

Senior Nonagency Lock Out Bonds: Superior Call Protection and Triple-A Credit

In a traditional senior/subordinate structure, the subordinate is locked out from prepayments, which are diverted to the senior until certain "stepdown" tests are satisfied. The purpose of this structure is to enhance the credit protection of the senior classes. However, it also has the effect of providing the subordinate class with tremendous call protection. More recent structures have created senior classes that are locked out from prepayments, like a subordinate, but that have the credit seniority of traditional senior classes.

Countrywide 1995-4 A8 is a good example of such an issue. Despite being backed by current coupon nonagency collateral, this issue offers similar weighted average life stability as discount GNMA's. Figure 36 compares Countrywide 1995-4 A8 to a duration-matched combination of GNMA 6.5s and 7s.

Figure 36. Return Advantage: Countrywide 95-4 A8 Versus Duration-Matched GNMA's, 18 Apr 96

Issue	Coup	Price	Yield	OAS	Eff Dur	Eff Convx	Nominal Return Scenario Analysis						
							-150	-100	-50	0	50	100	150
Countrywide 95-4 A8	7.5	\$97.940	7.839%	91bp	6.4	-0.44	15.36%	13.44%	10.90%	7.96%	4.94%	1.91%	-1.11%
Duration-Matched GNMA's ^a	6.8	95.363	7.603	66	6.5	-0.40	15.12	13.11	10.58	7.73	4.72	1.63	-1.46
Difference			0.236%	25bp	-0.1	-0.04	0.24%	0.33%	0.32%	0.23%	0.22%	0.28%	0.35%

^a Combined 40% GNMA 6.5 and 60% GNMA 7.

Source: Salomon Brothers Inc.

As shown in Figure 36, Countrywide 1995-4 A8 (priced at 128/10@200% PSA) has 25bp wider OAS than the duration-matched GNMA's. In addition, Countrywide 1995-4 A8 provides substantial projected return advantages in interest rate scenarios +/-150bp.