Investment Glossary

The Baker Group

Investment Glossary

— A —

Accrual Bonds: See Z Bonds.

Accrued Interest: Coupon interest earned but not yet paid from the time of the last coupon payment.

ARM (Adjustable-Rate Mortgage): A mortgage loan whose coupon rate is adjusted periodically at a given margin over a specified index, such as the one-year Constant-Maturity Treasury or the 11th District Cost-of-Funds Index, subject to specified coupon change and lifetime caps.

Allocation: The process by which the operations department of a brokerage firm matches mortgage pools to orders for generic pools according to PSA's good delivery guidelines, and subsequently notifies purchasers and sellers which mortgage pools will be delivered on the settlement date.

Amortization: A loan-repayment method whereby the total principal amount borrowed is repaid gradually during the life of the loan. The payment made by a mortgage holder each month is composed of interest on the outstanding principal amount and principal. Since the payment that is made by the mortgage holder is typically fixed, the interest component of the payment gradually decreases as the original principal balance is reduced.

Ask Price: The price at which a dealer is willing to sell a security.

Average Life: The weighted-average time (in years) the principal of a mortgage security is outstanding. An increase in prepayments of the underlying mortgage loans shortens the average life of a mortgage security since more principal has been repaid and a smaller amount of principal will be paid in the future.

— B —

Balloon-Payment Mortgages: An amortizing mortgage loan, that requires that the entire outstanding principal balance of the loan be repaid on a certain date.

Basis Point (bp): One-hundredth of one percent. Normally used to describe the change in yield of a security (e.g., a yield increase from 7.13% to 7.14% would be a two basis point increase).

Bid Price: The price at which a dealer is willing to purchase a security.

Bond-Equivalent Effective Margin (BEEM): The average spread of an adjustable rate security over the underlying index for the life of the instrument. BEEM assumes the index remains constant and the coupon of the security completely resets to the index over time, taking into account all caps, collars and floors.

Bond-Equivalent Yield (BEY): The yield of a mortgage security (a monthly yield) expressed on a semi-annual equivalent basis.

Buy-Down Loan: A loan whose monthly mortgage prepayments are subsidized by another party in the first several years after issuance. Home builders sometimes provide buy-down loans to assist home purchasers in financing their properties.

— C —

CAGE (Current Age): Current age (in months) of the underlying collateral.

Cap: A maximum limit on the interest rate of a floating rate security. The coupon can not reset above the Cap throughout the life of the security.

Cash-Flow Yield: The internal rate of return of a mortgage security that equates all monthly interest and principal cash flows (assuming a certain prepayment rate) to a given price plus accrued interest.

Cash Program (FHLMC): Through FHLMC's Cash Program, loan originators sell their mortgage loans directly to FHLMC for cash. In turn, FHLMC pools the mortgage loans of many originators into mortgage Participation Certificates.

CMT (Constant Maturity Treasury): The Average yield of Treasury Notes at constant maturities.

COFI (Cost of Funds Index): The average rate paid on liabilities for SAIF institutions within a specified region. Common examples include the 11th District COFI (comprised of institutions within the Federal Reserves 11th District) and the National COFI (comprised of all SAIF insured institutions in the country).

Collar: The maximum amount the coupon of an adjustable rate security is allowed to change at each reset date. Also known as periodic cap.

Collateralized Bond Obligation (CBO): A multi-tranche, pay-through debt security employing a pool of high yield corporate bonds as collateral. The corporate bond portfolio is highly diversified by both issuer and industry. Principal and interest payments on the underlying corporate bonds are used solely to meet CBO principal and interest obligations. The CBO is divided into several debt tranches and an equity portion. Similar to other asset-backed securities, the CBO structure is flexible and the debt may be structured in a variety of ways to satisfy investor cash flow requirements. A typical structure includes an A-rated senior secured tranche, a BB-rated second secured tranche and a Z-tranche. The secured tranches are normally sold to investors while the Z-bonds and equity portion are retained by the CBO sponsor. Currently, due to restrictions imposed by the Investment Company Act of 1940, CBOs are traded as private placements.

Collateralized Mortgage Obligation (CMO): A sequential-pay security that is collateralized by mortgage pass-through securities or mortgage whole loans.

Companion Bonds: Bonds created to absorb the volatility removed from the PACs and TACs. Companion bonds receive any principal payments in excess of those scheduled for the call-protected bonds. Likewise, principal payments to companion bonds can be delayed when prepayments slow and scheduled payments to extension-protected bonds are met first. As a result, the average lives of these bonds have more variability than comparable sequential pay bonds from traditional CMO structures. Companions may also be referred to as "support" bonds.

CPR (Constant Prepayment Rate): A method of measuring prepayments that assumes a constant portion of the outstanding MBS principal will prepay. 6% CPR assumes 6% of the outstanding principal balance will prepay in one year.

Construction Loan: A loan that finances the construction or substantial rehabilitation of residential or commercial property. See GNMA Construction-Loan Certificate/Project-LoanCertificate (CLC/PLC) Program.

Conventional Loan: A mortgage loan that is not FHA-guaranteed or VA-insured.

Convexity: The rate at which the duration of a security changes as interest rates change. Positive convexity implies that for small, equal and opposite changes in interest rates, the increase in price if rates go down will be more than the decrease in price if rates increase. Negative convexity, on the other hand, implies that the increase in price if rates go down will be smaller than the decrease in price if rates increase.

Corporate Bond-Equivalent Yield: See Bond-Equivalent Yield.

Cost of Carry: The implied borrowing cost of the seller of a dollar roll or repurchase agreement. It includes the value of the mortgage pass-through security's cash flow that was forfeited when the security was lent to the buying party over the roll period, as well as the difference between the sale price and the buy price of the security.

Coverage Ratio (Revenue Credit): A coverage ratio measures an issuer's ability to meet the debt service payments relative to the pledged revenue stream. A high coverage ratio indicates a better ability to meet the expense in question. *General benchmark for debt coverage ratio is >1.15x.

Current Face: The outstanding principal balance of a security.

— D —

Debt Service (Revenue Credit): The issuer's debt service reflects the cash required over a fiscal year for the repayment of interest and principal on a debt issue.

Default: Failure of a home owner to meet mortgage loan payments for a period of two or more months. A loan default may result in a foreclosure of the property. For GNMA and FNMA securities, servicers advance principal and interest payments during the time that any underlying loans are in default. Following the foreclosure of any property, the outstanding principal balance of the loan is passed through to the GNMA and FNMA pass-through investor as a prepayment of principal. FHLMC servicers advance only the interest payments for the underlying loans that are in default in a mortgage pool and guarantee the repayment of principal within one year of the date of default.

Delay: Investors receive interest and principal from mortgage pass-through securities after a stated delay. The delay is stated to be 45, 50, 55 and 75 days for GNMAs, GNMA IIs, FNMAs and FHLMCs, respectively. For example, interest for the month of January would be paid on February 15 for GNMAs, February 20 for GNMA IIs, February 25 for FNMAs and March 15 for FHLMCs. On these dates, the security holder would also receive any principal payments made by the mortgage holders during the month of January. However, since interest for the month of January would be paid on February 1 if there were no delays, the actual delays are 14, 19, 24 and 44 days, respectively.

Dollar Roll: A short-term financing transaction for mortgage pass-through securities. Unlike repos and reverse repos, dollar rolls involve the sale/purchase and subsequent repurchase/resale of substantially similar mortgage securities. A seller of a roll agrees to sell a mortgage security for an agreed-upon-price on a given date and buy back a similar security at a future date, while a buyer of a roll agrees to buy a mortgage security for a certain price and then sell a similar security at a future date. The seller of the roll receives the use of funds for the time period, but forfeits the monthly cash flows from that security during the roll period. The buyer of a roll (the counterparty) is the owner of that mortgage security for a time period and is entitled to its cash flows during that period. (See Drop and Cost of Carry for further description of dollar roll terms.)

Drop: Difference between the prices in a dollar roll in 32nds on the two settlement dates. The drop is the price that the buyer of the roll is willing to pay to borrow the mortgage pass-through security for the time period of the roll.

Due-On-Sale Clause: A provision in the original mortgage loan documentation that requires a home owner to repay the outstanding loan amount on the sale or transfer of the property collateral. Conventionally underwritten loans, which comprise the majority of FHLMC and FNMA pass-through collateral, have contained due-on-sale clauses since 1979. GNMA pass-throughs and some FHLMC and FNMA securities are backed by FHA/VA loans that are assumable, meaning that the buyer can assume from the seller the original mortgage loan on the property.

Duration (Effective): Duration as measured by the actual changes in a security's price.

Duration (Macaulay): The weighted-average time (in years) to maturity where the weights are the present values of all future cashflows. Duration is a measure of price sensitivity, where a security with a duration of 1 will appreciate or depreciate 1% given a 100 basis point change in yield.

Duration (Modified): Macaulay duration that has been modified to measure the price sensitivity of a fixed-income security to small changes in yield. Cash flows from the security are assumed to be interest-rate independent.

Dwarf: A 15-year FNMA security.

— F —

Factor: See Pool Factor.

FHLMC (Federal Home Loan Mortgage Corporation or "Freddie Mac"): A quasi-governmental corporation that was chartered by Congress to buy predominantly conventional mortgage loans and securitize them into FHLMC Participation Certificates (PCs). FHLMC is not an agency of the U.S. Government, but it does have access to borrowing rights within the Federal Reserve System. FHLMC's common stock is held by the 12 Federal Home Loan Banks and its preferred stock is held by the public. In the event of an underlying mortgage loan default, FHLMC guarantees uninterrupted payments of interest and eventual repayment (within one year) of principal to PC investors.

FHA (Federal Housing Administration): An agency within the Department of Housing and Urban Development (HUD) that provides federal mortgage insurance for single-family dwellings and multifamily projects.

FNMA (Federal National Mortgage Association or "Fannie Mae"): Like FHLMC, FNMA is a privately-held corporation that is engaged in buying and securitizing conventional and FHA/VA mortgage loans. FNMA issues mortgage pass-through certificates and Collateralized Mortgage Obligations. FNMA guarantees uninterrupted payment of interest and principal should any of the underlying mortgage-loans default in a FNMA pass-through.

FHA Experience: A mortality table, or statistical series, published by the FHA that shows the proportion of FHA and VA mortgage loans that terminate for a given policy year.

FHA-Insured Project: A multifamily, hospital, nursing home or land-development loan that has been fully insured or co-insured by the Federal Housing Administration.

FHLMC Participation Certificate (PC): A security backed by a pool of mortgages guaranteed by FHLMC. Investors in FHLMC PCs receive monthly payments from a pool of mortgage loans minus servicing fees and the agency guarantee fee. PC is another term for a FHLMC MBS.

Final Maturity (Mortgage Security): The maturity date of the last maturing mortgage loan in a mortgage pool.

Floor: The minimum coupon to which a floating rate security can reset over its life.

Floaters (Floating Rate CMO Bonds): CMO classes on which the coupon is periodically reset based on the level of some index of market interest rates plus a fixed spread. Caps and floors may define the highest and lowest levels at which the bonds can pay interest.

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Funding Note REMIC: A FHLMC program designed to permit financial institutions to dispose of below-market collateral. The institution books the transaction as a financing, amortizing the loss over a period of years, while the transaction is treated as a sale for tax purposes, with the loss taken immediately. (A pass-through option permits an issuer to defer the tax loss.)

— G —

Gnome: A 15-year FHLMC security that is issued under the FHLMC 15-year Cash Program.

Good Delivery: The Public Securities Association has published a series of guidelines to standardize the TBA allocation process. These guidelines stipulate, among other things, the maximum number of pools that can be allocated per $1 million of face amount and the percentage variance in current face value allowable for delivery. To "make good delivery", for example, only three pools are allowed to be allocated per $1 million current face value for coupons under 12% and four pools per $1 million for coupons 12% and over. The current face on the securities delivered is allowed to vary from the current face purchased by plus or minus 2.499%.

GL (Government Loan): A FNMA pass-through security whose underlying mortgage loans are FHA-guaranteed or VA-insured. Like GNMA securities, GL securities are assumable, i.e. upon sale of the property, the mortgage loan may be assumed by the new owners.

GNMA (Government National Mortgage Association): A wholly owned U.S. Government agency within the Department of Housing and Urban Development that guarantees the timely payment of principal and interest on securities backed by pools of FHA-guaranteed or VA-insured residential mortgage loans. GNMA securities are backed by the full faith and credit of the U.S. government.

GNMA I: Securities that are underwritten according to GNMA I program guidelines. The coupons on the underlying mortgage loans of GNMA I securities are 50 basis points higher than the pass-through rate. Investors in GNMA I securities receive interest and principal payments on the fifteenth day of each month from the issue of the security.

GNMA II: Securities that are underwritten according to GNMA II program guidelines. GNMA II securities are permitted to contain underlying mortgage loans with coupon rates varying from 50 to 150 basis points above the pass-through security rate. GNMA IIs can be single-issuer (Custom Pools) or multiple-issuer (Jumbo Pools). GNMA II securities can be either fixed or variable rate. All variable rate MBSs issued by GNMA are GNMA IIs. Investors in GNMA II securities receive payments on the twentieth day of each month from a central paying agent, Chemical Bank.

GNMA Construction-Loan Certificate/ Permanent-Loan Certificate (CLC/PLC): A two-part loan whereby a builder/developer of a multifamily, hospital or nursing home facility using funds financed by the sale of GNMA Construction-Loan Certificates (CLC) to construct the facility. When development has been completed, the interest-only paying CLCs are exchanged for an equivalent face amount of Permanent-Loan Certificates (PLC). PLCs are 40-year mortgage pass-through securities.

GPM (Graduated-Payment Mortgages): A mortgage loan whose monthly payments increase gradually over the first several years and then are fixed for the remainder of the term. GPMs are issued as a way for new home owners to afford the mortgage payments on a property.

Gross WAC: See Weighted-Average Coupon.

GEM (Growing-Equity Mortgage): A fixed-rate mortgage loan whose monthly payments increase each year. Since the initial loan payment is adequate to cover interest due, GEMs do not experience negative amortization. The increasing payments reduce the principal balance of the loan more quickly than is the case with non-GEM mortgage loans, so that equity in the property is built up faster.

Guaranteed Minimum Sinking Fund Bonds: This structure returns principal to the bondholder according to a defined minimum schedule. Because the repayments typically are faster than can be supported under the rating agencies' conservative structural tests, the issuer must guarantee to make up any shortfalls in the collateral cash flow.

Guarantor Program (FHLMC): A securitization program whereby issuers sell ("swap") their loans to FHLMC in exchange for a participation certificate. Issuers are free to sell their securities in the secondary market or retain them for their own inventory.

— H —

Half-Life: Time, in years, until half of the purchased principal has been repaid.

HUD (Department of Housing and Urban Development): A department of the United States government concerned with private and public housing issues. The Federal Housing Administration and the Government National Mortgage Association are two agencies within HUD.

— I —

Interest-Only Security (IO): A mortgage security that receives only interest cash flows from an underlying pool of mortgage loans or an underlying pass-through security.

Issuer: The legal entity that issues a security. For CMOs, these are often subsidiaries of companies created for the sole purpose of issuing CMOs.

Issue Date: The date on which a mortgage pass-through security begins to accrue interest and principal payments to investors. Also known as Dated Date.

Inverse Floater CMOs: Floating rate bonds with coupon rates based on some negative multiple of an index. Thus the coupon rate on the bonds varies inversely with market interest rates.

— L —

Level Payment Mortgage: A mortgage that requires constant, fixed payments at regular intervals during its term. A portion of each payment covers the interest due on the mortgage and the remaining amount is used to reduce the outstanding balance of principal.

LIBOR (London Interbank Offered Rate): The interest rate at which banks deposit Eurodollars with other banks outside the United States. In other words, the European equivalent of Fed Funds.

— M —

Manufactured Home Loan: A mortgage loan for manufactured or prefabricated housing. GNMA manufactured home loan securities are backed by underlying manufactured home loans, which typically have 15-year to 20-year maturities, mortgage loan coupon rates of 75 to 275 basis points above the pass-through security rate and are issued by one originator.

Margin: The spread, in basis points, a floating rate security floats above or below the underlying index.

Maturity: See Final Maturity.

Midget Security: A 15-year GNMA security.

Mortgage Loan: A self-amortizing loan that is collateralized by a residential or commercial property.

Mortgage Yield: See Cash-Flow Yield.

Multifamily Loan: Mortgage loan on a multifamily (4+ units) rental property.

Multiple-issuer Pool (GNMA jumbo): A large, multiple-issuer pool issued through the GNMA II program.

— N —

Negative Amortization: When the interest payments in the early years of certain types of mortgage loans, such as ARMs and GPMs, are insufficient to cover the scheduled interest payments on the outstanding loan, the difference between the scheduled interest amount and the amount of interest paid is added to the outstanding loan amount, which increases the mortgage loan balance. This process is called negative amortization.

Negative Duration: A security characteristic that indicates that the price of a security will be unresponsive or will decrease when market rates decrease. Premium mortgage pass-through securities and, in particular, low-premium coupons, sometimes display negative duration when yields decrease. The prices of these coupon securities may decrease when yields decrease since the likelihood of their underlying mortgage loans prepaying and hence, the probability that the investor will receive additional principal cash flows at par, increases.

Net Direct Debt (General Obligation): This reflects the total principal amount of the issuer's direct debt less all self-supporting debt, sinking funds, and short term debt such as tax anticipation notes and revenue anticipation notes.

Net Debt-to-Assessed Ratio (General Obligation): This ratio reflects a percentage of the issuer's total outstanding net general obligation debt (numerator) relative to the tax assessed value (denominator) of the issuer's taxing authority. *General benchmark for debt-to-assessed ratio is <15.0%.

New Issue: A mortgage pass-through security whose underlying mortgage loans were recently originated. The remaining-term criteria for what qualifies as a new issue are different for different market sectors. In general, in the 30-year sector, new issues are considered to have remaining terms of greater than or equal to 342 months. In the 15-year sector, new issues are generally thought to have remaining terms of greater than or equal to 168 months.

Non-Gnome Security: A 15-year FHLMC security that is issued under the FHLMC 15-year guarantor program. In the guarantor program, issuers sell their mortgage loans to FHLMC in exchange for a participation certificate.

— O —

Overcollateralization: Occurs when the principal balance of the collateral is greater than the principal balance of the CMO.

Overlapping Debt (General Obligation): Overlapping debt represents the general obligation debt of a political entity such as a city where its tax base overlaps the tax base of another political entity such as a school district, county, or any other political subdivision within the same taxing jurisdiction. The combination of overlapping debt and direct debt may also be compared to the assessed value. *General benchmarks for overlapping debt is < $6,000 per capita, with an overlapping debt-to-assessed of <30.0%.

— P —

PAC Z-Bonds: As the name indicates, this is a PAC bond which accrues interest for a defined period, just as a traditional CMO Z-Bond does. Instead of making cash payments of interest, the structure adds the accrued interest to the principal balance. At the end of the accrual period (normally when the first principal payment is scheduled to be paid) the bond begins to pay current interest on the principal balance and principal is returned according to a schedule. As with regular coupon-paying PACs, collars provide call and extension protection within a specified range of prepayments.

Par: The price at which the face value of a security's principal amount equals its actual selling price, or 100.

Parity Price: The price at which the yield-to-maturity of a security equals its coupon rate. In contrast to bullet pay securities, such as Treasury securities for which parity occurs at par at its coupon payment date, parity for mortgage securities is achieved slightly below par. This occurs because there is a delay in the receipt of the first initial payment to investors. At its parity price, changes in the prepayment rate of a mortgage security do not affect its yield.

PC (Participation Certificate): See FHLMC Participation Certificate (PC).

Pass-Through Security: A security that "passes through" monthly the interest and principal cash flows from a pool of underlying mortgage loans.

Pay Window: Period from the first principal payment of a CMO to the final principal payment.

Per Capita Debt (General Obligation): This figure is derived by dividing the issuer's net general obligation debt by to the total population of the taxable public within the issuers taxing authority. *General benchmark for per-capita debt ratio is <$3,000.

Planned Amortization Class (PAC) Bonds: Low call and extension risk bonds which pay interest and principal according to a fixed schedule so long as prepayments occur within upper and lower bounds or collars. The structure limits both call and extension risks. PAC bonds are designed to be close substitutes for corporate bonds, with cash flows that resemble those of sinking fund bonds. They are sometimes referred to as controlled amortization bonds.

Point: One percent of par. Usually used to describe the change in price of a security (e.g., an increase in the price of a CMO from 100 16/32 to 103 would represent a 2 1/2 point increase).

Pool: A group of mortgage loans underlying a mortgage security. Scheduled principal and interest payments from the underlying mortgage loans and any principal prepayments of individual mortgage loans within the pool are passed through to mortgage pass-through security investors at scheduled payment dates.

Pool Factor: The percent of the original principal balance that is currently outstanding. To determine what the current principal balance is, multiply the factor times the original principal balance at issuance. For example, if a $1,000,000 pool at issuance has a current factor of .9890080, the current outstanding balance would be $989,008.00 ($1,000,000 x .9890080).

Premium Security: A security that is trading above par. This happens when the coupon rate of the security exceeds the current level of market mortgage rates.

Primary Market: A market whose activities focus on mortgage loan origination.

Principal Balance: The amount of outstanding principal of a mortgage pass-through pool or whole loan at a given date. The principal balance of a non-GPM mortgage security decreases every month since principal is returned throughout the life of the underlying mortgage loans (see Current Face and Pool Factor).

Principal-Only Security (PO): A mortgage security that receives only the principal cash flows from an underlying pool of mortgage loans or an underlying pass-through security. POs are purchased at a discount and principal cashflows are received at par

Principal Prepayment: An unscheduled principal payment in excess of the scheduled principal amount required from amortization. The excess principal payment can cover the entire principal amount outstanding (full prepayment) or can cover only a portion of the outstanding principal amount (partial prepayment).

Project Loan: A mortgage loan on a multifamily (4+ units) dwelling, hospital or nursing home.

PSA (Public Securities Association) Model: The prepayment model most often used when analyzing CMOs. The model assumes that the likelihood of prepayment on a pool of mortgage loans increases as the security ages until the thirtieth month, after which it remains at a constant level. The PSA expresses the rate of prepayment of a mortgage pool as a percent of a benchmark curve. According to the PSA Model, a PSA of 100% means that prepayments on a 30-year security increase by increments of .2% CPR for the first 30 months of the security's life. After month 30, the mortgage pool experiences a prepayment rate of 6% CPR.

— R —

Rate Covenant (Revenue Credit): This provision in the bond indenture sets a requirement for charging or collecting revenue on the facility or project that is being financed in a specific amount to cover the debt service requirements. Rate covenants can vary in structure from covenants set to charge specific rates to utility customers, sales tax levy requirements, amounts to set aside in reserve accounts or bond funds, or pledged revenue streams in an amount over the debt service for each payment period.

REMIC (Real Estate Mortgage Investment Conduit): A tax treatment introduced by the 1986 Tax Reform Act for multi-class mortgage-backed securities such as CMOs, Strips and senior/subordinated pass-throughs. An objective of the REMIC legislation was to permit issuers to assume a more streamlined legal form than that of the owners trust under which most CMOs had previously been issued. Issuers have the option to elect REMIC tax treatment until 1992, when REMIC tax treatment becomes mandatory. REMIC treatment identifies the securities created as one or more "regular" interests and a single "residual" interest. In market parlance, the term REMIC is used to refer to a structured mortgage-backed security electing REMIC status. More loosely, it is used interchangeably with CMO.

Relocation Loan: A mortgage loan that finances the purchase of homes for transferred employees of corporations. Transferred employees tend to be higher-income, middle-managers and upper-managers of corporations who typically are assigned to certain locations for short periods of time.

Remaining Term: The remaining term (in years and months) is determined by subtracting today's date from the original weighted-average maturity of the pool.

Repurchase Agreement (Repo): A financing arrangement that involves the sale and subsequent repurchase of a specific security at a specified future date at two different, pre-negotiated prices.

Residual: The difference between monthly payments on the underlying collateral and the sum of CMO or REMIC bond payments plus administrative expenses. Residuals take the legal form of either an equity interest in a CMO owners' trust or a REMIC bond. Equity residuals generally are privately-placed ownership interest in CMO trusts, may have limited transferability and carry certain contingent liabilities. Any owner of a greater than 50 percent share of an equity residual must consolidate the entire CMO onto their balance sheet. Bond residuals have a nominal principal amount which allows them to be publicly registered bonds. These residuals are more liquid than equity residuals, having the same credit rating as the CMO, no consolidation requirements and fewer transfer restrictions. The performance of residuals indifferent interest rate environments is a function of the structure of the entire issue and must be analyzed on a case by case basis.

Reverse Buy-Down Loan: A mortgage loan whose monthly coupon payments are lowered by a one-time amount (usually 25 to 100 basis points) after a number of payments at a higher initial rate. Investors who own FNMA reverse buy-down pass-throughs receive a fixed coupon rate throughout the term of the security.

Reverse Repurchase Agreement (Reverse Repo): A financing arrangement that involves the purchase and subsequent sale of a specific security at a specified future date at two different, pre-negotiated prices.

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Reverse TAC Bonds: A variation on the TAC structure providing protection against average life extension but not call protection. The issue's system of payment priorities is designed to preserve the reverse TAC's schedule when prepayments slow. In addition, most reverse TACs have longer average lives at issue (typically 10 to 20 years), and this feature serves to limit extension risk. Reverse TACs have also been called "contraction" bonds in reference to their call risk.

— S —

Seasoned Issue: A mortgage pass-through security whose underlying mortgage loans have been outstanding for a number of years. Seasoned issues for a given sector have shorter remaining terms than new issues. The remaining-term criteria that qualifies an issue as Seasoned differ depending on the market sector. In general, in the 30-year sector, seasoned issues are thought to have remaining terms of less than 342 months and in the 15-year sector, seasoned issues are thought to have remaining terms of less than 168 months.

Seasoning: The aging process of a mortgage pass-through security. The implication of a seasoned security is that as the underlying mortgage loans age, it is likely to experience increasing prepayments up to a point and then prepayments are expected to level off.

Secondary Mortgage Market: A market whose activities involve the buying and selling of existing mortgage loans in either a securities or non-securities (whole loan) form.

Security (Revenue Credit): The security, or sources of payment, represents the specific revenue stream(s) pledged to pay the debt service requirements each fiscal year. This can vary in the form lease agreements, sales tax levies, or net revenues of the district and can include more than one source.

Servicing: A percentage of the interest payment of a mortgage loan that is paid to a servicer as compensation for processing mortgage loan payments.

Short WAM Bond: A specified FHLMC or FNMA pass-through security that possesses a shorter WAM than a generic security. A 30-year short WAM bond typically has a WAM of less than 16 years.

SMM (Single Monthly Mortality): A measure of the amount of principal from a mortgage pool that was prepaid during one month. SMM is calculated by dividing the principal prepaid during the month by the principal balance at the beginning of that month less scheduled principal payments.

Spread: This term can be used in 3 ways: 1. Spread to Treasuries - The yield spread of a security above treasuries with similar average lives. 2. Floating Rate Spread - The amount by which the coupon exceeds the index of a floating rate security. Also known as Margin. 3. Bid/Ask Spread - Difference between the bid and ask prices of a security.

Stated Maturity: (see Final Maturity)

Strip Security: A mortgage security that receives only a portion of the underlying interest and principal cash flows of a mortgage pool. Securities that receive only the interest cash flows are called Interest-Only securities (IOs) while Principal-Only securities (POs) receive only the principal cash flows.

Super-Floaters: A type of floating-rate CMO bond with the coupon set based on a multiple (greater than one) of an index less some constant. The formula results in an asymmetrical return pattern which favors rising rate environments. Super-floaters are typically collateralized by floating rate securities or adjustable rate mortgages.

Synthetic Bonds: A type of stripped MBS created by combining unequal proportions of interest and principal from the collateral to create a security that has either a higher or lower coupon than the underlying mortgages. For example, a fast-paying discount coupon "pass-through" can be created by structuring a low coupon bond from collateral with a high WAC.

— T —

Targeted Amortization Class (TAC) Bonds: Like PACs, TACs receive defined payments according to defined priorities. The payment schedule is defined at a single speed (usually the pricing prepayment assumption) with cash flows in excess of the TAC schedule going to companion classes. If prepayments remain at the stated speed for the life of the bond, the TAC schedule will be met. When prepayments decline below that speed, there is not enough principal to meet the schedule and the TAC extends like a traditional sequential pay CMO tranche. When prepayments rise, the additional cashflows are directed to other tranches in the structure. As a result, there may not be sufficient principal flows later in the deal to meet the TAC schedule, causing the bond to lengthen. As a result, TACs provide call protection and weak extension protection. Sometimes TACs are called half-PACs because the schedule is defined at a single constant prepayment speed rather than using upper and lower bands.

Tax Assessed Value (General Obligation): The tax assessed value represents the total dollar value of the assets (property) assigned by a public tax assessor for the purposes of taxation within the issuer's taxing authority. For purposes of establishing benchmarks, investors should make appropriate adjustments for states with wide spreads between their market values and assessment values as they tend to have relatively higher debt to assessed ratios.

TBA (To-Be-Announced) Market: A secondary mortgage market in which generic mortgage securities are bought and sold.

TBA (To-Be-Announced) Settlement: To facilitate the allocation process of generic security transactions, the Public Securities Association (PSA) publishes monthly settlement dates for securities purchased in the TBA Market. Within 48 hours prior to settlement, the investor will be notified of the pools and the face amounts that will be delivered at settlement versus the purchase amount (in accordance with PSA guidelines for good delivery).

Tranche: Classes within the CMO structure that have different principal and interest cash flow priorities. Each CMO will consist of one or more tranches, each with a distinct coupon, maturity and other features.

Trustee: The entity that holds the collateral for a CMO and is responsible for payment collection and disbursement. Trustees are normally commercial banks and are selected by the issuer.

— V —

Vanilla Bonds: Bonds from traditional, sequential-pay CMO structures in which no mechanism have been introduced to alter the volatility characteristics of any of the classes. These are also referred to as "clean" bonds.

VRM (Variable-Rate Mortgage): See Adjustable-Rate Mortgage.

VA (Veterans Administration): A U.S. government agency that administers mortgage insurance programs to encourage lenders to offer long-term, low down-payment mortgages to eligible veterans.

— W —

WAC (Weighted-Average Coupon): The weighted-average coupon of the collateral. The Gross WAC is the WAC of the loans underlying the MBSs. The Net WAC is the weighted-average pass-through rate of the MBSs serving as collateral.

WAM (Weighted-Average Maturity): The weighted-average maturity of the underlying mortgage loans in a mortgage pool. For CMOs, it refers to the WAM of the underlying collateral.

WAM Bond: (see Short WAM Bond)

WART (Weighted-Average Remaining Term): The weighted-average remaining term of the underlying mortgage loans in a mortgage pool.

Whole Loan: Single or grouped mortgage loan(s) that have not been rated by a credit agency, guaranteed by a governmental entity or credit-enhanced.

— Z —

Z-Bonds: These bonds have a stated coupon which is accrued rather than paid, increasing the principal balance until the preceding classes are retired. At that time, bondholders begin receiving cash payments of both principal and interest. Also called accrual, compound interest or accretion bonds.

** Benchmarks may not reflect those states with lower assessed values relative to market values. Subsequent municipal bonds should be evaluated on a case by case basis when establishing appropriate benchmarks.*