

Value in CMOs Backed by Relocation Mortgages

In the following analysis, we examine the prepayment differences between relocation mortgages and generics. Owing to their fast turnover-related prepayments, we find that CMOs backed by relocation mortgages are an attractive alternative to CMOs backed by generic conventional collateral.

“Relos” are mortgages made to corporate employees who are moving their residences to a new location for job purposes. In order for the mortgage to be designated as a relo, generally there must be a contribution from the employer, such as a subsidy of the mortgage rate or a contribution toward closing costs. Agency relo issuance has averaged \$1–2 billion per year over the past several years, with most of this issuance dedicated to CMOs.

Prepayment Rates Faster Than Generics

Prepayment rates on relo pools have tended to be consistently and substantially faster than generic conventionals, whether new or seasoned, discount or premium. The table below shows recent speeds on major vintages of Freddie Mac Gold relos (greater than \$100 million outstanding). We also show speeds on generic Freddie Mac Golds. As shown in the table, relos average about 150% of generic speeds, and sometimes more than 200%. This has been consistently true over the 10-year history of the relo program, for all except the first few months in

the life of the mortgages. (See “Prepayment Behavior of ‘Relo’ Mortgages,” *Mortgage Market Comment*, October 28, 1994.)

The faster prepayments on relo mortgages have tended to persist over time. The first chart on the next page highlights the prepayment experience of 1993-vintage relo 6s and generic 6s. As shown, relo 6s have prepaid consistently faster than generic 6s during this entire period. In higher coupons, relos have prepaid faster than generics as well, in both low and high interest rate environments. For instance, as shown in the second graph on the next page, 1992-vintage relo 7.5s have prepaid substantially faster than similar vintage generic 7.5s.

Relative Value in CMOs Backed by Relos

To value the difference in prepayments between relo mortgages and generic 30-year mortgages, we have computed OASs and option costs using 150% to 200% of our agency prepayment model. The table at the bottom of the next page shows these valuations for short and long relo sequentials (6s off 6% collateral) under various prepayment assumptions.

As shown in the table, the short sequential offers an OAS of 28 bp at 175% of the prepayment model, similar to that of generic sequentials backed by 6.5s. However, owing to the faster turnover of the relo sequentials, these securities have an option cost of 47 bp — approximately 10–15 bp lower than similar generics. The long sequential is priced at a very con-

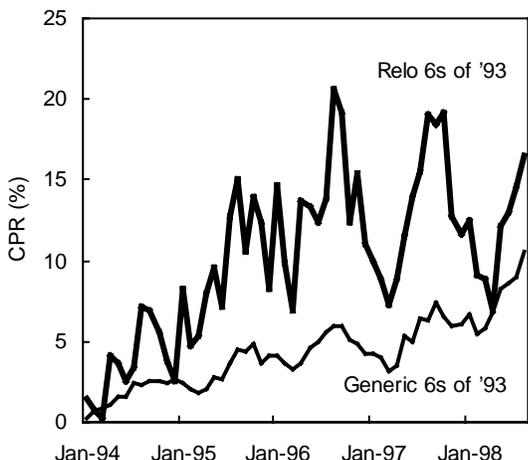
Speeds on Relo Mortgages Have Been Faster than Generics

3-month and 12-month Freddie Mac relo versus generic Gold prepayments (%CPR)

Coupon	Vintage	Curr Bal (\$mill)	Relo		Generic		Ratio	
			3-Mo	12-Mo	3-Mo	12-Mo	3-Mo	12-Mo
6.0	1993	420	16	14	9	7	1.71	1.94
	1994	125	21	17	9	7	2.39	2.53
	1997	172	4	--	2	--	1.50	--
	1998	621	1	--	1	--	0.92	--
6.5	1993	196	16	14	13	9	1.28	1.47
	1995	413	19	16	13	10	1.44	1.67
	1996	328	20	15	12	9	1.70	1.79
	1997	1,006	12	8	5	3	2.37	2.81
7.0	1992	186	23	19	20	14	1.19	1.30
	1995	306	23	20	19	14	1.22	1.41
	1996	250	21	16	17	13	1.24	1.26
7.5	1994	150	34	28	26	20	1.30	1.40
	1996	135	28	21	29	23	0.95	0.93

Relo Mortgages Prepay Fast as Discounts...

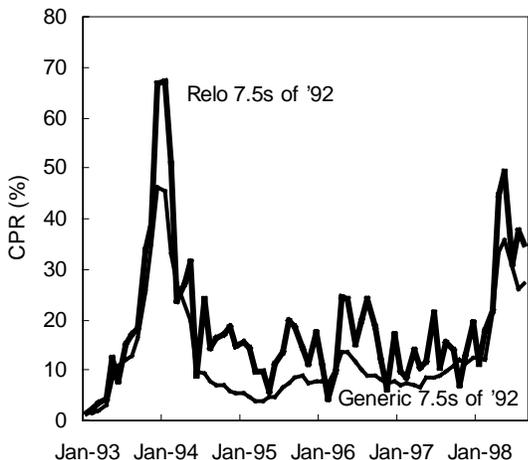
Prepayments on 1993-vintage 6s



favorable prepayment characteristics, we recommend sequentials backed by relo collateral as an attractive alternative to comparable CMOs backed by generic conventional collateral.

...And As Premiums

Prepayments on 1992-vintage 7.5s



servative 150% PSA, considerably slower than 150% of our long-term forecast using our agency model (220% PSA). Priced at 100 bp over the 30-year Treasury at 150% PSA, this security offers an OAS of 56 bp (at 175% of the model), similar to that of long sequentials backed by generic 6.5s, with approximately 5 bp lower option cost. Owing to their

Relative Value in CMOs Backed by Relo Mortgages

FH 2086, 6% Coupon Backed by 6% Collateral (10yr Tsy: 5.38%)

Tranche	Pricing	Avg Life	Price	OAS at % of Model			Option Cost at % of Model		
				150%	175%	200%	150%	175%	200%
GA	90/c/325	4.3	99-09	24	28	31	49	47	47
GB	100/30/150	24.1	94-17	56	56	58	34	38	40