RMBS/CMBS/Spain
New Issue

MBS Bancaja 2, Fondo de Titulización de Activos

Ratings

Class	Amount (m)	Final Legal Maturity	Rating	CE (%)
A	754.4	Feb. 2038	AAA	6.85
B	13.2	Feb. 2038	AA	5.20
C	10.4	Feb. 2038	A+	3.90
D	8.8	Feb. 2038	BBB+	2.80
E	13.2	Feb. 2038	BB+	1.15
F	10.0/8.4	Feb. 2038	CC	n.a.

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Closing occurred on 30 June, 2005. Changes prior to closing: No changes from the date of the presale report.

Summary

This EUR809.2 million transaction is a securitisation of Spanish residential and commercial mortgages originated by Caja de Ahorros de Valencia, Castellon y Alicante ("Bancaja", rated 'A+/F1'). Fitch Ratings has assigned ratings to the notes to be issued by MBS Bancaja 2, Fondo de Titulización de Activos ("MBS Bancaja 2" or "the fund") as indicated at left. The mortgage loans are, and will continue to be, serviced by Bancaja.

The assigned ratings on the class A to E notes are based on the quality of the collateral, the underwriting and servicing capabilities of Bancaja, available credit enhancement and the sound legal and financial structure of the transaction. Initial credit enhancement for the Class A notes, totalling 6.85%, will be provided by the class B, C, D and E notes and the reserve fund. Credit enhancement for all other classes of notes will be provided by the subordination of the classes junior to them and the reserve fund, with the exception of the class F notes, which is solely collateralised by the reserve fund.

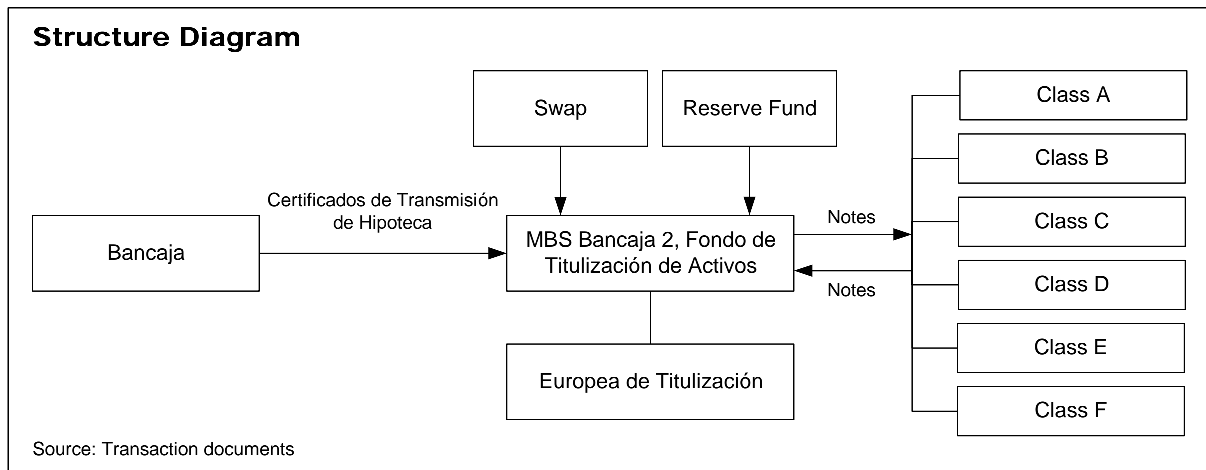
The class F notes issued to finance the cash reserve fund will be subscribed by Bancaja. The reserve fund will be fully funded at closing. Class F notes are ultimately likely to default and the ratings assigned to the class F notes are supported by the expected recovery rate for noteholders, i.e. the amounts investors are expected to receive during the life of the transaction.

Bancaja is the parent bank of Spain's sixth-largest banking group and was the country's third-largest savings bank by total assets at end-2003. For historical reasons, much of Bancaja's business is generated in Valencia.

MBS Bancaja 2 is regulated by Spanish Securitisation Law 19/1992 and Royal Decree 926/1998. Its sole purpose is to transform the mortgage loan certificates acquired from the certificate issuer, Bancaja, into fixed-income securities. The mortgage loan certificates will be subscribed on behalf of MBS Bancaja 2 by Europea de Titulizacion, S.A., S.G.F.T. ("the *Sociedad Gestora*"), whose sole function is to manage asset-backed funds.

At closing, MBS Bancaja 2 will acquire a portfolio of residential and commercial mortgage loans from the seller as collateral for the notes. The provisional portfolio consists of first-ranking, variable-rate mortgage loans granted for residential (67%) and commercial purposes (33%). 88.87% of the collateral consists of residential properties while the remainder consists of commercial properties, including retail outlets, occupied and non-occupied industrial warehouses and rural properties. All the collateral is located in Spain.

Structure Diagram



Source: Transaction documents

To determine appropriate levels of credit enhancement, Fitch analysed the collateral using a loan-by-loan mortgage default model specific to Spain (see *"Spanish Mortgage Default Model II"*, dated 24 March 2004 and available at www.fitchratings.com). Fitch also modelled the cash flow contribution from excess interest, using as inputs the stress scenarios determined by its default model.

The performance of the Class F notes requires very favourable conditions for the collateral backing the Class A to Class E notes. As Class F default is likely, Fitch conducted a scenario analysis using its cash flow model to calculate the expected recovery rate on the Class F notes. Fitch has performed a sensitivity analysis in order to stress test the variables that affect the cash available to pay down the note. This allowed the agency to estimate the likely recovery rate on the note with an acceptable degree of confidence based on the present value of interest and principal payments available to class F notes.

(Please see *Credit Committee Highlights* and *Cash Flow Analysis* below).

Credit Committee Highlights

- The reference portfolio consists of 8,669 mortgage loans, approximately 67% of which by value are residential and the remaining 33% for commercial purposes, according to Fitch calculations.

- The loans in the portfolio are secured by a variety of properties: residential properties (88.87%) retail outlets (7.69%), occupied and non-occupied industrial warehouses (2.58%) and rural properties (0.86%). Furthermore, some 15.9% of the loans in the provisional pool are secured by two or more properties (including combinations of residential and commercial properties) where, according to the Law 124/1946 governing mortgages markets in Spain, the borrower can release part of the collateral to maintain the original loan to value ratio ("LTV"). To mitigate the incremental risk associated with these types of loans and collateral:

  a. the default probability for the commercial - purpose loans was increased; and
  b. a recovery rate was estimated on a loan-by-loan basis for each individual item of collateral, and the market value decline ("MVDs") factor was increased for commercial properties.

  Please see the *Credit Analysis* section for further details.

- Around 64% of the portfolio is located in the Comunidad de Valencia. The related geographical concentration risk is mitigated by stressing the default probabilities for the loans concerned.

- A swap agreement is place to mitigate the basis risk arising from the mismatch between the 12-month EURIBOR base rate on the loans and the three-month EURIBOR base rate on the notes.

- The weighted average original loan to value ("WOLTV") is 69% and the portfolio's average seasoning is 13.04 months, which contributed to a lower indexed current LTV of 61.5%, as compared with the current LTV of 65.82%.

- The criteria that allow the notes issued in the Bancaja transactions to switch to *pro rata* amortisation are stricter than in other European RMBS transactions rated by Fitch.

Key Information

Structure

Originator and Seller: Caja de Ahorros de Valencia, Castellón, y Alicante ("Bancaja", 'A+/F1')

Servicer: Bancaja

Lead Managers: Bancaja, and JPMorgan and [ ]

Fund: MBS Bancaja 2, Fondo de Titulización de Activos ("MBS Bancaja 2")

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

Swap Counterparty: Barclays Bank PLC (rated 'AA+/F1+'.

Final Legal Maturity: February 2038

Provisional Portfolio Characteristics

Total Amount at Closing: EUR858m

(of which EUR800m is selected at closing)

WA Original LTV: 69.0%

WA Current LTV: 66.0%

WA Indexed Current LTV: 61.5%

WA Remaining Maturity: 21.28 Years

WA Seasoning: 13.04 Months

Concentration in Valencia: 64%

- The amortisation of the class F notes mirrors the amortisation profile of the reserve fund. Principal funds available to amortise the class F notes will be limited to the cash released from the reserve fund. No additional funds are available to amortise the class F notes, as any remaining excess spread will flow back to the Originator. Furthermore, as typically seen in other RMBS deals, the reserve fund is subject to a floor (0.625% of the initial Class A to Class E note balance), and will be released to the class F noteholders on the legal final maturity date.

- The ratings assigned on the class A to E notes address the likelihood that interest on the notes will be paid according to the terms and conditions of the documentation (which include an interest deferral trigger for the class B and C, notes) and that principal will be repaid by legal final maturity in February 2038.

- Based on Fitch's scenario analysis, default is probable for class F notes. The rating on the class F notes is supported by the expected recovery rate of outstanding principal and accrued interest, i.e. the amounts noteholders are expected to receive during the life of the transaction.

Financial Structure

The class A, B, C D, E and F notes will pay interest quarterly in arrears at a floating rate based on three-month EURIBOR plus a margin.

The mortgages will continue to be serviced by Bancaja, acting as administrator. The savings bank will transfer amounts received from the mortgages into the fund's treasury account every seven days or, if Bancaja is downgraded to below 'F2', on a daily basis. If Bancaja's Short-term rating is downgraded below 'F1', the *sociedad gestora* must take one of the following steps within 30 days:

1. appoint a counterparty rated at least 'F1' to guarantee Bancaja's obligations under the treasury account agreement;
2. transfer the treasury account to a counterparty rated at least 'F1'; or
3. if unable to effect either of the above, it will pledge assets with a rating equal to that of the Kingdom of Spain ('AAA/F1+'); or
4. if none of the previous options are achievable, it will invest the funds then standing to the credit of the treasury account in fixed-rate, EUR-denominated notes rated at least 'F1', maturing, at latest, on the next notes payment date.

Servicing of the Securitised Portfolio

The mortgages will continue to be serviced by Bancaja in its role as servicer.

Royal Decree 685/82, which governs the issuance of the mortgage loan certificates that will be subscribed by MBS Bancaja 2, indicates that the issuer of the mortgage certificates must service the mortgage loans (which in turn back the notes); it does not envisage the possibility of replacing the CTH issuer as the servicer of these loans. However, the servicing agreement has certain mechanisms in place whereby the *Sociedad Gestora* may replace the servicer, if this is legally possible under current legislation.

Priority of Payments

Prior to enforcement, revenue payments will be allocated according to the following priority of payments on each distribution date:

1. senior fees and expenses;
2. payments due under the interest rate swap agreements (see *Swap Agreements*);
3. interest due on the class A notes;
4. interest due on the class B notes, unless deferred;
5. interest due on the class C notes, unless deferred;

6. interest due on the class D notes, unless deferred;
7. interest due on the class E notes, unless deferred;
8. principal on the A, B, C D and E notes in order of seniority (see *Principal Redemption)*;
9. replenishment of the reserve fund up to its required amount (see *Reserve Fund*);
10. interest due on the class F notes;
11. principal due on the class F notes in an amount equivalent to funds released from the Reserve Fund on such payment date;
12. swap termination payments;
13. subordinated amounts, including interest and principal due on the start-up loan granted by the seller to the fund at closing; and
14. Deferred consideration to the Originator.

Interest due on the class B notes will be deferred if the amortisation deficit (see below) exceeds the sum of: i) 85% of the outstanding balance of the B notes; plus ii) 100% of the outstanding balance of the C notes; plus iii) 100% of the initial balance of the D notes plus iV) 100% of the initial balance of the E notes. Similarly, interest due on the class C notes will be deferred if the amortisation deficit exceeds the sum of: i) 85% of the outstanding balance of the C notes; plus ii) 100% of the outstanding balance of the D notes plus iii) 100% of the initial balance of the E notes. Interest due on the class D notes will be deferred if: the amortisation deficit exceeds the sum of 85% of the outstanding balance of the class D notes; plus ii) 100% of the outstanding balance of the E notes. Interest due on the class E notes will be deferred if the amortisation deficit exceeds the sum of 85% of the outstanding balance of the E notes.

The amortisation deficit is the difference between the scheduled amortisation funds, defined as the difference between the outstanding balance of the A, B , C, D and E notes and non-defaulted collateral (i.e. performing loans and those that are up to 18 months delinquent) and funds available for amortisation. This includes the sum of principal and interest payments received on the collateral since the last note payment date, the balance of the reserve fund, any yield generated by the treasury account and any amount received from the swap counterparty if applicable.

Class A to E Principal Redemption

The scheduled amortisation funds will initially be allocated to redeem the class A notes until fully amortised, subject to the *pro rata* amortisation rules described below.

The B, C, D and E notes will be redeemed sequentially only after the class A notes have been repaid in full, subject to the redemption rules detailed below. Likewise all remaining classes of notes will begin to amortise only when the class immediately senior to them is fully amortised. Legal final maturity for the notes will be in February 2038, which is three years after the final scheduled maturity date of any loan in the collateral, to ensure that collections on the mortgages will be sufficient to redeem the obligations of the fund in respect of any defaulted loans.

Other Redemption Rules

The following redemption rules also apply:

- The class B, C D and E notes will be redeemed *pro rata* with the class A notes if: a) the principal outstanding balances on the B, C D and E notes are equal to or more than 3.3%, 2.6%, 2.2% and 3.3%, respectively, of the aggregate principal amount outstanding on the notes, (double the level at closing); and b) the outstanding balance of mortgages more than three months in arrears is less than 1.50% (for class A and B to amortise *pro rata*) 1.25%, (for class A, B and C to amortise *pro rata*) 1.0% (for class A, B, C and D to amortise *pro rata*) and 0.75% (for class A, B, C, D and E to amortise *pro rata*).

  Any amortisation of the B, C, D and E notes will be capped until their balances reach 3.3%, 2.60%, 2.20% and 3.3%, respectively, of the outstanding balance of the notes excluding Class F notes.

- The class B, C D and E notes may be redeemed *pro rata* only if: a) the reserve fund is at its required level; and b) the outstanding balance of mortgage loans is greater than 10% of the notes issued.

- All the notes (excluding the class F notes) are subject to a clean-up call when less than 10% of the initial collateral remains outstanding.

Interest Rate Risk

The fund will enter into two interest rate hedging agreements with Barclays Bank PLC (“the swap counterparty”, rated ‘AA+/F1+’) to hedge the basis risks arising from the mismatch between the reference indices for the collateral (e.g. 12-month EURIBOR) and the three-month EURIBOR payable on the notes.

Under the swap agreements, the fund will pay the swap counterparty WA 12-month EURIBOR taking into account the distribution of annual and semi-annual re-set dates on the collateral as of the closing

date. In return, it will receive three-month EURIBOR (plus a positive or negative margin that will be decided at closing) over a notional defined as the balance of the performing and delinquent collateral that is less than 18 months in arrears.

Although the swap agreements will mitigate the basis risk on the collateral, they will not guarantee minimum excess spread to the fund during the life of the transaction. Therefore, any risk of margin compression on the collateral will be assumed by the fund. If the swap counterparty is downgraded below ‘A/F1’, it will, within 30 days, take one of the following steps:

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

Credit Enhancement

Initial credit enhancement for the class A notes, totalling 6.85%, will be provided by the class B, C, D and E notes and the reserve fund. Initial credit enhancement for all other classes of notes will be provided by the subordination of the classes junior to them plus the reserve fund.

Reserve Fund

A reserve fund will be funded using the proceeds of the class F notes issuance. The initial reserve fund amount will be decided on the closing date, based on the gross margin to be paid in by the swap counterparty.

The potential amounts of the Reserve Fund can be summarised as follows:

Swap Margins Paid in by the Swap Counterparty

	-0.075%, -0.025%	-0.025%, +0.025%	Higher than + 0.025%
Initial Reserve Fund Amount	EUR10m	EUR9.2m	EUR8.4m
Thereafter, the higher of a multiple of the outstanding note balance	2.50%	2.30%	2.10%
or Reserve Fund Floor	EUR5m	EUR5m	EUR5m

Source: Transaction documents

However, the required amount will remain the same as on the previous payment date if the outstanding balance of mortgages more than three months in arrears exceeds 1.0% of the outstanding mortgage balance.

Legal Structure

At closing, the sellers will transfer the mortgage loans to the *Sociedad Gestora* on behalf of the fund. The seller will also transfer or pledge all present or future claims and/or rights under the various transaction documents to the fund. The *Sociedad Gestora* is a special-purpose company with limited liability incorporated under the laws of Spain, whose activities are limited to the management of asset-backed notes. The Sociedad Gestora is owned by 16 entities, including:

- Banco Bilbao Vizcaya Argentaria, S.A. (83%, ‘A-(A minus)/F1+’)
- JP Morgan España, S.A. (4%)
- Caja de Ahorros del Mediterráneo (1.5%, ‘A+/F1’)
- Bankinter, S.A. (1.5%)
- Barclays Bank (1.5%, ‘AA+/F1+’)
- Citibank España, S.A. (1.5%)

The mortgages will be transferred to the fund as certificates of mortgage transfer (*Certificados de Transmisión Hipotecaria*).

Representations and Warranties

No search of title will be conducted by the fund or other transaction parties; instead, they will rely on the representations and warranties provided by Bancaja in relation to the pool of mortgage loans, as detailed below. If there is an irretrievable breach of any of these representations or warranties, Bancaja will be required to substitute or repurchase the loan(s) in question.

Specifically, the representations and warranties include the following:

- Bancaja has full right and title to the mortgage loans and the power to sell and transfer them;
- all the mortgage loans were granted to individuals;
- each mortgage loan was originated by Bancaja in accordance with its standard underwriting criteria and procedures;
- each mortgage loan is registered in the relevant property registry and represents an economic first-ranking claim on the corresponding property;
- Bancaja is not aware of any dispute affecting any of the mortgage loans;
- Bancaja is not aware that any of the underlying properties have been subject to more than a 20% reduction in value;
- Bancaja has full title to all the mortgage loans;

- the property underlying each mortgage loan has undergone a valuation, as required by law; and
- each mortgage loan constitutes a legal, valid, binding and enforceable obligation for the relevant borrower.

Collateral

The reference portfolio consists of 8,669 mortgage loans originated by Bancaja in the normal course of its business. All the loans are secured by properties in Spain.

Security for the loans takes the form of mortgages registered in the *Registro de la Propiedad* (the official register) and all are first-ranking, although for some loans, the legal procedures to cancel a previous charge on the collateral have not yet been formalised.

Approximately 67% of the loans by value are for residential and the remaining 33% for commercial purposes.

The loans in the portfolio are secured by a variety of properties: residential properties (88.87%) retail outlets (7.69%), occupied and non-occupied industrial warehouses (2.58%) and rural properties (0.86%).

Furthermore, some 15.9% of the loans in the provisional pool are secured by between two and 12 properties (including combinations of residential and commercial properties). In these cases, the borrower, according to Law 124/1946 governing the mortgage markets in Spain, may release part of the collateral securing the loan to maintain the original LTV ratio if certain loan amounts have amortised. The release of the collateral is not subject to any additional underwriting by Bancaja.

Some 64.0% of the portfolio is located in the Comunidad de Valencia, which is the region that provides the bulk of Bancaja's business.

Fitch has increased the default probability for the commercial-purpose loans and the MVDs for the commercial properties; it has given no credit to for property price increases.

Origination and Servicing

As part of its analysis, Fitch has reviewed and analysed Bancaja's origination and servicing guidelines. It visited the bank's premises and met the originator and servicer managers responsible for the mortgage loan department.

Bancaja is the parent bank of Spain's sixth-largest banking group and was the country's third-largest savings bank by total assets at end-2003. For historical reasons, much of Bancaja's business is generated in Valencia, as reflected by the portfolio's 38.72% exposure to the region.

Irrespective of the purpose of the loan, the bank's credit analysis for mortgage loans to individuals is based on reactive and (for existing clients only) behavioural credit-scoring systems that Bancaja began developing 10 years ago. The analysis focuses on the borrower's ability to honour their debt payments in a timely fashion based on stresses of monthly instalments..

The information analysed includes debt-to-income ratios ("DTI", with a maximum allowable level of 45%), data from CIRBE (a Bank of Spain database that gathers information on borrower exposure and non-payments from all Spanish entities and individuals) and Experian or RAI (the *Registro de Aceptación de Impagados*), in addition to other credit parameters that evidence the applicant's financial stability. The credit limit for self-employed individuals is based on the tax declaration presented to the tax authority. The scoring assigns a minimal weighting to other sources of income declared by the applicant.

The majority of the properties are valued by TINSA, Tasaciones Inmobiliarias S.A., Spain's largest

Provisional Portfolio Summary

Pool Characteristics	
Current Principal Balance (EURm)	858.0
WA Original LTV (%)	69.0
WA Current LTV (%)	66.0
WA Indexed* Current LTV (%)	61.6
Average Current Loan per Borrower (EUR)	100,038
Average Original Loan per Borrower (EUR)	106,117
Oldest Loan in Portfolio	Sep 1994
Most Recent Loan in Portfolio	Dec 2004
Interest Rate Type	
Floating-Rate Loans (%)	100
WA Interest Rate (%)	3.29
WA Interest Margin (%)	0.97
Interest Index	EURIBOR/MIBOR
Payments	
Payment Frequency (%)	100
Payment Method	Direct Debit
Loans <30 Days in Arrears (%)	100
Regional Concentration (%)	
Madrid	11
Comunidad Valenciana	64
Cataluña	7
Lien Position (%)	
First-Ranking	100.0

* Based on Fitch's Indexation methodology, whereby 50% credit is given for property price appreciation (on the residential properties only).
Source: Fitch

valuation company, which is registered with and regulated by the Bank of Spain.

Arrears Management

Mortgages in arrears are managed by the branches for the first 90 days, and by the risk department thereafter. Several letters, automatically originated by the bank's system, are sent and calls made, their frequency and content depending on the level of exposure to the borrower. The documentation and procedures required for the foreclosure process are prepared as soon as is deemed necessary (even before 90 days of delinquency) to enable the lawyers to start proceedings within 24 hours of a decision to do so.

Typically, 52% of loans up to 60 days overdue are resolved before they reach 90 days in arrears, and only 3% will go into foreclosure. As a last resort, and if the central office decides to do so, Bancaja will renegotiate the repayment of amounts in arrears. Defaulted loans, i.e. those over 90 days in arrears, are seldom renegotiated

■ Credit Analysis

Fitch's methodology for assigning credit ratings to Spanish residential mortgage transactions in general is described in Appendix 1. The following section details the agency's particular areas of focus and concern regarding MBS Bancaja 2, as well as the factors it incorporated into its analysis to deal with them.

Fitch Default Model Output

Rating Level	WAFF* (%)	WARR** (%)	Loss Severity (%)	MVD
AAA	17.10	73.0	35.5	42.3
AA	13.68	78.7	29.5	37.9
A	10.30	84.0	24.2	33.7
BBB	6.80	87.8	20.4	30.5

Recovery time (years): interest accrued at the contractual rate for three years
Foreclosure cost: 10%
* Weighted Average Foreclosure Frequency
** Weighted Average Recovery Rate
Source: Fitch

To evaluate the contribution of structural elements such as excess spread, subordination and other factors, Fitch modelled the cash flows based on the WA recovery rate and the WA frequency of foreclosure provided by the loan-by-loan collateral analysis (see "*A Guide to European RMBS Cash Flow Analysis*" dated 20 December 2002 and available at www.fitchratings.com).

Default Probability

Generally, the two key determinants of default probability are a borrower's willingness and ability to make the mortgage payments. Willingness to pay is usually measured by the 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 to maintain/protect their equity, thereby eliminating the need for the lender to repossess the property.

The ability to pay is usually measured by the borrower's net income in relation to the mortgage payment. The bank has a strong focus on a borrower's ability to pay, implements comparatively strict origination guidelines in this area and allows a maximum DTI of only 45%. Therefore Fitch assumed that the borrowers generally have an average ability to pay.

Fitch took the specific characteristics of the loans into consideration in its default probability analysis of the portfolio. It increased the default probability for commercial-purpose loans, self-employed borrowers with residential loans, loans used for second homes and those originated in the Comunidad de Valencia to reflect the additional risk implicit in this transaction.

Recoveries

Market Value Decline

To estimate recoveries on the mortgage loans, Fitch examined house price movements in Spain on a regional basis from 1987-2003 and found significant differences, most notably between Madrid, Cataluña and País Vasco, and the other regions. Cities in these three regions have experienced higher price increases than those elsewhere in Spain. Based on its analysis of the real estate market, Fitch assumed marginally larger MVDs for certain regions, as well as for some large urban areas.

Based on its CMBS rating methodology, Fitch used commercial MVDs reflecting the property type, and the region-specific market and asset value volatility to calculate the recovery rate for the commercial properties of the pool.

Recovery Rate

Asset recovery rates were calculated for each item of collateral and grouped on a loan basis using standard RMBS methodology. To determine the recovery rate for each loan, Fitch used the calculation described below.

The lesser of: a) the indexed property value net of foreclosure costs (based on Fitch's indexation

methodology, whereby 50% credit is given for property price appreciation and foreclosure costs, assumed to be 10% of the value of the underlying property) reduced by the MVD factor less: (i) accrued interest relating to the mortgage receivable based on the contractual rate for a period of three years; and (ii) the principal balance of the mortgage receivable; or b) the current balance plus accrued interest for a period of three years.

No credit was given for property price appreciation on the commercial properties.

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 WA recovery rate and the WA frequency of foreclosure 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 simulates the cost of carrying defaulted loans as the difference between the performing balance of the mortgages and the notional note balance. Excess spread, the reserve fund and principal must be sufficient to cover the carrying cost until recoveries are received after 36 months. Variable interest rates are stressed upwards over time, although the effect of this increase is limited by the swap.

The cash flow analysis assumes a high level of annual prepayments on the mortgages (which stresses available excess spread) of 25%, 21% and 18% under ‘AAA’, ‘A’ and ‘BBB’ scenarios, respectively.

Under these stresses, repayment of principal will be received before the final legal maturity date. Payment of interest will be received without interruption, although in the case of the class B, C, D and E notes, this will be subject to the deferral triggers and the terms and conditions of the notes.

Class F Notes

The class F notes will be issued to finance the reserve fund, which will be fully funded at closing.

The amortisation profile for the class F notes has been structured to mirror the amortisation profile of the reserve fund. Principal funds available for the amortisation of the class F notes will be limited to the cash released from the reserve fund. The reserve fund is subject to a floor (0.625% of the initial Class A to E notes balance) and will be released to the class F noteholders at legal final maturity, (or before if the 10% clean-up call is exercised).

The performance of the Class F notes requires very favourable conditions for the collateral backing the Class A to E notes. Fitch calculated an expected recovery rate after testing several cash flow scenarios commensurate with speculative grade rating levels. The sensitivity analysis performed consisted in testing several variables that affect the release of the reserve fund and consequently the availability of interest and principal payments on the class F notes. Fitch ran multiple stress scenario assumptions including:

- Alternative timing of default assumptions: back-loaded, front loaded as well as evenly spread defaults;
- Alternative interest rates: increasing, low, and constant interest rate scenarios;
- Prepayment speeds: high, low and average historical prepayment rates;
- Different weighted average margin compression rates on the mortgage loans: the agency modelled high and low margin compression rates assuming the percentage of prepayments are allocated to the higher margin loans in the portfolio;
- Exercise of the clean up call by the Originator.

The ‘CC ’ expected rating on the class F notes is supported by the expected recovery rates. As default on the Class F notes appears probable, a distribution of possible recovery rates was obtained. The recovery rate has been calculated as the present value of the class F notes’ expected interest and principal payouts. Based on Fitch’s calculation, the expected recovery rate was 45%-65% of the initial note balance.

Performance Analytics

Fitch will monitor the transaction on a regular basis and as warranted by events. Its structured finance surveillance 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 accessible at www.fitchratings.com.

Appendix I: Rating Methodology

To determine appropriate levels of credit enhancement, Fitch analyses the collateral for Spanish residential transactions using a loan-by-loan mortgage default model. The model subjects the mortgage loans to stresses resulting from its assessments of historical home price movements and defaults. Fitch's study showed that the LTV, reflecting the size of the borrower's down payment, and the borrower's income multiple (original loan advanced divided by income) are the primary indicators of default risk in Spain. Fitch also modelled the cash flow contribution from excess interest using stress scenarios determined by its default model. The cash flow test showed that each class of rated notes, taking available credit enhancement into account, can withstand loan losses at a level corresponding to the related stress scenario without incurring any principal loss or interest shortfall.

Default Probability

Generally, the two key determinants of default probability are the borrower's willingness and ability to make the mortgage payments. The willingness of a borrower to pay is usually measured by the LTV. Fitch's model assumes higher default probabilities for high-LTV loans and lower default probabilities for low-LTV loans. The main reason 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, eliminating the need for the lender to repossess the property.

The ability to pay is usually measured by the borrower's net income in relation to the mortgage payment. Historical data available for Spain show low levels of default. Base default probabilities are determined using a matrix which considers each loan's affordability factor and LTV. The matrix classifies affordability into five classes, the lowest of which (Class 1) encompasses loans with DTIs of less than 20% and the highest of which (Class 5) encompasses all loans with DTIs exceeding 50%. The average DTI for the mortgage market in Spain is around 27%-33%.

Adjustments

Fitch adjusts the base default rates on a loan-by-loan basis to account for individual loan characteristics of the collateral across all rating levels.

- **Product Type:** Fitch increases default probability assumptions by 0%-10% for the index volatility experienced by variable-rate mortgage holders.
- **Repayment Type:** Fitch will increase base default rates by 5%-10% for loans to be paid by *cuota creciente*, whereby the amortisation of capital is always the same and the interest payment increases.
- **Loan Purpose:** Fitch believes that a financially distressed borrower is more likely to default on a second home or investment property than on a primary residence. Accordingly, the agency will double the base default rates in both cases. If the purpose of the loan is not the acquisition of a property in Spain, Fitch will increase the default probability by 10%-100%.
- **Borrower Profile:** Fitch increases default probability on loans to self-employed borrowers by 10%-50% to account for their lack of a fixed annual salary.
- **Arrears Status:** when rating portfolios combining current and arrears mortgages, Fitch increases base default rates for mortgages in arrears by 1-30, 31-60, and 61-90 days by 10%, 35% and 70%, respectively, and mortgages over 91 days in arrears (non-performing status) by 100%.
- **Underwriting Quality:** Fitch's review and analysis of the origination process determines whether the agency decreases default rates by up to 25% or increases them by 0%-200%.

Recovery Rate

To estimate recovery rates on mortgage loans in Spain, Fitch examined home price movements there on a regional basis from 1987–2001. The agency found significant differences in price development across regions, mainly between the regions of Madrid, Cataluña, País Vasco, and the rest of the regions in Spain. The cities of these regions have experienced higher price increases than other cities in Spain. As in most other countries, rural areas tend to develop on a more stable basis. Based on its analysis of the real estate market, Fitch assumed slightly higher MVDs for certain regions and some large urban areas.

To derive MVDs for the respective stress scenarios, Fitch then compared the characteristics of the Spanish real estate market with markets in other European countries. As with its other European mortgage default models, Fitch has increased MVDs for higher-value properties. These properties are generally subject to larger MVDs in a deteriorating market than homes with average or below-average market values due to limited demand for such properties.

When calculating recovery value, Fitch’s model reduces each property value by the MVD, external foreclosure expenses and the cost to the servicer of carrying the loan from delinquency through to default. For Spain, Fitch assumes that external foreclosure costs represent 10% of the loan’s balance at the time of default. Fitch also incorporates the fact that the length of time of the foreclosure process might be longer than the actual one in a recession period. To calculate carrying costs, Fitch uses a worst-case scenario analysis, which assumes that the borrower pays no pay interest and the collateral is not realised for a period of three years.

Excess Spread

Excess spread represents the monetary difference between the income received by the issuer from the borrowers and the interest on the notes and other expenses paid by the issuer. Any reserve fund will be replenished from available excess spread, if it is drawn. The actual value of excess spread depends on levels of delinquencies, defaults and prepayments, as well as the WA interest rate of the reference mortgage portfolio throughout the life of a transaction.

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