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Moody's Projects Losses of Almost Half of Original Balance from 2007 Subprime Mortgage Securities

by: Research Recap

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Ratings agency now expecting significantly higher losses than previously projected as foreclosures take their toll.

Moody's has revised its loss projections for US subprime residential mortgage backed securities (RMBS) issued between 2005 and 2007. On average, Moody's is now projecting cumulative losses of 18.7% for 2005 securitizations, 38.4% for 2006, and 48.1% for 2007, as a percentage of the original balance. As a result of the revision, Moody's has now placed 5,698 tranches of subprime RMBS with an original balance of $584 billion and an outstanding balance of $319 billion, on review for possible downgrade.

Moody's last revised its loss projections in March 2009, to 13%, 30%, and 36% of original balances on 2005, 2006 and 2007 vintages, respectively.

On October 29, 2009, Moody's announced that it would update certain assumptions underlying loss projections for each of the major RMBS sectors. Since March 2009, when Moody's last announced a revision to its subprime loss projections, serious delinquencies (loans that are 60 or more days delinquent, including loans in foreclosure and homes that are held for sale) in subprime pools from 2005, 2006, and 2007 have increased to 48% from 43%, 56% from 51%, and 55% from 47%, respectively (reported as a percentage of outstanding pool balance).

> Even though the Case-Shiller index in recent months has reported very modest home price gains, Moody's believes the overhang of impending foreclosures will impact home prices negatively in the coming months.

Moody's Economy.com (MEDC) expects home prices to fall by an additional 11% to reach a peak-to-trough decline of approximately 37%. Adding to borrowers' financial pressure, unemployment is now projected to peak at around 10.5%. Both measures are expected to reach their peaks sometime in the second half of 2010, after which recovery is expected to be slow.

Standard & Poor's said last week that under an expected case scenario,

> our recovery results for subprime securities show an average recovery of 60.5% of a security's current balance and 66.0% of a security's initial par value" for the 2005-2007 vintages of subprime mortgages released to date. This equates to a loss of 34% of principal on average for the three vintages.

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