FTN FINANCIAL
CAPITAL ASSETS CORPORATION

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Weekly Comments by Tom McLemore

WHOLE LOAN MARKET COLOR

The whole loan secondary market seems to have stabilized from its state of disarray in 2018 as pricing for sellers has become more attractive. Buy-side demand and sell-side interest have remained strong, and the drop in the 10yr Treasury has helped sellers finally achieve acceptable pricing levels. Many institutions continue to struggle with tight liquidity, a flat yield curve, rising cost of funds, and strong loan demand, causing a need to look to the whole loan secondary market as an option for balance sheet management strategies. Below is some general market color on what we are seeing in the secondary whole loan market as many institutions consider using their loan portfolio to manage balance sheet issues, such as liquidity and NIM compression, or to reduce concentrations in what we expect to be an active second half of 2019.

Residential Market: Agency-Grade Loans

For Agency-grade conforming balance portfolio loans, Q1 2019 kicked off in a similar fashion to 2018. However, institutions that experienced price shock in 2018 after seeing 1% to 5% discounts are now seeing their loans price at a palatable loss to slight gain, thanks to a decline in the 10yr Treasury from a 2018 trade range of 2.90% to 3.20% to around 2.60% to 2.70% in early 2019. This put many institutions into a slight loss or breakeven pricing situation, causing institutions to again consider a trade.

For institutions that were on the fence, we implemented a considerable number of "Prep & Hold" strategies aimed at managing IRR and NIM compression in an effort to be proactive for when/if the market moved in the institutions' favor. A "Prep & Hold" strategy is where FTN Financial Capital Assets Corporation (Capital Assets) completes due diligence on a population of loans and when the market moves in their favor, Capital Assets is able to lock and hedge the price on that pool of loans.

In late March 2019, when the Federal Reserve indicated they would likely pause on interest rate hikes causing the 10-year rally to the 2.40% range, we had a handful of institutions take advantage of that opportunity and lock price. Many of these were low-coupon long-term fixed-rate securitizations that were priced at a gain. With the Fed considering rate decreases for later this year, now is a good time to implement a Prep & Hold strategy.

Residential Market: Private-Grade Loans (Institution to Institution)

Market demand for investment-grade jumbo loans, as well as prime-credit, non-agency conforming balance loans, has come alive as investors search for additional yield opportunities and strive to deploy excess liquidity. In late 2018, the private market for loan pools seemed to take about a three-month holiday as liquidity completely dried up across the market. In early 2019, the floodgates for private grade transactions opened up and pools that had been languishing in inventory began to trade. This year, we have seen an even mix of fixed and ARM loans trade, both at gains and slight discounts. In late 2018, we saw spreads widen because there were more sellers than buyers, but we saw that come back into balance in Q1 2019, with loans trading at a BEYs roughly 100 basis points through where comparable mortgage-backed securities are trading.

Currently, there is a disconnect in the market, as new origination yields are below secondary market trade levels, causing many institutions to take advantage of where loans are trading vs where the same institution could originate a similar loan. Some buyers looked to purchase low-premium, short-roll ARMs with an eye towards prepay risk because many ARM loans will likely adjust above current market rates for a 30yr fixed-rate loan due to the flat yield curve. For those ARMs, borrowers will likely refinance into 30yr fixed-rate loans at the lower rate.

For sellers who want to take a gain, many institutions are considering selling higher-coupon, short-roll ARMs that are currently pricing at a gain, but will pay off or refinance at the roll at a PAR price if they remain in the portfolio. This is a viable strategy to monetize the gain that will otherwise roll off at par. For sellers wanting to manage NIM, the market is providing the opportunity to consider selling low-coupon, long-term fixed rates and going back into higher-coupon, current-market mortgages or a higher-yielding loan type.

As sellers continue to position their balance sheet to manage liquidity and NIM compression, we expect to see the Agency and private secondary market heat up in the second half of 2019.

HELOCs and Second Mortgages

For the first time since the 2008 crisis, we began to see an uptick in demand for HELOCs and second mortgages in 2018, which has carried over into 2019. The relatively short duration, collateral profile, and higher yield, compared to a first mortgage, is stimulating interest in these loans. During the first part of 2018, pools were trading with yields to the buyer of 5% to 5.75%. That has dropped to 4.75% to 5.50% in 2019.

Auto Secondary Market

Auto trades hit the accelerator in early 2019, but that is not saying much considering auto trades came to a near halt in 2018. The severe drop-off in 2018 from the high volume of trades we saw in 2016 and 2017 was not due to lack of interest from both buyers and sellers, but rather from a disconnect in buyers' yield requirements and where sellers could get out at breakeven. Sellers' main issue remained their cost basis in the loans in the form of high dealer reserves, causing them to need large premiums to break even.

The market continued to be dominated by credit unions. Buy-side yields seemed to remain steady in the plus 1.50 to 2% range over the 2yr Treasury. The below chart demonstrates the auto market shift over the last few years.

Secondary Market Auto Pricing

	Current	2018	2017	2016
Bond Equivalent Yield (BEY)	3.90 to 4.40%. Increased demand from buyers compared to 2018	BEY of 3.50% for large A grade portfolios. 4% BEY for WA 700 FICO pools. Equal demand from buyers and sellers	Tepid demand as buyers' liquidity dried up and reached concentration limits. Traded from BEY of 3% to 3.50%	Strong buyer demand and excess liquidity drove prices down. Trade range of BEY 1.85% to 2.25%
2-year Treasury Yield	January 1, 2019- 2.50% May 7, 2019 - 2.28%	January 1, 2018- 1.88% May 9, 2018 - 2.48%	January 1, 2017 1.21% December 31, 2017 1.88%	January 1, 2016 0.93% December 31, 2016 1.19%
BEY spread to 2 year	Currently 150 to 200 basis point spread over the 2-yr. Could tighten if more sellers don't emerge	Sellers cost basis caused spreads to tighten to about 100 to 150 basis point spread over the 2-yr	Due to more sellers than buyers, spreads widened to 200 basis points over 2-yr	Spreads tightened to as little as 75 basis points over the 2-yr with average of 100 through

Source: FTN Financial Capital Assets Corporation

Commercial Loans

Interest in purchasing well-documented commercial loans seems to be increasing at a steady pace as investors look for yield opportunities on relatively short duration assets. Activity in this sector has increased as institutions in strong origination markets attempt to reduce concentration risk and capture gains. Investor yield requirements for Multi-Family and CRE dropped roughly 25bps relative to 2018 levels, equating to buy-side yields of 4.25 to 4.5%. Office and Retail seemed to be trading in the 4.75 to 5% yield range.

Non-Performing/Distressed/Scratch and Dent

Price levels have remained stable after the significant increase in pricing for distressed loans that occurred during 2015. Collateral values quantified by recent Broker Price Opinion ("BPOs") are the primary component in pricing non-performing and distressed loans. Loans in non-judicial states have been pricing at 70% to 75% of QS BPO values. Pricing on loans in judicial states have been trending closer to 65% to 70% of QS BPO values. Outside of the large GSE sales, there have been very few community or regional banks and credit unions implementing balance sheet clean-up strategies to sell non-performing distressed assets and re-performing loans. Scratch and Dent loans that are current but have credit and/or collateral issues are trading in a range of 80% to 90% of the unpaid balance.

Summary

Capital Assets continues to be actively involved in the development and implementation of balance sheet management strategies designed to reduce risk, improve capital via a loan sale or securitization, or to enhance returns by acquiring prime credit loans at yields frequently through current market yields for comparable loan types. Portfolios are traded both servicing retained and released. For institutions that want to be proactive, Capital Assets can help you explore options to consider in comparison to your other liquidity contingency plans.

One of the best ways to understand your retained loan portfolio is to run a Portfolio Performance Analysis to identify loan level pricing as well as pockets of risk and opportunity. To learn more, please reach out to your FTN Financial representative or Capital Assets directly at 1-800-456-5460.

CURRENTLY AVAILABLE FOR PURCHASE

FTN Financial Capital Assets Corporation is the exclusive agent for the sale of a $30.2MM Residential First Mortgage Conventional Fixed Rate and 15x1 CMT ARM Loan Portfolio. The portfolio is being offered on a servicing retained basis. The portfolio is collateralized with properties located in Indiana (97.44%) and Florida (2.56%). The seller is a nationally chartered bank located in the Mid-West region. Based on the high FICO scores, low LTVs, and clean pay history, the portfolio appears to have a low risk profile.

PRICING

The portfolio is offered at a discounted dollar price of 99.636% on a servicing retained basis. Using a .25% servicing fee and a 15 CPR speed, this dollar price produces a BEY of 3.98%

Highlights	
Principal Balance	$30,268,330
Loan Count	46
Avg Loan Balance	$658,007
Gross WAC	4.141%
Servicing Fee	0.250%
Net WAC	3.891%
WA FICO	754
Contractual WAM	339 Months
12 Month Pay History	
0x30 Days	100%
Pricing	
Price	99.6360%
BEY	3.980%
CPR	15%

Seasoning / LTV	
Seasoning	14 Months
Original LTV	73.35%
Amortized LTV	71.21%
Case Shiller® Updated LTV	61.65%
Loan Type	
30yr Conventional Fixed Rate	56.48%
15x1 CMT Hybrid ARMs	43.52%
Property Type	
Single Family	45.74%
Condominium	54.26%
Owner Occupancy	
Owner Occupied	90.63%
Second Home	9.37%
Collateral Distribution	
Indiana	97.44%
Florida	2.56%

Source: FTN Financial Capital Assets Corporation

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Jerry Hubbard, President
901.435.8758 | jerry.hubbard@ftnfinancial.com

Tom McLemore, SVP
901.435.8222 | tom.mclemore@ftnfinancial.com

Pete Taglia, CPA, CGMA, CMB
312.258.5000 | pete.taglia@ftnfinancial.com

Lester Coleman, VP
901.435.8219 | lester.coleman@ftnfinancial.com

Mark Cary, CPA, CGMA
901.435.8141 | mark.cary@ftnfinancial.com

Mitchell Redd, SVP
901.435.8622 | mitchell.redd@ftnfinancial.com

Rachael Leamon, VP
901.435.8864 | rachael.leamon@ftnfinancial.com

Mia Condon, VP
901.435.4716 | mia.condon@ftnfinancial.com

David Cluck, SVP
901.435.7917 | david.cluck@ftnfinancial.com

Andrew Marino, VP
901.435.8748 | andrew.marino@ftnfinancial.com