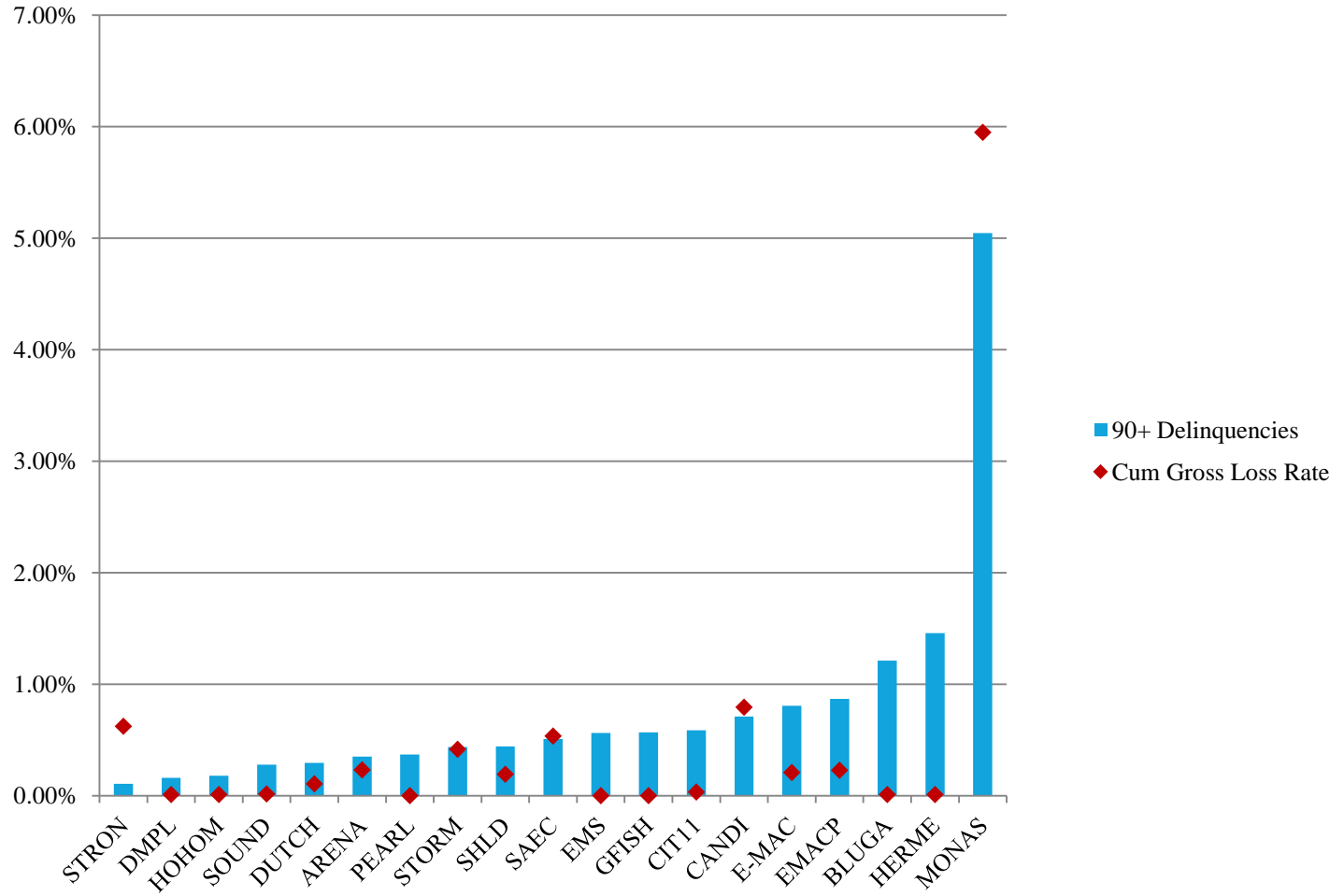
Source: Eurostat

Significant increase in delinquencies, although low in absolute terms

In the rear-view mirror, arrears are low in absolute terms (as of Q4 2011)



Dutch RMBS Performance Per Issuer as of Q3 2011



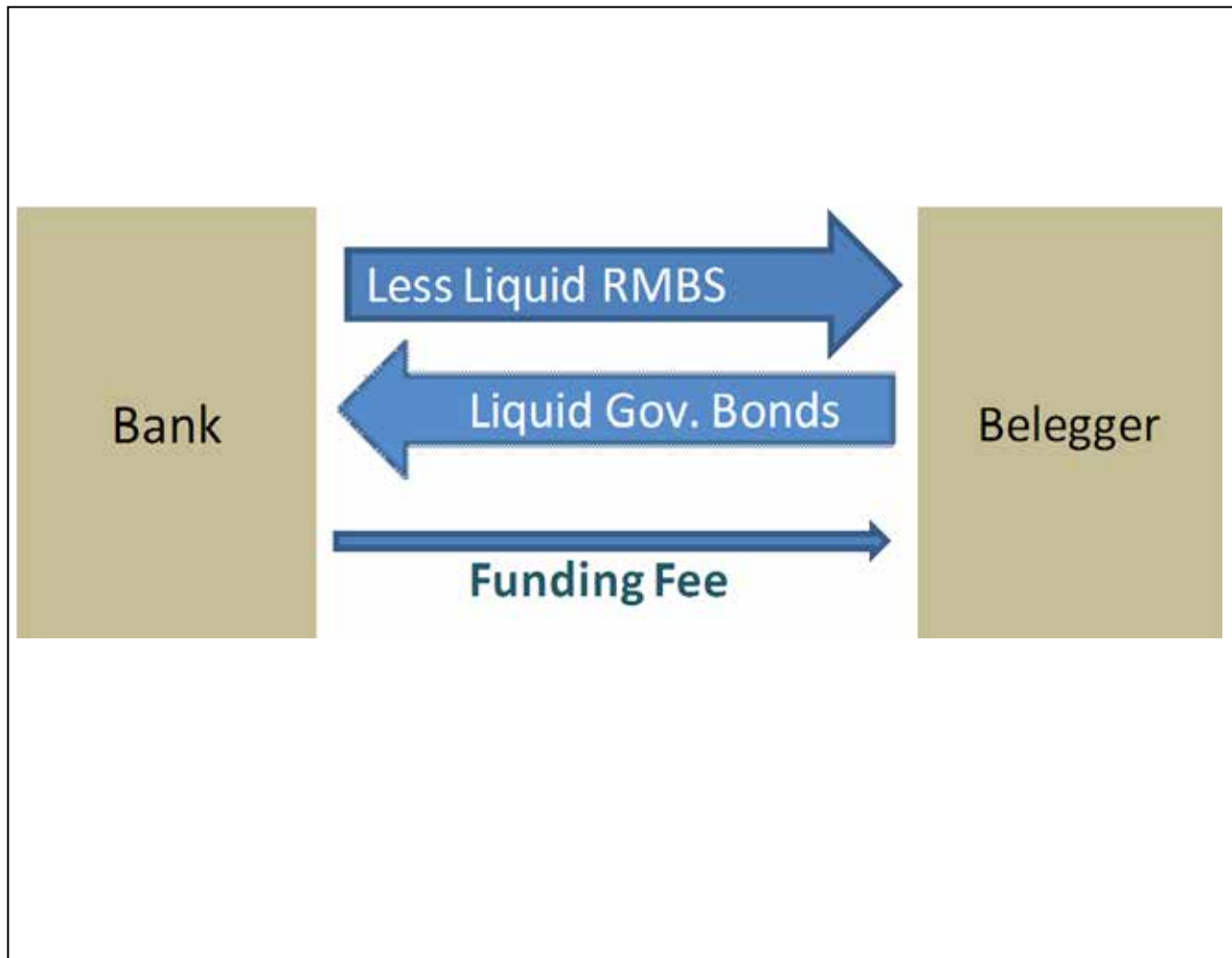
Alternative Funding

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Alternative Funding: Collateral Swap

- Economic ownership of the RMBS stays with the bank



- Haircuts + **daily Mark-to-Market**
- è The investor stays **collateralized** on a daily basis

Alternative Funding: Collateral Swap

Advantages:

Investor	Bank
<u>Customized</u> (term and collateral)	<u>Customized</u> (term and collateral)
<u>Direct</u> access to collateral when the Bank defaults	Relatively low funding cost
<u>Daily</u> collateralized	Diversification of Funding
<u>Low</u> 'Loss-Given-Default'	Liquidity ratio ↑ Stable Funding ratio ↑

Hurdle for investors, partially through the perception of the regulator's opinion

Requirements on:

- Valuation
- Transparency
- 'Internal Management Environment'

Advantages of Collateral Swaps for banks

