RMBS/Spain
Presale Report

Valencia Hipotecario 1, Fondo de Titulización de Activos

Expected Ratings*

Class	Amount (EURm)	Final Maturity	Rating	CE (%)
A	454.3	Feb 2036	AAA	5.10
B	11.8	Feb 2036	A+	2.60
C	5.9	Feb 2036	BBB+	1.35

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* Expected ratings do not reflect final ratings and are based on information provided by the issuer as of 17 March 2004.

Special Reports
The following special reports provide additional detail on Fitch's rating approach to, and performance of, the RMBS market, each available at www.fitchratings.com:

- Spanish Residential Mortgage Default Model II
- A Guide to European RMBS Cashflow Analysis
- Spanish RMBS Performance bulletin

Summary

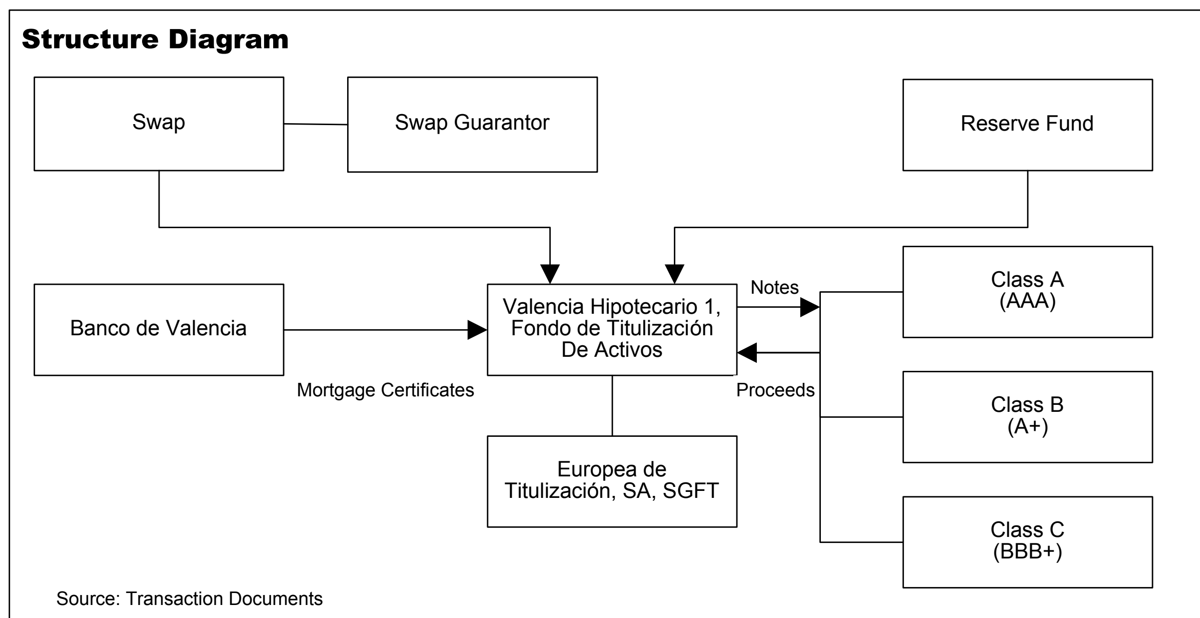
This EUR472million transaction is a securitisation of 9,636 residential mortgage loans originated in, and secured on property located in, Spain. Fitch Ratings has assigned expected ratings to the notes to be issued by Valencia Hipotecario 1, Fondo de Titulización de Activos ("Valencia Hipotecario 1" or "the fund") as indicated at left.

At closing, Valencia Hipotecario 1 will issue notes backed by a portfolio of residential mortgage loans originated by Banco de Valencia S.A. ("the seller", rated 'A/F1'), which will continue to service the loans. Valencia Hipotecario 1 is regulated by Spanish Securitisation Law 19/1992 and Royal Decree 926/1998. Its sole purpose is to transform the mortgage certificates acquired from the seller, Banco de Valencia, into variable-rate residential mortgage backed securities ("RMBS"). The certificates will be subscribed on behalf of Valencia Hipotecario 1 by Europea de Titulización, S.A., S.G.F.T. ("the *Sociedad Gestora*"), whose sole function is to manage asset-backed funds.

Banco de Valencia is the parent of the 33rd largest banking group in Spain (by total assets as of end-2002). For historical reasons, the bank's business is concentrated in the Valencia and Murcia regions, although it has expanded into other parts of Spain, notably Madrid. The bank's largest shareholding stake (38.3%) is held by Caja de Ahorros de Valencia, Castellón y Alicante (Bancaja), rated 'A+/F1' by Fitch.

The expected ratings are based on the quality of the collateral, the underwriting and servicing of the mortgage loans, available credit enhancement and the sound legal and financial structures. Initial credit enhancement for the Class A notes, totalling 5.10%, will be provided by subordination of the Class B notes (2.50%), the Class C notes (1.25%) and an initial reserve fund (1.35%). Initial credit enhancement for the Class B notes will be 2.60%, provided by the Class C notes and the reserve fund. Initial credit enhancement for the Class C notes will be 1.35%, provided by the reserve fund.

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*", published on 24 March 2004 and available at www.fitchratings.com). The agency also modelled the cash flow contribution from excess interest using stress scenarios determined by its default model. The cash flow test showed that, taking available credit enhancement into account, each class of rated notes could withstand loan losses at a level corresponding to the related stress scenario without incurring any principal loss or interest shortfall, according to the terms and conditions of the notes.



Credit Committee Highlights

- The loan-to-value ("LTV") ratios in this portfolio are among the lowest for any securitised Spanish residential mortgage loan portfolio. Consequently, the default probabilities are lower than for other Spanish RMBS transactions.
- Higher-than-average seasoning (around 36.8 months) contributed to a lower weighted average ("WA") indexed current LTV of 51.4%, compared with a current WA LTV of 59.2%.
- The mortgage loans in the portfolio are concentrated in Valencia (63%) and Murcia (21%). Fitch has accounted for the concentration risk in Valencia by increasing default probabilities for loans in this region.
- The interest rate hedging mechanism in place mitigates the risk of differences between the mortgages' indices (ie the portion of the pool bearing one-year EURIBOR (84%), and the portion bearing *Tipo Medio de los Préstamos Hipotecarios* "TMPH" (16%)) and the notes' three-month Euribor.
- The expected ratings address the likelihood that investors will receive timely payment of interest on the notes according to the terms and conditions of the documentation, subject to a deferral trigger for the Class B and Class C notes. They also address the likelihood that principal will be repaid at final maturity.

Financial Structure

Interest on the notes will be paid quarterly in arrears based on three-month EURIBOR plus a margin.

The mortgage loans will continue to be serviced by Banco de Valencia, acting as the administrator. However, in the event that it is unable to perform this function adequately, the *Sociedad Gestora* will appoint a replacement administration company in accordance with Law 19/1992, subject to rating agency confirmation.

Amounts received from the mortgages by the seller will be transferred by the bank into the fund's account, held at Banco de Valencia, on a daily basis. From there, the funds will be transferred on a weekly basis to the fund's treasury account, held at Bancaja.

The legal maturity of the notes is February 2036. The notes are subject to a clean-up call when less than 10% of the mortgage certificates at closing remain outstanding.

Priority of Payments

On each distribution date, revenue payments will be allocated in the following order of priority:

a. senior fees and expenses;
b. payments due under the interest rate swap agreement;
c. interest due on the Class A notes;
d. interest due on the Class B notes, if not deferred;
e. interest due on the Class C notes, if not deferred;
f. principal due on the notes;
g. replenishment of the reserve fund;
h. interest due on the Class B notes, if deferred;
i. interest due on the Class C notes, if deferred;

Key Information

Provisional Portfolio Characteristics

Total Amount at Closing: EUR472m

Weighted Average "WA" Original LTV: 68.9%

WA Current LTV: 59.2%

WA Indexed Current LTV: 51.4%

WA Remaining Maturity: 16.4 years

WA Seasoning: 36.8 months

Structure

Originator & Seller: Banco de Valencia S.A. (" Banco de Valencia", rated 'A/F1')

Servicer: Banco de Valencia

Fund: Valencia 1, Fondo de Titulización de Activos ("Valencia Hipotecario 1")

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

Swap Counterparty: Banco de Valencia

Swap guarantor: Caja de Ahorros de Valencia, Castellón y Alicante (Bancaja, rated 'A+/F1')

Final Legal Maturity: February 2036

j. payments due under the swap in the event of a swap counterparty default;
k. interest due on the loan for initial expenses;
l. amortisation of the loan for initial expenses;
m. interest due on the subordinated loan;
n. amortisation of the subordinated loan;
o. payments due to the loan administrator if the latter is Banco Valencia;
p. variable remuneration on the subordinated loan.

Interest due on the Class B notes will be deferred if the Amortisation Deficit exceeds 50% of the initial Class B note balance and 100% of the initial Class C note balance. Interest on the Class B notes may only be deferred if the Class A notes remain outstanding.

Interest due on the Class C notes will be deferred if the Amortisation Deficit exceeds 50% of the initial Class C note balance. Interest on the Class C notes may only be deferred if the Class A and Class B notes remain outstanding.

The Amortisation Deficit is the difference between:

1. the positive difference between: a) the current balance of the notes; and b) the current balance of the loans excluding losses. Losses are defined as mortgages more than 18 months in arrears; and
2. the funds available for principal payments.

In the event that the fund needs to be liquidated, the notes will become due and payable. All available funds will then be allocated sequentially to cover interest and principal payments due on the Class A notes, then the Class B notes and finally the Class C notes.

Principal Redemption

The principal repayments due on the notes will be allocated sequentially, starting with the Class A notes, then the Class B notes and finally the Class C notes.

However, the notes may be amortised on a *pro rata* basis if the Class B and Class C notes represent twice the credit enhancement they did at closing, ie 5% and 2.5%, respectively. However, *pro rata* amortisation can only take place subject to the following conditions:

- the reserve fund is at its maximum level;
- there is no Amortisation Deficit; and
- the current balance of loans more than 90 days in arrears, excluding losses, is less than 1.5% of the outstanding balance of the loans.

Interest Rate Risk

The fund will enter into an interest hedging agreement with Banco de Valencia, in order to cover the risk of the difference between the indices on the one-year Euribor bearing mortgage loans (84% of the pool), the TMPH bearing mortgage loans (16% of the pool) and the three-month Euribor of the notes.

Under the swap agreement the fund will, on each payment date, pay Banco de 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.

In the event that Bancaja, as swap guarantor, is downgraded below 'A+', Banco de Valencia will, within 10 days: a) have its obligations guaranteed by a third party rated at least 'A+'; b) be replaced by a counterparty with a rating of at least 'A+'; or c) cash-collateralise its obligations.

Loan Margin Renegotiation

Banco de Valencia may renegotiate the margin on the mortgage loans if requested by the borrower. Nevertheless, the mortgage portfolio is subject to a minimum WA margin of 0.50% on the outstanding

balance of the loans, below which point the bank may no longer renegotiate margins.

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.

Credit Enhancement

Initial credit enhancement for the Class A notes, totalling 5.10%, will be provided by subordination of the Class B notes (2.50%), the Class C notes (1.25%) and an initial reserve fund (1.35%). Initial credit enhancement for the Class B notes will be 2.60%, provided by the Class C notes and the reserve fund. Initial credit enhancement for the Class C notes will be 1.35%, provided by the reserve fund.

Reserve Fund

The balance of the reserve fund at closing will be equivalent to 1.35% of the initial note balance. It will be permitted to amortise to the lesser of: a) 1.0% of the initial note balance; or b) 2.7% of the then-outstanding note balance subject to the following conditions:

- the balance of mortgage loans more than 90 days in arrears remains below 1% of the outstanding mortgage balance;
- on the previous payment date, the reserve fund was replenished to the required amount; and
- the WA margin on the mortgage loans remains above 0.50%.

The reserve fund will be subject to a floor of 1.0% of the original note balance at all times.

Representations and Warranties

Banco de Valencia will provide representations and warranties in relation to the pool of mortgages, any breach of which will result in it repurchasing the loan(s) in question.

Specifically, the representations and warranties include the following, among others:

- each mortgage loan is registered in the relevant property registry and represents a first-ranking claim on the corresponding property;
- Banco de Valencia has full right and title to, and the power to sell and transfer, the mortgages;
- Banco de Valencia is unaware that any of the underlying properties' assessment values have been subject to a reduction of more than 20%;
- all properties are located in Spain;
- each property underlying a given mortgage loan has been the subject of a valuation, as required by law; and,
- each mortgage loan constitutes legal, valid, binding and enforceable obligations of the relevant borrower.

Legal Structure

At closing, the mortgage loans will be transferred by Banco Valencia to the *Sociedad Gestora* on behalf of the fund. The seller will also transfer all present or future rights under the various transaction documents to the fund. The *Sociedad Gestora* is a special purpose company with limited liability incorporated under Spanish laws. Its activities are limited to the management of asset-backed notes.

Mortgages are transferred to the fund as certificates of mortgage transfers (*Certificados de Transmisión de Hipoteca*).

Collateral

The provisional reference portfolio consists of 9,636 mortgage loans originated by Banco de Valencia. All are secured by residential properties in Spain and benefit from first-ranking mortgages registered in the *Registro de la Propiedad* (the Spanish official register).

Almost 100% of the loans are on variable rate, linked to one-year EURIBOR/MIBOR or TMPH. The portfolio is geographically concentrated in Valencia and Murcia, which account for 63% and 21% of the pool, respectively.

Income information was not available on a loan-by-loan basis. The agency applied an overall 35% Debt-to-Income ("DTI") ratio, which corresponds to Fitch's Class 3 definition (see "*Spanish Mortgage Default Model II*", dated March 2004 and available at www.fitchratings.com). While the original WA LTV level was 68.9%, current WA LTV is 59.2%. WA seasoning is 36.8 months, which has caused a significant decrease in the current LTV to an indexed current LTV of 51.4%. The largest current LTV in the pool is 79.5%.

The WA property price is EUR129,662 and no property price exceeded EUR600,000.

Origination and Servicing

Banco de Valencia, the originator and servicer within the transaction structure, is the parent of the 33rd largest banking group in Spain (ranked by total assets as at end-2002). Founded in 1900, its current structure dates back to the 2002 merger of Banco de Valencia and Banco de Murcia. Some 38.3% of Banco de Valencia's share capital is held by Bancaja,

Spain's seventh largest banking group, although Banco de 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. Business generation outside its home region increased from 3% to 32% of the total between 1994 and 2003.

Origination

Mortgages are mostly originated through the bank's branches and a network of real estate agencies. Potential borrowers are required, among others, 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 de 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 credit 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 level of 40% for first property applicants and 29% for second property applicants. It allows LTVs of up to 80% for first, and up to 70% for second mortgages. Maximum mortgage tenors of 25 and 20 years are allowed for first and second properties, respectively.

Provisional Portfolio Summary

Pool Characteristics	
Current Principal Balance (EURm)	502.1
Average Current Loan per Borrower (EUR)	52,102
Average Original Loan per Borrower (EUR)	63,189
Oldest Loan in Portfolio	January 1992
Most Recent Loan in Portfolio	March 2003
Interest Rate Type	
Floating-Rate Loans (%)	100
WA Interest Margin (%)	0.78
Interest Index	EURIBOR, MIBOR, TMPH
Payments	
Payment Frequency (%)	Monthly: 100
Payment Method	Direct Debit
Regional Concentration (%)	
Valencia	63
Murcia	21
Lien Position (%)	
First-Ranking	100

Source: Fitch Ratings

The bank requests the borrower to keep its current account at Banco de Valencia, although this is not compulsory.

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 actions. 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 de Valencia's collection 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 prepare required documentation and organise the foreclosure process, but must refer all business decisions to Banco de 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.

■ Credit Analysis

Fitch analysed the collateral for this transaction by subjecting the mortgage loans to stresses resulting from its assessment of mortgage loan defaults and historical house price movements in Spain. The analysis was based on default probability and expected recoveries on individual loans (see Appendix 1). To evaluate the contribution of structural elements such as excess spread, subordination, deferral triggers and other factors, Fitch modelled the cash flows based on the WA frequency of foreclosure and WA recovery rate 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 ratio. Fitch assumed higher default probabilities for high-LTV loans and lower default probabilities for low-LTV loans. This is because 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 borrower's net income in relation to the mortgage payment. Banco Valencia largely focuses on a borrower's ability to pay and has comparatively strict origination guidelines in this area.

Fitch takes into consideration the specific characteristics of the product in its default probability analysis of the portfolio, adopting the LTV based on the original balance of the initial drawdown as the main measure of a borrower's willingness to pay.

Recoveries

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, Catalonia and the Basque Country, and the other regions. Cities in these three regions have experienced higher price increases than elsewhere in Spain. Based on its analysis of the real estate market, Fitch assumed marginally larger market value declines ("MVDs") for certain regions, as well as for some large urban areas. Although price growth was stable in the period examined, it was slower in the regions of Valencia and Murcia. However, MVDs for these regions have tended to be lower than for the more highly populated areas of Spain such as Madrid and Catalonia.

Fitch has increased MVDs for higher-value properties. These are generally subject to greater MVDs in a deteriorating market than homes with average or below-average market values for reasons of limited demand. Approximately 21% of the reference pool is considered by Fitch to be secured on high-value ("jumbo") properties.

When calculating recovery values, Fitch'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. The carrying cost will depend on the time to foreclosure as well as the interest rate applied, which Fitch assumes to be 5%. Banco de Valencia's current time to foreclosure is one to one-and–a-half years, but Fitch assumed a figure of three years.

Cash Flow Analysis

To evaluate the contribution of structural elements such as excess spread, reserve fund and other factors, Fitch modelled the WA cumulative frequency of foreclosure and WA recovery rate provided by the loan-by-loan collateral analysis to determine cash flows generated by the mortgages. Recoveries included both interest and principal.

The cash flow model assumes that defaults are spread over the first five years of origination immediately following closing. The analysis calculates 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 the assumed 36 months. The variable interest rates due on the notes are stressed upwards over time. However, the effect of this factor is limited owing to the basis swap in place.

Fitch's cash flow analysis assumes a high level of prepayments on the mortgages, which stresses available excess spread, of 25%, 21% and 18% *per annum* under 'AAA', 'A' and 'BBB' scenarios, respectively. Furthermore the agency stressed its cash flow analysis to account for a potential decrease in the margin to be received from the portfolio following renegotiations between Banco Valencia and its customers.

Under these stresses, the repayment of principal will be received before the final legal maturity date. The payment of interest will be received without interruption for the Class A notes. However, receipt of interest on the Class B and Class C notes will be subject to the deferral trigger and the terms and conditions of the notes. If the deferral triggers are hit, the Class B and Class C notes may not receive any interest for a certain period.

■ 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 house 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 debt-to-income ratios (DTI) 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 c. 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 is increasing.
- **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, Fitch will double the base default rates in both cases. If the purpose of the loan is not to acquire a property in Spain, Fitch will increase the default probability by 50%-100%.
- **Borrower Profile:** Fitch increases default probability on loans to self-employed borrowers by 33%-50% to account for their lack of 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 Fitch decreases default rates by up to 25% or increases them by 0%-200%.

Loss Severity

To estimate loss severity on the mortgage loans in Spain, Fitch examined house price movements in Spain on a regional basis from 1987–2001. Fitch found significant differences in price development among the regions, mainly between the regions of Madrid, Catalonia, the Basque Country, 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 market value declines for certain regions and for some large urban areas.

To derive market value declines 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 market value declines for higher value properties. These properties are generally subject to larger market value declines 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 market value decline, external foreclosure expenses, and the cost to the servicer of carrying the loan from delinquency through default. For Spain, Fitch assumes external foreclosure costs represent 10% of the loan's balance at the time of default. Loss severity 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, one that assumes the borrower does not pay any 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 weighted average interest rate of the reference mortgage portfolio throughout the life of a transaction. The Threshold Rate calculation is designed to guarantee the issuer a minimum level of excess spread.

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