

First Mortgage Agent of AHML: Fixed Income Comment

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With this report the Analytical Division of Securitization and Syndication Department is starting analytical reports series to analyse issues in Russian ABS/MBS securitization. We will take a look at new and existing deals, structures, ratings, collateral parameters and performance data, including prepayments, delinquencies, defaults and recoveries.

Key Points

In May 2007 Agency for Housing Mortgage Lending (AHML) closed the sixth public RMBS transaction in Russia, the second and the largest public securitization of RUR denominated mortgage loans and the first domestic securitization transaction featuring tranching. On November 15 the issuer SPV (Mortgage Agent) paid the second period proceeds.

Interest Coverage Ratio of the Class A Bond coupon slightly declined from 2.06 to 1.95 due to prepayments skewed towards higher yielding mortgage loans. Because the Class A bonds benefit from fully sequential amortization (i.e. all principal collections are first applied to repay Class A notes before any amortization of the junior notes) we would expect that this ratio will go up.

Prepayment speed of the collateral keeps increasing and has reached 29% CPR in December. We think it is driven by several factors: continuing economic growth of Russia, relatively high pool WAC and substantial reduction in mortgage loan rates within the last two years. We expect that prepayment speeds will slow down and stabilize when collateral becomes more seasoned and lenders adjust its underwriting policies to the new market circumstances.

We think that Class A bond priced at 99.50 is fair. It has duration of 1.49 with WAL 0.59. The bond has the highest possible credit rating in Russia. We compared it to other fixed income instruments with similar rating and WAL. We expect that accelerated amortization and further increase in credit support would move its price close to par.

Class A bond is trading with 136bps spread over Russian treasuries. This is 50-75bps wider than comparable bonds of government sponsored/owned corporations with similar WAL and credit rating. In our opinion this spread is sufficient compensation for prepayment and liquidity risks. Prepayment speed of AHML deal collateral has fluctuated from 17% to 29% CPR since the issue date. This alone could easily justify 30-35bps additional spread. The trading volume (liquidity) was low and this fact has contributed to the bond spread over treasuries.

Capital Structure

Class	Rating	Amount (RUR, millions)	% of Bonds	Coupon
A	A3	2,900.000	88.00	6.94
B	Ba1	264.000	8.00	9.50
C	NR	130.794	3.97	variable
Total:		3,294.794	100.00	

- **Class A Bonds (A3).** This is the senior tranche in the capital structure. Its face value was 88% of the whole deal. It pays 6.94% fixed coupon on the quarterly basis. Its credit support consists of 12% subordination and a reserve fund. The reserve fund size was 4% at closing and supposed to be increased from excess spread to reach 7%. All collateral principal payments are used to pay Class A balance first. Down the road its credit support will be going up.
- **Class B Bonds (Ba1).** The mezzanine tranche of the deal. It has deferrable 9.5% fixed coupon based on the formula and *de minimis* payment of 0.01 RUR per bond. It was privately placed with EBRD. Its size is 8% and credit support consists of 4% subordination and reserve fund. It could be sold publicly in the future.
- **Class C Bonds (NR).** The junior tranche of the deal. It has variable interest rate paid from the excess spread to the extent available (if any) and annual fixed *de minimis* payment of RUR 0.01 per bond. Essentially Class C is an equity tranche and was retained by the issuer. Nonetheless it is worth to take a look at its relative value.
- **Clean-up Call.** Both subordinated tranches could be paid down early via clean-up call. The Issuer may decide on early redemption of the Class B Bonds and the Class C Bonds after redemption in full of the Class A Bonds.
- **Reserve Fund.** The non-amortizing Special Reserve of RUR 230.6 million (7.0% of the initial bond balance) was be partially funded at closing to the amount of RUR 131.8 million (4.0% of the initial bond balance) and the remaining balance has to be funded by the excess spread. Available excess spread will be used to bring the Special Reserve to the initial target level where there have been drawings in earlier collection periods. The required Special Reserve amount will remain at the same level until the final maturity of the Bonds. Drawings on the Special Reserve may be used to meet shortfalls in available revenue receipts in order to pay the required interest on the Bonds, as well as to cover credit losses.

Waterfall

The Bonds interest priority of payments

- 1) Taxes
- 2) Third party expenses (costs of regulatory compliance, Issuer's bank accounts fees, etc.)
- 3) *pari passu* and *pro rata* to the Management Company and to the Accounting Company
- 4) *pari passu* and *pro rata* to:
 - a) the Calculation Agent
 - b) the Paying Agent
 - c) the Custodian
 - d) the Special Depository
 - e) the Auditor and
 - f) the Rating Agency
- 5) to the Servicer
- 6) coupon to Class A Bonds
- 7) *pari passu* and *pro rata*:
 - a) the Minimum Class B Coupon
 - b) the Minimum Class C Coupon
- 8) Class A Principal Deficiency Ledger
- 9) coupon to Class B Bonds
- 10) Class B Principal Deficiency Ledger
- 11) Class C Principal Deficiency Ledger
- 12) Reserve Fund Ledger

Bonds Principal Priority of Payments

- 1) Principal Draw (in case principal was used to pay interest)
- 2) redemption of Class A Bonds
- 3) redemption of Class B Bonds
- 4) redemption of Class C Bonds

Collateral

Description

The collateral pool initially consisted of an aggregated amount of RUR 3.3 billion of receivables arising from 8,168 mortgage loans denominated in RUR which were secured by mortgages on properties located in 55 regions of the Russian Federation.

All loans in the pool have been originated by a range of local regional banks and non-banking entities located in various regions of the Russian Federation in accordance with standards set by the AHML.

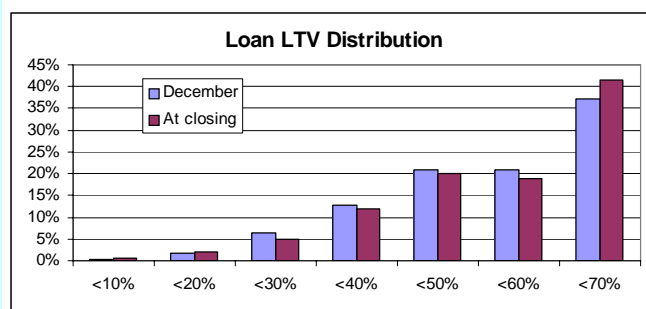
All loans in the pool are fixed-rate amortizing loans with an initial WAC (Weighted Average Coupon) of 14.33% and no interest rate reset until maturity. The underlying loan conditions for the majority of loan agreements allow the borrowers to prepay without penalty following the expiry of a six month period after its disbursement.

All loans in the pool benefit from property insurance, life and disability insurance for the entire life of the loan. The beneficial rights under the insurance policies have been transferred to the Mortgage Agent, and cash received by the Mortgage Agent under the insurance policies is included in the security pool and therefore pledged in favor of bondholders.

LTV

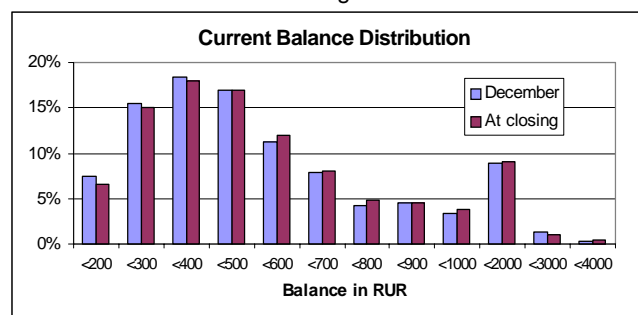
Collateral pool had moderate LTV (Loan-To-Value) ratio of 53.97% initially. As of December 2007 it is 46.30%. The following diagram depicts changes in LTV distribution occurred in the period from cut-off date to the last payment period. As we can see the biggest drop happened in the percentile of loans with high LTVs (60% and above). That would definitely benefit the current credit support and reduce risk of losses in

case of loan default.



Current Outstanding Amount

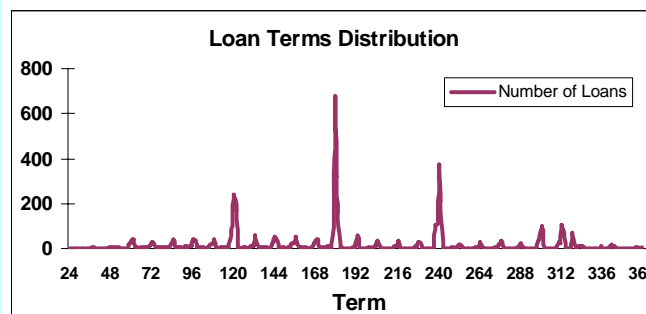
The other important parameter of the collateral pool is loan current outstanding amounts (balances). The next diagram depicts the distribution by the loans current outstanding balances in the pool. Due to scheduled pool amortization and high rate of prepayments the distribution has shifted left towards the lower end of the range.



This is also a positive change in the Class A bonds support that is reducing value at risk during foreclosure. As was mentioned before the deal has non-amortizing reserved fund of fixed size. At the present time the fund is receiving part of the excess spread in order to reach size of 7% of the amount outstanding of all AHML bonds as of the placement date. At the present time it has reached RUR 165.4M (5.02%).

Maturity

Initial WAM (Weighted Average Maturity) of the collateral pool was 192 months. The latest WAM as of December was 196. This is very unusual trend comparing to the performance of US and European mortgage pools. The explanation is simple - the composition of the collateral pool. The following diagram shows the distribution of loan maturities.

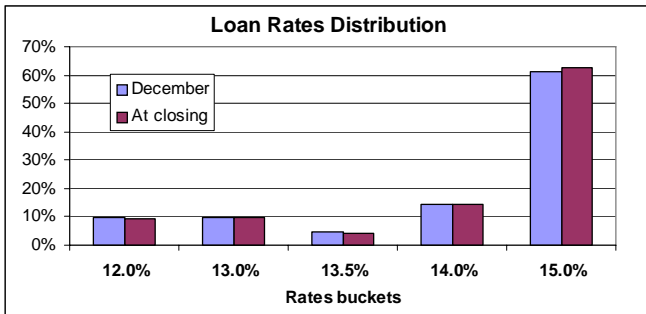


Mortgage pools used to secure MBS in US, Europe, and Australia are homogeneous. Loans included in such pools have similar parameters: coupon, maturity, vintage, etc. In a contrary to this practice the AHML pool includes a blend of very different loans: rates (from 12% to 15%), maturities (from 24 to 369 months) and so on. The prepayment profile of the

pool with such parameters could differ from conventional. Accelerated amortization of loans with short maturities could explain an unusual trend in pool WAM.

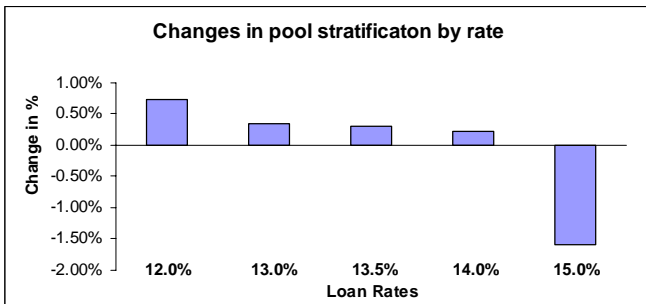
Loan Rate

Let us take a look at the distribution of loan rates. Every mortgage certificate that is representing single mortgage loan in the pool was reviewed by AHML for compliance with its origination standards. These standards allow mortgages with the following interest rates: 12%, 13%, 13.5%, 14%, and 15%. The following diagram depicts the weights of different rate buckets in AHML pool.



As can be seen on the diagram the pool is dominated by loans with 15% rate.

In order to see dynamics of changes in these buckets we calculated another diagram. It depicts changes in the bucket weights after the last payment period.

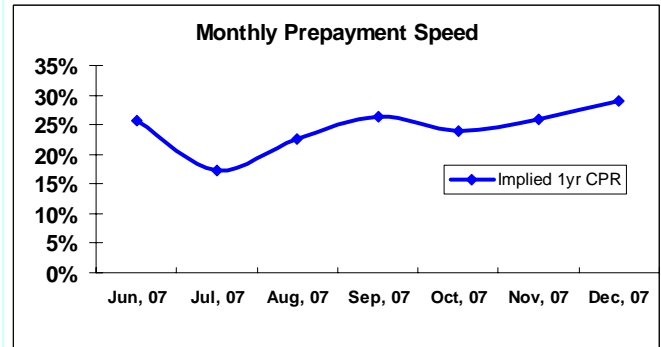


As expected, the 15% bucket has been prepaying at a higher speed and its share in the pool has been declining.

Prepayments

Since inception of AHML deal its collateral pool has paid total sum of RUR 519M of principal payments including scheduled amortization, unscheduled and voluntary prepayments. The implied one year CPR was calculated using collateral reports disclosed by Mortgage Agent of AHML. It is depicted

on the following diagram.



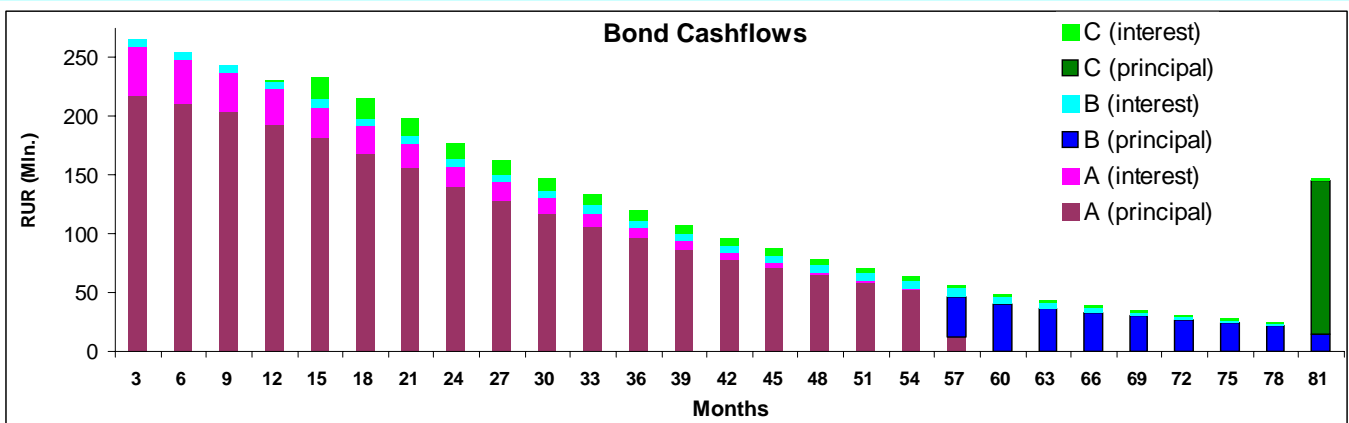
It is substantially higher than the 15% prepayment speed that was originally stated in the AHML presale reports.

There are two major components of prepayments in Russia: curtailments and full repayment. On the average the amount of curtailment payments accounts for about 33% of the total prepayment. Unfortunately at the present time and current legal requirements for disclosure in securitization there is no way to distinguish between the turnover and refinance types of prepayment. In turnover prepayment event a mortgage borrower is selling his house and that is the reason for the full prepayment. The refinance prepayment means that borrower has got another mortgage loan and used it to pay down balance on the original mortgage. The refinancing programs were announced by several Russian commercial banks but the percentage of refinanced mortgages is still very low. The reason for that is high cost of refinance procedure. In the current mortgage rates environment when prevailing mortgage rate has upward trend the refinancing risk does not pose a real threat.

We interpolated observed prepayments and assumed that starting January 2008 pool implied 1year CPR will stay constant at 29% level till maturity of Class A bond. We expected that rates of delinquency, defaults and recoveries will follow patterns observed in the last two payment periods.

We used VTB's mortgage pool model to calculate cashflows from the deal collateral pool. We reverse-engineered AHML deal waterfall to estimate each particular bond (A, B, and C) cashflows. We assumed that Class C bond will be redeemed early by the exercising of clean-up call. The expected cashflows for each bond are depicted on the following diagram.

Note a deficiency in the Class C bond interest in the next four payment periods and than spike in the fifth one. This is because excess spread was used to fill up the Reserve Fund.

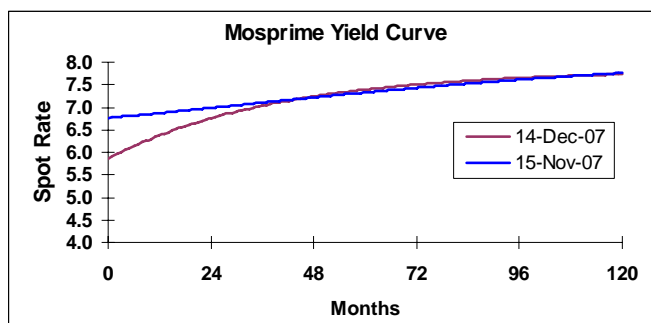


Calculating bond prices

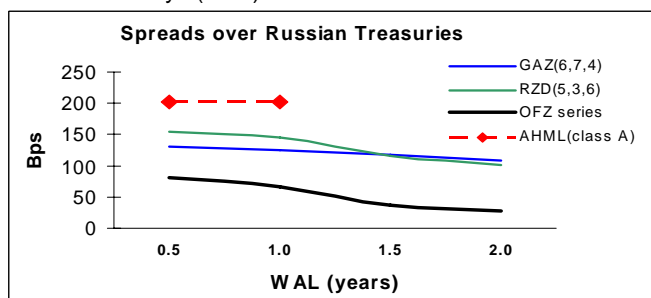
In order to evaluate financial characteristics of AHML bond (all classes) we have modeled collateral pool, reverse-engineered waterfall and treated all three classes of bonds as standalone financial instruments.

Yield Curve

The Mosprime yield curve was used to discount future bond cashflows. We used the curve as of December 14 closing. The curve used is shown on the following diagram. The November 15th curve was calculated to show the difference.



In order to get a sense of relative value of AHML Class A bond we compared it with corporate bonds. The bonds used were domestic RUR denominated bonds of Gazprom (GAZ) and Russian Railways (RZD).



Below are the results of chosen securities evaluations.

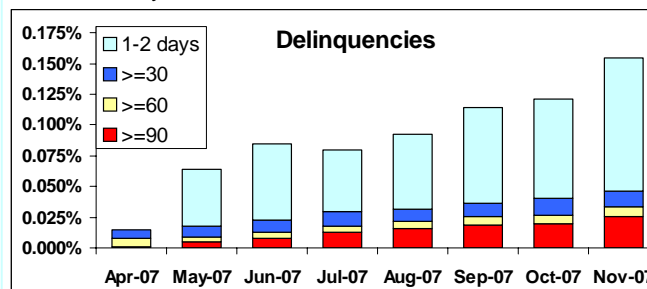
Issue	Maturity	Coupon	Price	Spred	WAL
GAZ - 6	Aug-09	6.95	100.41	117	1.66
GAZ - 7	Nov-09	6.79	100.21	108	1.89
GAZ - 4	Feb-10	8.22	102.90	109	2.18
RZD - 5	Jan-09	6.67	99.90	145	1.12
RZD - 3	Dec-09	8.33	103.12	101	1.98
RZD - 6	Nov-10	7.35	101.17	104	2.92
T25060	Feb-09	5.80	99.84	66	1.13
T25057	Jan-10	7.40	102.96	27	2.12
T25061	May-10	5.80	99.47	33	2.39
AHML	Feb-39	6.94	99.50	203	0.59

Based on the VTB's model and our assumptions we had calculated all bond price sensitivity parameters

Name	Base Price	Duration	WAL
Class A bond	99.50	1.49	0.59
Class B bond	97.78	3.87	2.29
Class C bond	143.60	3.60	2.89

Delinquencies

At the first glance each monthly collateral report shows a lot of loans delinquent. But more detailed study of the delinquencies shows that most of them are just simple technical delays. With this in mind and taking into account credit enhancement and low pool LTV we can conclude that risk of losses due to loan defaults is very small.



Liquidity

Due to the novelty of domestically issued RUR denominated MBS regular trading volumes of Class A bonds are low. The volume of trades on repo accounts has been approximately eight times higher than average volume of regular trades.

The relative illiquidity is probably the highest risk related to AHML MBS bonds.

There are several legal legislative issues in the process of resolution that should help to make high quality Russian MBS more liquid.

- a) As of today Russian Pension Fund does not have a right to invest in MBS according to its Chart. The list of financial instruments it may invest is restricted to the papers that have government guarantees. That constraint should be removed by Federal Financial Markets Service (FFMS) in the nearest future. Russian Pension Fund could become one of the largest institutional investors in Russian ABS/MBS.
- b) Driven by recent liquidity crisis the Central Bank of Russia (CBR) is considering revision of its so called "lombard list". This list includes securities that could be taken by CBR as collateral in repo lending. It is expected that certain MBS bonds will be included in this list.

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