Valuation NEWS
from G.A. Farrell & Associates Ltd.
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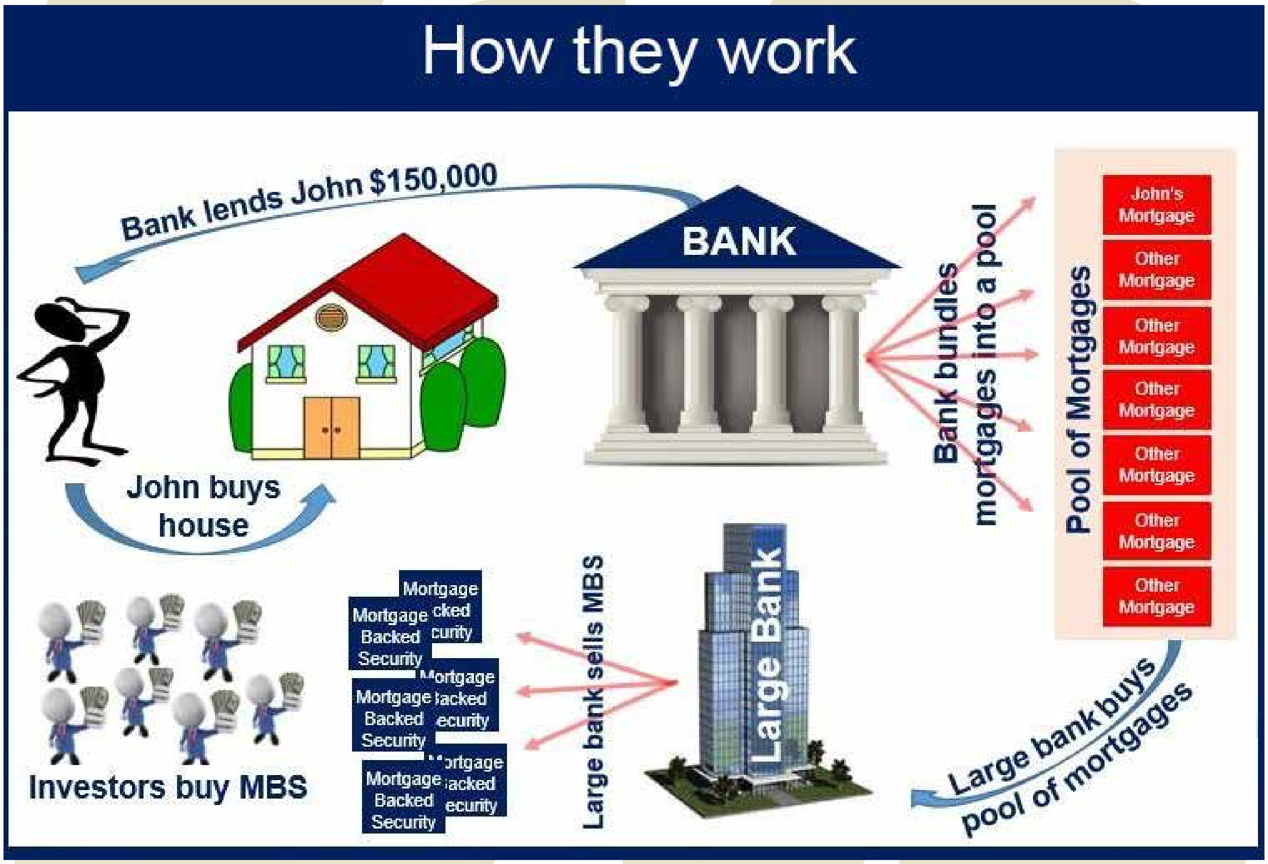
# MORTGAGE-BACKED SECURITIES




The Home Mortgage Bank recently announced the introduction of its Mortgage-Backed Securities (MBS). In the US there are 3 government agencies involved in MBS – Fannie Mae, Freddie Mac and Ginnie Mae as they are commonly known as.

The MBS is a type of bond representing an investment in a pool of Real Estate loans. Originally created in the US around 1968, the idea was to allow banks to 'sell-off' their mortgages and so free up funds for them to lend to other borrowers.

To explain what a MBS is basically, we will examine the customary mortgage loan process. Let's say John is interested in buying a home and applies to a bank to borrow $900,000. When the bank makes the loan to John, in most cases it receives a monthly payment of principal

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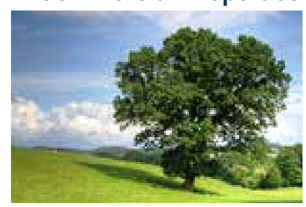
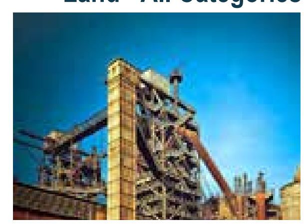
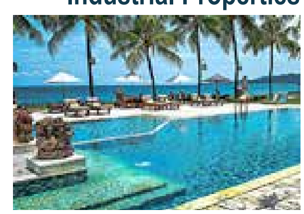

Land - All Categories


Industrial Properties


Special-Purpose Properties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and interest on the loan for its duration – say 25 years. A drawback from the standpoint of the bank is that its capital is tied up for 25 years.

With the advent of MBS, the bank 'sells' the mortgage (the income stream of monthly payments of interest and principal) to an entity thereby freeing up capital and enabling the bank to make more loans. The bank makes money from the originating and servicing of the loan and other fees. The entity that purchases the loan will pool it with other loans purchased by it and then this pool is sold to investors in the form of bonds secured by the mortgages. So, although John continues making his monthly mortgage instalment to the bank, it is really going to the investors.

> "MBS allows banks to free-up capital (to make additional loans) and provides an investment opportunity for investors"

As will be seen from the above, MBS allows banks to free-up capital (to make additional loans) and provides an investment opportunity for investors. In the US, Mortgage-Backed Securities got a bad reputation as they enabled non-bank financial institutions to enter the mortgage business. These non-bank financial institutions were not too careful about the credit-worthiness of borrowers. This created more competition for banks who then lowered their lending criteria to compete which allowed people to get into mortgages they couldn't really afford.

With US mortgage interest rates increasing and housing prices falling in 2006, many of these borrowers with adjustable-rate mortgages were unprepared when their payments rose. As interest rates were now higher, they were also unable to qualify to refinance their loans. The result was that many of the borrowers defaulted and this led to the subprime mortgage crisis and the resulting 2008 financial crisis.

From the local investment standpoint, there are two main risk factors:

The first is the default risk which is if the borrower does not repay his/her mortgage. In Trinidad & Tobago, this risk is relatively small as local banks are generally very stringent in their lending practices. Besides, even if a borrower defaults, he/she is only one in a larger pool and furthermore, the loan is secured by a mortgage on a real estate property that most often has a higher value than the outstanding loan.

The other factor is the interest rate risk. When mortgage interest rates decline, borrowers tend to take new loans and repay their existing ones (aka refinance). While most loans have some form of prepayment penalty interest to help offset this occurrence, it nevertheless means that the investor would get back some of his/her invested capital at an inopportune time – i.e. when investment interest rates are low.

Nevertheless, if properly managed, local MBS can be expected to be relatively low-risk and customarily offer an attractive return.

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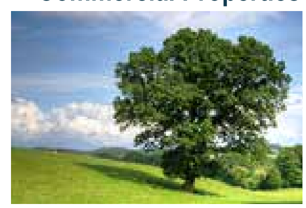

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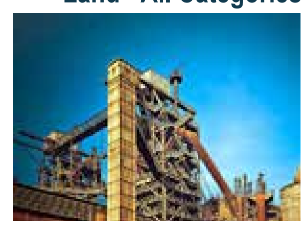

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