RMBS/Spain
Presale Report

Valencia Hipotecario 3 Fondo de Titulización de Activos

Expected Ratings*

Class	Amount (EURm)	Final Maturity	Rating	CE (%)
A1	90.0	Sept 2044	AAA	4.47
A2	780.7	Sept 2044	AAA	4.47
B	20.8	Sept 2044	A+	2.16
C	9.1	Sept 2044	BBB	1.15
D[1]	10.4	Sept 2044	CCC	n.a.

[1]Uncollateralised notes issued to finance the creation of the reserve fund

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* Expected ratings do not reflect final ratings and are based on the portfolio information provided by the issuer as of 23 October 2006. Expected ratings are contingent on final documents conforming to information already received. Collateral may be added or removed from the portfolio. Ratings are not a recommendation to buy, sell or hold any security. The prospectus and other offering material should be reviewed prior to any purchase.

Special Reports

The following special reports provide additional detail on Fitch's rating approach to the RMBS market; all are available at www.fitchratings.com

- "*Spanish Residential Mortgage Default Model III*", dated 15 September 2005;
- "*Spanish RMBS Performance Bulletin 2005*", dated 14 September 2005;
- "*A Guide to Cash Flow Analysis for RMBS in Europe*", dated 20 December 2002;
- "*Fitch Issuer Report Grades May 2006 Update*", dated 5 June 2006.

Summary

This EUR911.0 million transaction is a securitisation of residential mortgage loans originated by Banco de Valencia ("Banco Valencia" or "the originator", rated 'A/F1') and secured on properties in Spain. Fitch Ratings has assigned expected ratings to the notes to be issued by Valencia Hipotecario 3 Fondo de Titulización de Activos ("Valencia Hipotecario 3" or "the issuer") as indicated on the left.

This is the third standalone securitisation transaction to be brought to the market by Banco de Valencia and shares similar structural features and collateral characteristics to its two predecessors rated by Fitch in December 2005 and April 2004 (see reports "*Valencia Hipotecario 2*" and "*Valencia Hipotecario 1*", respectively, available at www.fitchratings.com). The issuer will be regulated by Spanish Securitisation Law 19/1992 and Royal Decree 926/1998. Valencia Hipotecario 3 will be legally represented and managed by Europea de Titulización, S.A., S.G.F.T. ("the *sociedad gestora*"), a limited liability company incorporated under the laws of Spain, whose activities are limited to the management of securitisation funds.

The expected ratings are based on the quality of the collateral, the available credit enhancement ("CE"), Banco Valencia's underwriting and servicing capabilities, the integrity of the transaction's legal and financial structure and the *sociedad gestora*'s administrative capabilities. The expected ratings address payment of interest on the notes according to the terms and conditions of the documentation, subject to a deferral trigger on the Class B and C notes, as well as the repayment of principal by legal final maturity for each note.

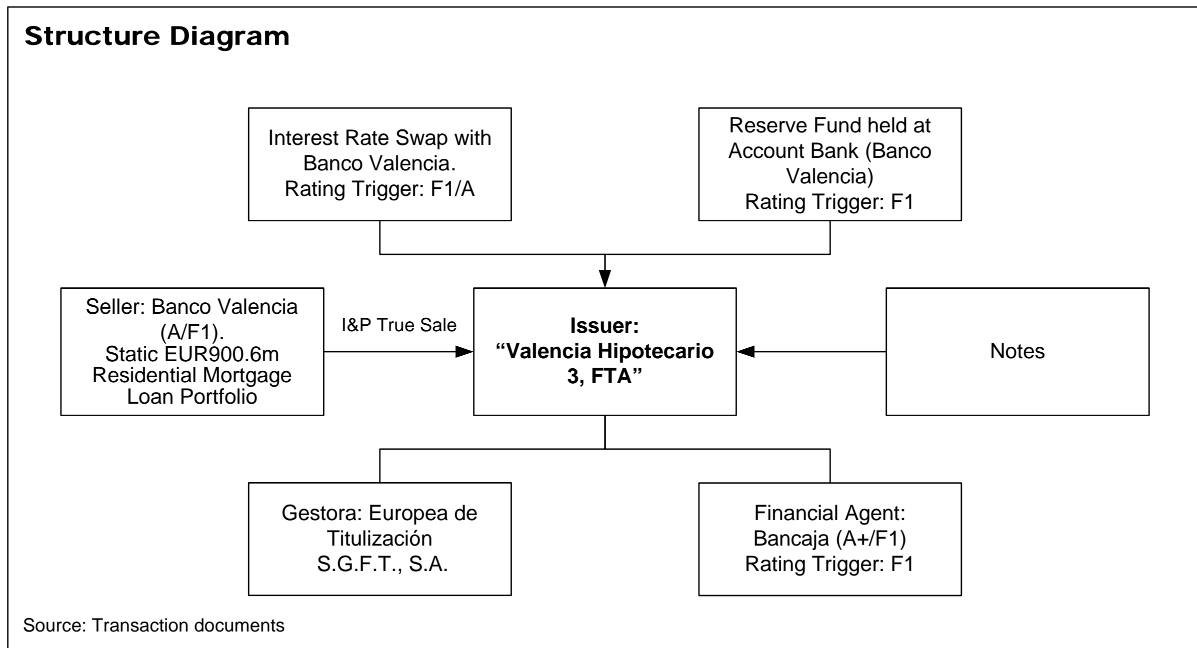
Credit Committee Highlights

Assets

- All of the loans to be included in the final collateral will be performing and linked to first-ranking residential mortgages.

- The main collateral characteristics are in line with the previous two transactions, although Valencia Hipotecario 3 has slightly higher loan-to-value ratios ("LTV"). See *Appendix 3* for a comparison table. For example, the weighted-average original loan-to-value ("WAOLTV") is 68.72%% and the WA current LTV 63.70%. The WA seasoning of the portfolio is 23.3 months, contributing to a 57.38% WA indexed CLTV. Note that all percentages are expressed in volume terms as a proportion of the outstanding balance as of 23 October 2006.

- Affordability - Fitch was provided with debt-to-income ("DTI") ratio information for c. 73% of the pool. Conservative assumptions have been adopted to loans where the affordability information was missing.



- Geographical breakdown - The pool is concentrated in the region of Valencia (67.73% compared to 65.3% in Valencia Hipotecario 2 FTA). Conservative assumptions have been applied to account for the concentration risk, by increasing the default probability of these loans by 10.0%.

- Employment status – 1.65% of the borrowers in the pool are self-employed and 22.66% "unknown". Fitch has increased the base default probability for these borrowers by 15.0%.

- Investment properties/second homes – 9.09% of the pool is secured over investment properties and 4.89% over second homes. Fitch has increased the base default probability of these loans by 15.0%.

- 2.47% of the portfolio comprises loans (also secured on first ranking mortgages over residential property) which declared a main purpose linked to consumption activities. The agency has assumed these loans to be equivalent to "equity withdrawal" loans and a 15.0% default probability hit has been applied.

- Grace period - 2.66% of the collateral has a principal repayment grace period of up to six years. Fitch has increased the base default probability of those loans with the grace period ending after the closing of the transaction by 5.0%.

- Repayment types – Fitch has increased the base default probability of loans repaying quarterly by 5%, semi-annually by 10% and annually by 15%.

- As can be seen in the performance chart on page 10 of this report, the performance data for Valencia Hipotecario 1 and 2, FTA has shown an unexpected trend with arrears over 60 days higher than the Fitch Spanish RMBS Index for the first two periods, reaching 0.64% and 0.86% of the collateral outstanding balance, respectively. The Fitch Spanish RMBS Index is calculated based on the performance data of the Spanish RMBS transactions rated by Fitch only. However, after discussing these figures with the originator and the sociedad gestora, a reporting error was detected in which some already amortised loans had been incorrectly classified as delinquent. The sociedad gestora and Banco Valencia have presented to Fitch an updated delinquency report, which will also be available on the gestora's website replacing the one currently displayed. Fitch has accepted the new calculations and has taken them into account to plot Banco Valencia's previous transactions and their performance relative to the Fitch index (see *Performance Analytics*).

Liabilities

- The Class D notes will be issued to finance the reserve fund (see *Reserve Fund*) at closing, and will be subscribed by Banco de Valencia. As the Class D notes are likely to default, Fitch conducted a sensitivity analysis using its cash flow model to stress the variables that will affect the cash available to pay down the Class D notes and, in turn, to calculate their expected recovery

Key Information

Portfolio Characteristics*

Total Principal Amount: EUR900.6m

WA Remaining Maturity: 21.9 years

WA Seasoning: 23.3 months

WA Original LTV: 68.72%

Largest OLTV: 100.00%

WA Current LTV: 63.70%

Largest CLTV: 99.42%

WA Indexed Current LTV: 57.38%

Key Parties

Issuer: Valencia Hipotecario 3 Fondo de Titulización de Activos

Originator/Seller: Banco de Valencia ("Banco Valencia", 'A/F1')

Sociedad Gestora: Europea de Titulización, S.A., S.G.F.T.

Swap Counterparty: Banco Valencia

Servicer of the collateral: Banco Valencia

Servicer of the notes: Caja de Ahorros de Valencia, Castellon y Alicante ("Bancaja", rated A+/F1)

Arranger and Lead Managers: Europea de Titulización, S.A., S.G.F.T., Bancaja

Interest Payments: Floating rate payable quarterly in arrears from March 2007, for all the notes

Principal Payments: Subject to certain performance tests, pro rata among the class A, B, C and D notes. Otherwise, sequential payments

Optional Redemption Date: When collateral outstanding balance is less than 10% of its original balance

Legal Maturity: September 2044

* As of 23 October 2006

rate based on the present value of interest and principal payments. The expected rating assigned to these notes is supported by the expected recovery rate for noteholders. The expected recovery rate on the Class D notes reflects the amounts that investors are likely to receive during the life of the transaction. (see *Credit Analysis*).

- The issuer allows the originator to lower margins on the loans subject to a minimum WA margin of 0.50%. Mitigated by: In its cash flow analysis, Fitch has compressed the WA margin of the loans from the initial margin of 0.81% to 0.50% progressively from the first month after closing.

- The notes will benefit from a swap agreement between the fund and Banco Valencia, which hedges the structure against an interest rate mismatch between the assets and the liabilities arising from differences in the reference indices, and it also mitigates against the mismatch between the annual rate reset frequency for the loans and the quarterly reset frequency for the notes. The swap agreement will not guarantee excess spread to the fund during the life of the transaction, and therefore the fund will assume the risk of loan coupon compression on the collateral.

Legal and Financial Structure

Spanish legislation allows RMBS transactions to be structured through two alternative schemes, involving different types of special-purpose vehicles ("SPVs"): *Fondo de Titulización Hipotecaria* ("FTH") and *Fondo de Titulización de Activos* ("FTA").

Under Spanish law, assets are not transferred, as this would entail a lengthy process of re-registering the mortgages at the property registry. Mortgage originators issue mortgage participations (*"Participación Hipotecaria"*) or mortgage transfer certificates ("*Certificados de Transmision de Hipoteca*"), which are backed by the mortgage loans. The securitisation fund, FTH or FTA, subscribes the mortgage participations or certificates under the terms of the deed of incorporation and the transaction documents.

The issuer will be a limited-liability SPV incorporated under the laws of Spain, whose sole purpose is to acquire credit rights from Banco Valencia as collateral for the issuance of the floating-rate amortising securities.

The mortgages will continue to be serviced by Banco Valencia in its role as servicer. Collections from the mortgages will be transferred by the originator weekly into the treasury account, held in Banco Valencia in the name of the issuer. Amounts standing to the credit of the treasury account will receive a guaranteed interest rate equal to three-month Euribor. However, for the protection of investors, if Banco Valencia is unable to continue to service the collateral, the *sociedad gestora* must appoint a replacement administration company, in accordance with the Spanish securitisation law and Fitch's commingling risk criteria (see "*Commingling Risk in Structured Finance Transactions*", dated 9 June 2004 and available at www.fitchratings.com). The latter report indicates that if the counterparty Short-term rating is downgraded below 'F2', the exposure at risk should be covered by credit enhancement.

Two days prior to any payment date on the notes, the *sociedad gestora* will communicate to Caja de Ahorros de Valencia, Castellon y Alicante ("Bancaja", rated A+/F1), as paying agent, the amounts to be paid to noteholders in terms of interest and principal. On every payment date, and only after Bancaja has certified to the *sociedad gestora* full and correct payment of monies to the investors in line with the instructions received, the *sociedad gestora* will transfer an equivalent amount from the treasury account to Bancaja. The remaining items of the waterfall (see *Revenue Priority of Payments* below) will be operationally conducted through the treasury account.

With regard to the treasury account, if the Short-term rating of Banco Valencia is lowered below 'F1', the *sociedad gestora* will take one of the following steps within 30 days:

1. find a third party with a satisfactory rating to guarantee its obligations;
2. transfer the treasury or amortisation account to another entity rated at least 'F1'; or
3. if neither of the above is possible, provide a guarantee of financial assets rated at least on a par with the Kingdom of Spain ('AAA/F1+'). If option 2 above is not possible, the *sociedad gestora* could also invest the balance of the treasury account temporarily, and until the next payment date, in fixed-income assets ("qualified investments"). An 'F1' rating is sought by Fitch for qualified investments maturing within 30 calendar days, and a rating of 'F1+' for longer investments.

Moreover, with regards to paying agent agreement, if the short-term rating of Bancaja is lowered below 'F1', the *sociedad gestora* will find a replacement entity rated at least 'F1' within 30 days.

Representation and Warranties

The seller will provide representations and warranties in relation to the collateral, including the following:

- Each mortgage loan is registered in the relevant property registry and represents a first-ranking claim on the corresponding property.
- Each mortgage loan finances the purchase, refurbishing or construction of a residential property.
- All loans have been fully disbursed.
- The seller has full right and title to, and the power to sell and transfer, the mortgages.
- The seller is unaware of any of the underlying properties being subject to a reduction in value of more than 20% since acquisition.
- All properties are located in Spain.
- None of the mortgage loans will be in arrears at closing.
- All properties have undergone a valuation process, as required by law.

Neither the issuer nor any other transaction parties will conduct a search of title; rather, they will rely on the above-mentioned representations and warranties provided by Banco Valencia in relation to the collateral. Following an irremediable breach of any of the representations or warranties, Banco Valencia will replace or repurchase the loan(s) in question.

Revenue Priority of Payments

On each quarterly payment date, commencing with that in March 2007, the combined ordinary priority of payments will be as follows:

1. expenses, taxes and servicing fees;
2. payment under the swap agreement (if applicable);
3. class A1 and A2 interest pro rata;
4. class B interest (if not deferred);
5. class C interest (if not deferred);
6. principal redemption in order of seniority excluding the class D notes (see *Amortisation of the Notes)*;
7. class B interest if deferred, which will occur if the principal deficiency ledger ("PDL") exceeds 50% of the outstanding balance of these notes, plus 100% of the outstanding balance of the class C notes;
8. class C interest if deferred, which will occur if the PDL exceeds 50% of the outstanding balance of these notes;
9. reserve fund top-up if required (see *Reserve Fund*);
10. class D interest;
11. class D principal; and
12. other subordinated amounts, including reimbursement and remuneration of the start-up loan to cover initial expenses.

A PDL is defined on every payment date as the difference between the balance outstanding on the A to C notes, and the outstanding balance of non-defaulted loans (i.e. those that are less than 18 months in arrears).

The structure will cover ordinary and extraordinary expenses using excess spread generated by the collateral. Initial expenses will be covered via a subordinated loan agreement granted to the issuer by Banco Valencia before closing.

Amortisation of the Notes

The principal repayments due on the notes will be allocated sequentially and on a pass-through manner, starting with the class A1 notes, then moving to the class A2, B and finally the class C notes. The first payment date on the notes is March 2007. However, the A1 and A2 notes will amortise pro-rata among themselves if the ratio of loans in arrears over 90 days is in excess of 1.5% of the then outstanding balance of the non defaulted collateral.

In addition, the documents allow the B and C notes to amortise on a pro rata basis with the Class A1 and A2 notes if the following conditions are met:

- the CE level of the Class A1 and A2 has doubled,
- the reserve fund is at its required level; and
- the current balance of loans more than 90 days in arrears, excluding losses, is less than 1.00% for Class B and 0.75% for Class C of the outstanding balance of the loans.

The class D notes amortisation profile is structured to mirror the amortisation profile of the reserve fund (see *Reserve Fund*). Because the reserve fund is subjected to an absolute floor of 0.58% of the original note balance, these funds will only be released to the class D investors at legal final maturity, or before, if the 10% clean-up call is exercised and sufficient funds are available after redeeming the class A to C notes in their entirety.

Clean-up Call

All notes are subject to a clean-up call option in favour of the *sociedad gestora* when less than 10% of the initial collateral balance remains outstanding.

The clean-up call will only be executed if the then-outstanding balance of the class A to D notes is redeemed in full.

Reserve Fund

A reserve fund in an amount equivalent to 1.15% of the original collateral balance will be created at closing through the issue of Class D notes subscribed by Banco Valencia and will be held in the treasury account at Banco Valencia.

Subject to the following conditions, the reserve fund may amortise to the greater of: i) 2.30% of the outstanding note balance; and ii) 0.58% of the initial note balance:

- the balance of loans more than 90 days in arrears remains below 1.0% of the aggregate outstanding non defaulted mortgage balance;
- on the previous payment date, the reserve fund was replenished to its required amount;
- the WA spread on the collateral is at least 50bps, and
- the closing date of the transaction was more than three years earlier.

Interest Rate Swap Agreement

The issuer will enter into an interest hedging agreement with Banco Valencia to hedge the difference between the one-year Euribor on the mortgage loans and the three-month Euribor of the notes.

Under the swap agreement the fund will, on each payment date, pay Banco Valencia the index corresponding to any mortgage loans that are less than 18 months in arrears, and will receive from the swap counterparty three-month Euribor on the same notional amount. Since no excess margin is guaranteed, the agency stressed the average margin to be received to address the risk that the loans with the highest-yielding margin might prepay before those with the lowest-yielding margin.

If the swap guarantor is downgraded below ‘A/F1’, it will, within 30 days, take one of the following steps:

- find a replacement counterparty rated at least ‘A/F1’;
- find an entity rated at least ‘A/F1’ to guarantee its obligations under the swap agreement; or
- cash- or security-collateralise its obligations in an amount sufficient to satisfy existing Fitch criteria.

■ Collateral

At closing, the final portfolio will have an outstanding balance of EUR900.6m, selected from a provisional portfolio of 10,432 mortgage loans originated by Banco Valencia in its normal course of business. All were first-ranking loans secured by residential properties in Spain. Security for the loans took the form of mortgages registered in the *Registro de la Propiedad* (the official register).

The portfolio has a WA original LTV of 68.72% and a WA current LTV of 63.70%. In its recovery calculations, Fitch used an indexed valuation of the underlying properties based on regional residential indices. After giving 50% credit to increases in property prices, the WA indexed CLTV of the pool is 57.38%.

The portfolio has no VPO-protected housing. The portfolio is predominantly exposed to the autonomous communities of Valencia and Murcia (67.73% and 11.14%, respectively).

Portfolio Summary

Pool Characteristics	
Current Principal Balance (EURm)	984,552,229
Average Current Balance (EUR)	96,073
Average Original Balance (EUR)	106,980
Oldest Loan in Portfolio	01/11/96
Most Recent Loan in Portfolio	06/22/06
Interest Rate Type	
Floating-Rate Loans (%)	100
WA Interest Rate (%)	3.72
WA Margin (%)	0.81
Payments	
Payment Method	Direct Debit
Regional Concentration (%)	
Region of Valencia	67.73
Region of Murcia	11.14
Lien Position (%)	
First-Ranking	100.0

Source: Fitch

The portfolio has a WA seasoning of 23.3 months and a WA current remaining maturity of 262.9 months. All variable-rate loans, and all fixed-rate loans after their fixed period are linked to 12-month Euribor.

■ Credit Analysis

Fitch analysed the collateral for the transaction by subjecting the mortgage loans to stresses resulting from its assessment of historical home price movements and defaults in Spain. The agency focuses its analysis of Spanish RMBS structures on the probability of default and recoveries for a portfolio's individual loans (see Appendix 1)

Default Probability

Generally, the two key determinants of default probability are the borrower's willingness and ability to make their mortgage payments. The willingness of a borrower to pay is usually measured by LTV. Fitch assumed higher default probabilities for high-LTV loans and lower default probabilities for low-LTV loans. The main reason for this is that, in a severe negative equity situation, borrowers in financial distress but with equity in their homes (low-LTV loans) have an incentive to sell and maintain/protect their equity, thereby eliminating the need for the lender to repossess the property.

Ability to pay is usually measured by the mortgage payment in relation to the borrower's net income. Fitch considered the specific characteristics of the product in its default probability analysis of the portfolio. The LTV based on the original balance of the loan is used as the main measure of a borrower's willingness to pay.

Over 40% of the pool by current balance has OLTVs in the 70-80% bucket. Approximately 43% of the pool has OLTVs lower than 80%.

Fitch also increased the base default probabilities for the following types of loans that have non-standard characteristics.

- Affordability: Fitch was provided with DTI information for c. 73% of the pool. Fitch adopted conservative assumptions where the information was missing or inconsistent. Following Fitch's adjustment, the WA DTI of the portfolio is 30.36%;

- Geographical Concentration: The pool is concentrated in the region of Valencia (67.73%). Fitch applied conservative assumptions to account for the concentration risk, increasing the base default probability of loans located in Valencia by 10.0%.

- Employment Status: Employment data was provided for 77.34% of the pool on a loan-by-loan basis. Some 1.65% of the pool comprises self-employed borrowers and 22.66% of the pool was made up of borrowers with "unknown" employment status. The base default probability of self-employed and "unknown" borrowers was increased by 15.0% to reflect the higher probability of default of borrowers relying on their own business only and therefore more susceptible to economic cycles and business interruption.

- Second Homes/Investment: Fitch increased the base default probability of loans secured over investment properties ("inversión") (9.09% of the pool) and second homes (4.89% of the pool). The rationale is to take into account the increased likelihood that a borrower experiencing financial difficulties will default on the loan supporting a rental property or a second home before one secured over their own home. Generally, as the property is not the full-time residence of the obligor, there are fewer incentives to avoid repossession.

- "Consumo" Loans: some 2.47% of the loans in the pool are "consumo" loans. These loans are secured over the property: however, the purpose of the loan is other than for the purchase or improvement of the house but rather for personal purposes (i.e. travelling, furniture, etc). Since the ultimate purpose of these loans is to remove equity from the home, Fitch increased the base default probability of "consumo" loans.

- Principal Grace Period: Some 2.66% of the loans has a principal repayment grace period of up to six years. Fitch has increased the base default probability of those loans with the grace period ending after the closing of the transaction. This is to account for the potential payment shock that borrowers may experience on these mortgage loans when the grace period ends.

- Repayment Type: Most of the mortgage loans in the pool are paid in monthly instalments; however, 1.45% of the loans in the pool repay quarterly, semi-annually or annually. Fitch increased the base default probability of those loans to account for the lower frequency of payment and therefore for the higher probability of default on fewer payments.

Recovery Proceeds

To estimate recoveries on mortgage loans in Spain, Fitch examined house price movements on a regional basis from 1987-2001. The agency found significant differences, most notably between Madrid, Catalonia and the Basque Country, and the other regions in Spain. Cities in these three regions have experienced higher price increases than regions elsewhere in Spain. Based on its analysis of the real estate market, Fitch assumed slightly higher market value declines ("MVDs") for certain regions, as well as for some large urban areas. The agency's MVD assumptions are largely a function of historical regional volatility and sustainable growth in property prices. MVDs are further adjusted by factors related to specific loan and property attributes, including low- and high-value properties. The resulting recovery rate is weighted by the loan outstanding balances and default probability. This is defined as the weighted-average recovery rate ("WARR").

To derive MVDs for the respective stress scenarios, Fitch then compared the characteristics of the Spanish real estate market with those of markets in other European countries. As with its other European mortgage default models, the agency has increased MVDs for higher value properties. These are generally subject to higher declines in a deteriorating market than houses with average or below-average market values owing to limited demand. Only 4.6% of the collateral is considered by Fitch to be secured on high-value ("jumbo") properties.

When calculating recovery value, the agency's model reduces each property's worth by the MVD, external foreclosure expenses and the cost to the servicer of carrying the loan from delinquency through to default. This cost depends on the time to foreclosure as well as the interest rate applied, which Fitch assumes to be 10%. Fitch assumes a time to foreclosure of three years.

Fitch Default Model Outputs (%)

Rating Level	AAA	AA	A	BBB	BB
WAFF	10.01	8.0	6.0	4.0	2.0
WARR	84.5	90.0	95.1	98.6	101.8
WALS	35.3	29.4	23.9	20.1	16.5
WAMVD	45.8	41.1	36.4	32.9	29.4

Source: Fitch

Cash Flow Analysis

To evaluate the contribution of structural elements such as excess spread, the reserve fund and other factors, Fitch modelled the cash flows from the mortgages based on the WARR and the WA frequency of foreclosure ("WAFF") provided by the loan-by-loan collateral analysis. Recoveries included both interest and principal.

The cash flow model assumes that defaults are spread over the first five years of origination, starting straight after closing. The analysis calculated the cost of carrying defaulted loans as the difference between the performing balance of the collateral and the notional note balance until all the recovery proceeds are collected. Excess spread, the reserve fund and principal collections must be sufficient to cover the carrying cost until all recoveries are received.

The cash flow analysis accounted for the interest deferral mechanism in place on the Class B and C notes, which will redirect funds away from the junior notes and towards the more senior notes. Should the triggers be hit, interest on the B and C notes may be deferred for a period but will ultimately be paid prior to the legal maturity date.

Prepayments may also cause adverse selection as the strongest obligors are likely to be most inclined to prepay, which would leave the pool dominated by weaker obligors as the collateral ages.

Fitch applied prepayment rates up to 25.0%, 21%, and 18% under the 'AAA', 'A' and 'BBB' scenarios, respectively. For the low prepayment stress, Fitch applied an annual level of prepayments of 5.0%.

The analysis showed that the CE levels provided for each of the tranches would be sufficient to withstand the default hurdles and losses determined by the agency for the individual ratings.

Loan Maturity Change and Margin Compression

The originator has the right to change the margin on the mortgages: this is limited to the pool having a WA margin of at least 0.50% at all times.

As of the pool's cut-off date, the WA margin of the pool was approximately 0.81%%. In its analysis, Fitch has assumed that the WA margin of the pool will fall from the initial level to 0.50% progressively from the first month after closing. The CE levels reflect the most severe stress assumptions under the terms and conditions of the transaction.

It should be noted that if the WA margin on the current loan balance falls below 0.60%, the seller will be obliged to pay the fund the difference between the actual WA margin and 0.60%. Fitch does not give any credit for this payment obligation.

The originator also has the right to extend the final maturity of the loans in the pool up to the maximum maturity date: this is limited to 10% of the overall pool size.

Class D Notes

Because funds available for the amortisation of the Class D notes will be limited to those released from the reserve fund (if any), the performance of these notes will be highly dependent on very favourable conditions for the collateral backing the Class A to C notes.

Fitch calculated an average recovery rate for the Class D notes after testing several cash flow scenarios commensurate with the speculative rating levels. In its sensitivity analysis, it tested several variables that affect the release of the reserve fund, and, consequently, the availability of funds for interest and principal payments on the Class D notes.

The 'CCC' expected rating on the Class D notes is supported by the recovery rates. As a default of the Class D notes appears probable, Fitch assessed the distribution of possible recovery rates. These were calculated based on the present value of interest and principal payouts on the Class D notes, measured as a proportion of the original outstanding notes balance. Based on Fitch's calculation, the average recovery rates were between 50% and 60%.

■ Origination and Servicing

The Originator

In addition to the pool analysis, Fitch has reviewed and analysed Banco Valencia's origination and servicing guidelines. It has conducted several interviews with the originator and servicer managers responsible for the mortgage loan department. Banco Valencia follows a tight process of underwriting criteria based on a detailed procedure underwriting manual.

At the end of the third quarter 2006, the bank operated a network of 416 branches and had 1,971 employees.

Some 38.4% of Banco Valencia's share capital is held by Caja de Ahorros de Valencia Castellón y Alicante ("Bancaja", rated 'A+/F1'), Spain's sixth-largest banking group, although Banco Valencia remains independent.

For historical reasons, the bank's activities are concentrated in the regions of Valencia and Murcia, although it has expanded into other parts of Spain, notably Madrid. Its core businesses are SME and mortgage lending.

Banco Valencia is taking advantage of the development of risk management systems by Bancaja as well as from its participation in the development of a global risk management system spearheaded by CECA, the representative body of Spanish savings banks. This will include a more sophisticated credit scoring system for lending to individuals and internal ratings for corporate lending. Banco Valencia intends to apply the advanced internal rating based ("IRB") approach in the medium term.

Origination and Underwriting

The lending approval process is fairly centralised, with conservative limits at different exposure levels. Mortgages are mostly originated through the bank's branches and a network of real estate agencies. Potential borrowers are required, among other things, to provide information on their family circumstances, employment situation, other sources of revenue, history with the bank and total debts outstanding. The underlying property must also undergo valuation by one of the bank's eligible valuers, all of which are registered with the Bank of Spain and are regulated valuation companies. Banco Valencia will consult its own internal customer databases as well as external credit sources, such as ASNEF and CIRBE (which keeps records on default history and current debt exposures) to verify the credit profile of the borrowers. Its internal approval system is based on the borrower's capacity to repay their debt, and the vast majority of mortgages loans are approved through this system.

Banco de Valencia allows a maximum DTI ratio of 45% for residential property applicants. It allows LTVs of up to 80% for residential mortgages and 70% for commercial mortgages. However, in special

cases, subject to the approval of the special credit committee, these limits can be extended to a maximum of 100%. Maximum mortgage tenors are 30 years. These maximum limits have been applied since 27 January 2005.

The bank requests that borrowers maintain a current account at Banco Valencia, although this is not compulsory. However, all mortgage loan payments must be made by direct debit.

Servicing

When a mortgage loan is more than 90 days overdue, the position is transferred to the recovery department, where a specialised team carries out the appropriate recovery processes. A credit officer decides whether to initiate legal proceedings, while other internal measures are applied to other products the customer may have with the bank – such as blocking any accounts the borrower holds with it. According to Banco Valencia's collections policy, foreclosure proceedings will be initiated after all pre-enforcement measures have been attempted.

The bank employs internal and external legal counsel for all legal proceedings. The latter prepares the documentation and organises the foreclosure process, but must refer all business decisions to Banco Valencia.

The majority of delinquent loans are overdue owing to temporary financial difficulties. However, where the borrower will not be in a position to repay their debt, they will most often organise the sale of the property to avoid going to court. The bank's estimated recovery period is 380 days, although general legal proceedings in Spain can take between one and two years, and in some cases up to three years.

Exposures to the construction and real estate sectors are primarily through residential development projects, with the majority of the loans likely to convert to individual residential mortgages, forming part of a strategy aimed at gaining new individual clients.

■ Cash Bond Administration

The cash bond administration ("CBA") function for this transaction will be carried out by the *sociedad gestora*, a company regulated and supervised by the Comisión Nacional del Mercado de Valores ("CNMV") whose activities are limited to the management of securitisation funds. Europea de Titulización, SGFT SA, incorporated under the laws of Spain in 1993 and currently managing 59 securitisation funds, has been actively involved in the pre-closing phase of the deal. After closing, the *sociedad gestora* will be responsible for cash reconciliation, waterfall calculations and their reporting, including the monitoring of applicable triggers. It will also be responsible for taking any action in the interest of the noteholders, such as the replacement of the servicers, account bank or swap counterparty according to the terms and conditions of the documentation.

■ Performance Analytics

Fitch will monitor the transaction regularly and as warranted by events. Its structured finance performance analytics team ensures that the assigned ratings remain, in the agency's view, an appropriate reflection of the issued notes' credit risk.

Details of the transaction's performance are available to subscribers at www.fitchresearch.com. Further information on this service is available at www.fitchratings.com.

Performance data for Valencia Hipotecario I and II shows high level of arrears in the 60+ day delinquency bucket, compared with the Fitch Spanish RMBS Index. Both the originator and the *sociedad gestora* have informed Fitch that some loans that were already amortised have been incidentally recorded as delinquent amounts. The agency has therefore received and reviewed updated delinquency statistics from the originator and the *sociedad gestora*, and has accepted and taken them into account to plot Banco Valencia's previous transactions performance (please see *Appendix 1*).

Fitch will monitor the performance of the Valencia Hipotecario transactions, particularly with regards to this reporting issue.

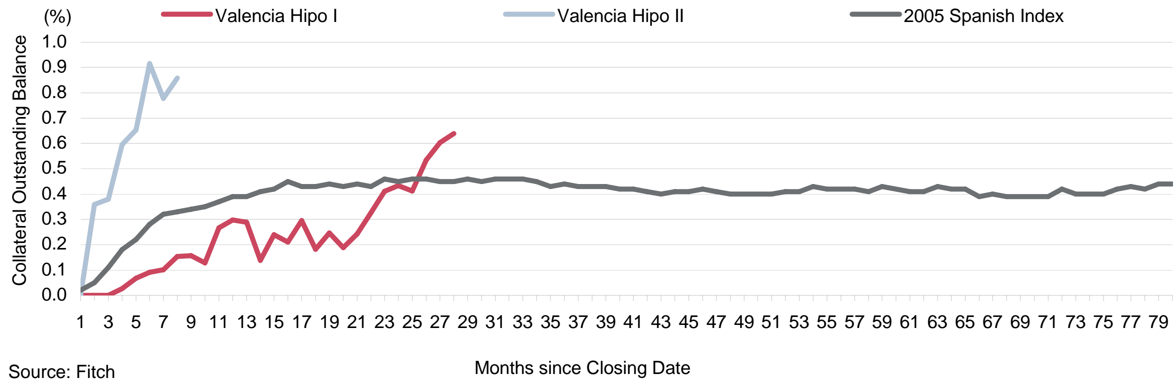
Please call the Fitch analysts listed on the first page of this report with any queries regarding the initial analysis or the ongoing performance.

Issuer Report Grades

Fitch published the second edition of the Issuer Report Grades (see report "*Fitch Issuer Report Grades May 2006 Update*" date 5 June 2006 and available at www.fitchratings.com). This is part of an ongoing effort to improve the transparency of transaction performance to investors. Transactions are scored on a system ranging from one star (meets basic requirements) to five stars (outstanding). Valencia Hipotecario transactions have a current score of four, which equate to "Good" according to Fitch's published reporting standards.

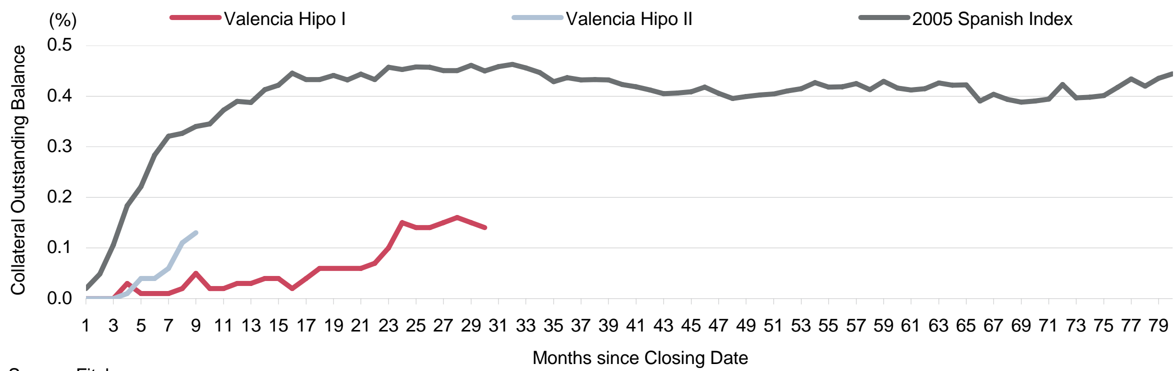
Appendix 1

Delinquencies Over 60 Days Plus Defaults
Spanish RMBS Index and Fitch-Rated Valencia Hipo Transactions



Source: Fitch

Delinquencies Over 90 Days Plus Defaults - Amended
Spanish RMBS Index and Fitch-Rated Spanish Transaction



Source: Fitch

Appendix 2: Rating Methodology

Model Approach

To determine loss coverage for RMBS, Fitch's default model employs a loan-by-loan review, examining several loan, borrower, lender and property-specific factors that most influence default probability and loss severity. Fitch's base default probability analysis focuses primarily on the borrower's income multiple, in conjunction with the loan's LTV. These expected default rates are then adjusted further by loan, borrower, lender and property attributes. A large component of Fitch's loss severity analysis is market value trends. Fitch's market value assumptions focus on historical regional volatility and sustainable growth. Market value projections are then adjusted by loan and property attributes.

Default Probability Adjustments

Underwriting and Servicing Quality

When applying the default probability matrix, Fitch also considers a lender's underwriting and servicing guidelines. Fitch's views will be formed following a due diligence visit, where the lender's criteria and procedures regarding borrower income, LTV, borrower's past credit performance and many other factors will be considered. Fitch's review and analysis of the originator determines whether it decreases base default rates by up to 25% or increases them by up to 250%.

Investment Properties

Fitch's methodology in evaluating the default probability of a Buy-to-let ("BTL") portfolio is to use the UK residential default model, but with the following additional assumptions:

For the base probability of default, BTL loans are assigned an affordability class based on underwriting criteria related to the minimum interest cover requirement. Generally speaking, Fitch will assign a high affordability class (meaning that loans are less affordable and thus a higher base probability of default) unless rental yields are estimated to exceed 150% of the mortgage payment, including principal, and are tested at a stressed interest rate.

A loan-by-loan increase in base default probabilities of 25% to account for the fact that the properties are non-owner occupied.

An increase in the underwriting quality factor to account for the lack of experience in BTL. This factor also incorporates originator-specific issues related to underwriting criteria, historical experience as well as servicing capabilities.

Repayment Types

The most common repayment types in the UK market are repayment and interest-only mortgages. Interest-only mortgages are usually linked to some form of investment vehicle: either an endowment policy, a pension or Individual Savings Account ("ISA"), which are designed to repay the loan principal on maturity. The following factors should be noted:

- Repayment mortgages incur no default probability adjustment.
- Interest-only mortgages are susceptible to the payment shock associated with a "balloon" repayment for the entire principal at maturity. The borrower may be able to remortgage and thereby pay off their existing mortgage; however, if their circumstances have changed this may not be possible. The further off the maturity date is, the more there is capacity for the borrower's circumstances to change. For this reason, Fitch applies an increased default factor to interest-only loans of between 1.0-1.33, depending upon the length of time to maturity.

Loan Purpose

Fitch does not penalise mortgage loans advanced to purchase a home or those advanced to refinance existing mortgage loans, nor loans to release equity for the purpose of home improvements. However, Fitch views mortgage loans advanced to release equity in the home (equity refinance mortgages) to consolidate other existing debts (such as credit cards) as more risky by their nature. For this reason, Fitch applies an increased default factor of 1.1-1.25 depending on the underwriting criteria for such loans.

Mortgages in Arrears
When rating a portfolio combining current and arrears mortgages, Fitch increases base default rates for mortgages in arrears up to 90 days by factors between 1.25 and 1.75. For mortgages that are in arrears for more than 90 days, Fitch assumes a 100% default probability.

Second Homes
While information about mortgage performance for second homes is limited, Fitch believes that second homes are considerably more susceptible to default. A financially distressed borrower is more likely to default on a second home than on their primary residence. Accordingly, Fitch increases base default by a factor of 1.1-1.25.

Right to Buy
Council tenants have the opportunity to purchase their own homes through the UK government's Right to Buy scheme. Available information suggests that there is a higher propensity to default. For this reason Fitch applies and increases default probability factor of between 1.1-1.25.

Product Type
Most UK RMBS issues are primarily backed by variable-rate mortgages. While variable-rate mortgages can experience payment shock due to underlying index volatility, this risk is usually gradual, with 0.5%-1% interest rate rises. Other mortgage types commonly available include initially fixed-rate mortgages and capped-rate mortgages, which reset to a variable rate after a limited period. Although these loans may be more susceptible to payment shocks after the reset date (if rates have risen substantially during the fixed or capped-rate period) Fitch believes this does not warrant a supplementary default factor. Other product types will be evaluated individually.

Loss Severity
Fitch's UK default model quantifies loss severity (or, conversely, recovery value) by focusing on several factors, including MVDs, foreclosure and carrying costs, and LTV.

Market Value Declines
Fitch's MVD methodology focuses on three key factors: the volatility of observed prices from the long-term trend; historical levels of stress experienced in the housing market of each region and the current position of the index relative to the long-term trend.

For example, the MVDs for East Anglia, London and the south east are highest, reflecting high historical volatility and current prices well above the long-term trend line. The MVD for Scotland is lowest, reflecting low historical volatility and current prices slightly below the long-term trend line.

Indexing of Property Valuation
Fitch's model uses a conservative index to adjust original property values depending on the year of valuation. The index is based on information obtained from sources in the mortgage industry and considers both the year of valuation and the region in which the property is located. Where there has been capital appreciation, this is a mitigating factor in the calculation of loss severity but will be offset by higher MVDs assigned to regions that have seen above-average price appreciation.

High- and Low-Value Properties
Homes with relatively high or relatively low market values are generally subject to higher MVDs in a deteriorating market than homes with average market values owing to limited demand for such properties. Imprecise pricing information, caused by the lack of comparable benchmark homes in the case of high-value properties, also influences the amount of price volatility during a market downturn. The market value thresholds are increased periodically to reflect the increase in housing prices. Adjustments for high- and low-value properties are split between London and the rest of the country owing to higher prices in London, and the differential between what would constitute a high- or low-value property.

Mortgage Indemnity Guarantee ("MIG") Policies

Many lenders require borrowers to pay for MIG for that portion of their mortgage loan which exceeds a certain LTV level (usually 75%). In case of default by the borrower, the lender will be able to recover any loss on the portion of the loan in excess of that LTV limit (subject to any policy deductions) from the MIG provider. Fitch will give credit for MIG on a case-by-case basis. It will review the MIG policies to determine the extent of coverage and payment terms and to determine whether there are any exclusion clauses that might lead to non-payment of claims by the insurer. The insurer's rating is also taken into consideration when determining the amount of credit to be given for MIG

Geographic Concentration

Fitch also assumes that a mortgage portfolio is generally broadly diversified in geographical terms. A particular region might be more sensitive to economic downturns and/or other negative developments in the property and mortgage market than others. If a portfolio has significant regional concentrations, Fitch will make adjustments on a case-by-case basis. As a general rule, for pools with high concentrations in specific regions, the credit enhancement necessary for a particular rating level will be higher than for geographically diversified portfolios.

Foreclosure and Carrying Costs

When calculating recovery value, Fitch's model reduces the property valuation by foreclosure costs and the cost to the administrator of "carrying" the loan from delinquency through to default. Fitch assumes that foreclosure costs amount to 5% of the sale price at the time of foreclosure. This estimate is based on actual cost data supplied to Fitch, and may be adjusted as cost structures change in the industry and jurisdiction.

To calculate carrying costs, Fitch assumes the borrower does not pay interest for 18 months in the case of a residential property and 12 months in the case of an investment property. The interest rate used reflects the need to continue to service the notes during the period that the defaulted loans are not generating any revenue. The 18- and 12-month time frames are based on worst-case estimates obtained from UK mortgage lenders.

Appendix 3

Valencia Hipotecario: Comparison Table

Issuer	Valencia Hipotecario 1	Valencia Hipotecario 2	Valencia Hipotecario 3
Closing Date	Jul 04	Dec 05	Nov 06
Gross Credit Enhancement (%)[1]			
AAA	2.5	3.3	3.5
AA	1.6	2.1	2.4
A	0.8	1.2	1.4
BBB	0.4	0.7	0.8
BB	0.2	0.3	0.3
WAFF (%)[2]			
AAA	12.6	9.5	10.01
AA	10.1	7.6	8.0
A	7.5	5.7	6.0
BBB	5.0	3.8	4.0
BB	2.5	1.9	2.0
WALS (%)[3]			
AAA	20.2	34.3	35.3
AA	15.4	27.7	29.4
A	11.2	21.7	23.9
BBB	8.8	17.3	20.1
BB	6.6	13.4	16.5
Issuance Balance (EUR x m)	500,0	940,1	900.6
Average CBAL (EUR x 000)	52.6	76.1	96.1
Largest CBAL (EUR x 000)	295.4	497.6	948.6
Average Original Valuation (EUR x 000)	98.3	144.5	171.5
Largest Indexed Valuation (EUR x m)	0.8	10.98	3.2
(%)			
WA OLTV	68,9	67.0	68.7
WA CLTV	59.2	60.9	63.7
WA CLTV (Indexed Values)	51.4	55.1	57.4
OLTV>80%	17.3	10.5	7.6
WA DTI	35.0	35.9	30.4
WA Seasoning (Months)	36.8	26.0	23.3
Jumbo Properties (%)	21.1	4.4	4.16

[1] Gross CE levels are defined as expected losses for the relevant rating levels.
[2] Weighted Average Foreclosure Frequency ("WAFF") is the weighted average cumulative default probability of the mortgage pool. The weighted averages are calculated using the loans' current balance as weights.
[3] Weighted Average Loss Severity ("WALS") is the weighted average cumulative severity of loss of the mortgage pool. The weighted averages are calculated using the loans' current balance as weights.
Source: Transaction documents, Fitch

Appendix 4

Capital Structure

Class	Rating	Size (%)	Size (EURm)	CE (%)	Interest Rate	PMT Freq	Maturity	ISIN/CUSIP
A1	AAA	10.00	90.0	4.47	3 Month Euribor + Spread	Quarterly	September 2044	
A2	AAA	86.68	780.7	4.47	3 Month Euribor + Spread	Quarterly	September 2044	
B	A+	2.31	20.8	2.16	3 Month Euribor + Spread	Quarterly	September 2044	
C	BBB	1.01	9.1	1.15	3 Month Euribor + Spread	Quarterly	September 2044	
D	CCC	1.15	10.4	N.A.	3 Month Euribor + Spread	Quarterly	September 2044	

	Size (%)	Size (EURm)
Cash Reserve	1.15%	
Liquidity	No	
Step Up Date	No	
Swap	Basis swap	
Excess Spread (Closing)		

Key Information

Closing Date	20 November 2006
Country of Assets	Spain
Country of SPV	Spain
ISIN	
Issuance Date	20 November 2006
Structure	Sequential pass through, pro-rata under certain conditions
Settlement	
Listing	The fund will be listed at AIAF
Analyst	Federica Fabrizi +44 20 7862 4061 federica.fabrizi@fitchratings.com

Parties	
Seller/Originator	Banco de Valencia
Servicer of the collateral	Banco de Valencia
Swap Counterparty/Account Bank	Banco de Valencia
Paying Agent	Bancaja
Joint Lead Managers	Bancaja, Deutsche Bank AG
Fund	Valencia Hipotecario 3 FTA
Fund Manager	Europea de Titulización
	Marina Alcalde +34 9 1702 4612 marina.alcalde@fitchratings.com

Others (Summary)

Short Term Rating Triggers (Minimum)
'F1' on Banco Valencia as treasury account bank.
If the swap counterparty short-term rating falls below 'F2', the exposure at risk should be covered by credit enhancement.
'A/F1' on the swap guarantor.

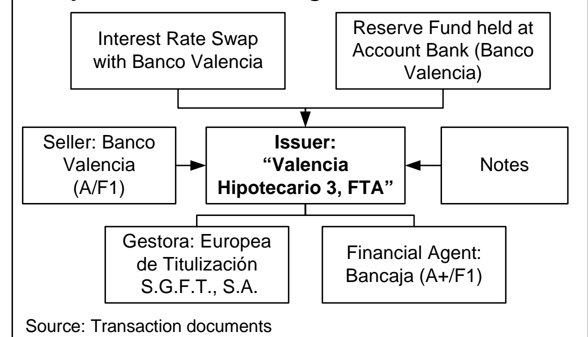
Credit Enhancement
Excess spread
Reserve Fund
Subordination
Class A1 4.47%
Class A2 4.47%
Class B 2.16%
Class C 1.15%

Credit Committee Highlights
- 100% of the loans are performing
- 100% of the loans are linked to first lien residential mortgages
- the mortgage pool is concentrated in the region of Valencia
- uncollateralized note to fund the reserve fund
- margin re-negotiations are permitted on the mortgage loans with a 50bps floor

Fitch Default Model Output

Rating Level	AAA	AA	A	BBB
WAFF (%)	10.01%	8.0%	6.0%	4.0%
WARR (%)	79.7%	85.6%	91.1%	94.9%
Loss Severity (%)	35.3%	29.4%	23.9%	20.1%
MVD (%)	45.8%	41.1%	36.4%	32.9%

Simplified Structure Diagram



Source: Transaction documents

Collateral

Pool Characteristics

Original Principal Balance (EUR)	1,096,334,265
Current Principal Balance (EUR)	984,552,229
Average Current Loan per Borrower (EUR)	96,073
Average Original Loan per Borrower (EUR)	106,980
Number of Borrowers	10,248
Number of Loans	10,432
Seasoning (Years)	1.94
Loan to Value (LTV) (%)	
WA OLTV (%)	68.72
WA CLTV (%)	63.70
WA Indexed CLTV (%)	57.38
Mortgage Characteristics	
Government Subsidised (%)	0.00
Non Government Subsidised (%)	100.00
First Home (%)	83.56
Second Home (%)	4.89
Interest Rate Type	
Floating Rate Loans (%)	100.00
Fixed Rate Loans (%)	0.00
WA Interest Margin (%)	3.72
Interest Index (Euribor)	12-month Euribor

Regional Concentration (%)	
Valencia (%)	67.73%
Murcia (%)	11.14%
Lien Position (%)	
First Ranking (%)	100.00
First & Subsequent Ranking (%)	100.00 first ranking
Jumbo (%)	4.16
Payments	
Payment Frequency	98.55% Monthly, 0.64% Quarterly, 0.61% Semi-Annually, 0.20% Annually
Payment Method	Direct Debit
Performing Loans (%)	100.00
DTI Distribution (%)	
Class 1	14%
Class 2	25
Class 3	54
Class 4	7
Class 5	0
Employment Status (% of Self-Employed)	1.65

Source: Transaction documents

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