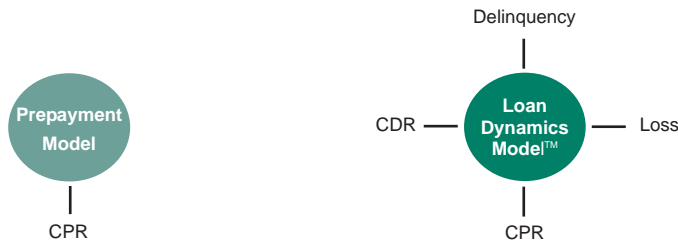


The risks inherent in credit-sensitive mortgages and related securities have the market clamoring to better understand prepayment, delinquency, default and loss severity on mortgage loans. In response, we have extended our current prepayment model subroutines to address the needs of those who are exposed to these risks. The result is the Loan Dynamics Model™.

OUR APPROACH TO CREDIT

For issuers and investors, the Loan Dynamics Model™ produces required performance metrics such as CPR (prepayment), CDR (default), 60+ delinquency and loss severity, given loan characteristics and a scenario for interest rate and house price indices.



The Loan Dynamics Model™ is the culmination of a 2-year company-wide development effort. As a starting point, we examined historical data, including roughly 8 million loans from 144 issuers from 1990 to 2005. Over the course of our analysis, we found that borrower behavior can be described realistically yet parsimoniously using 4 categories of payment status:



Our team built a set of economic models to explain the motivation for borrowers to transition from one payment status to the others given a wide variety of economic scenarios and loan characteristics. The model is estimated using observed historical data to provide a probabilistic assessment of how a loan will behave in the future.

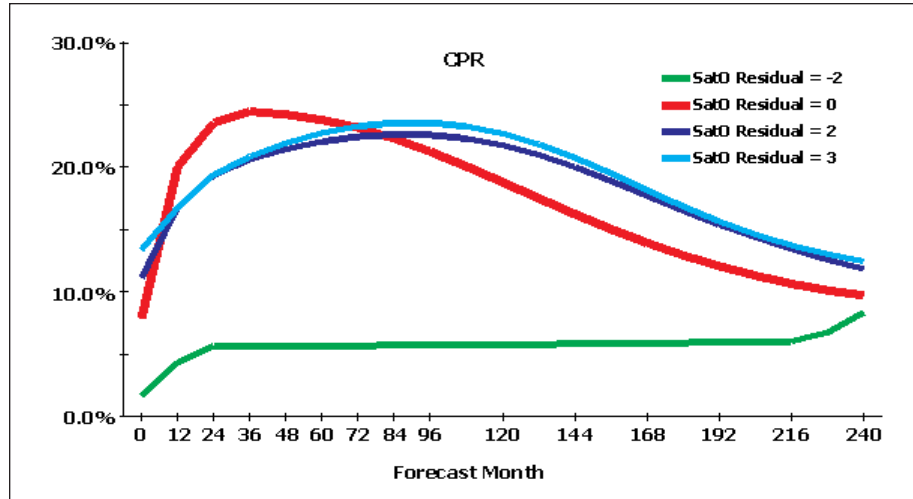
A BROADER OUTLOOK

The Loan Dynamics Model™ goes beyond a traditional “2-state” competing risk model (which includes just prepayments and defaults), and can be used to model the effects of 60+ delinquency on bond triggers. Our model also builds upon traditional transition models with 7 or 8 payment status categories by focusing only on those that have the greatest impact on investment performance. This simplification allows for greater emphasis on the dynamic aspects of the loan transitions.

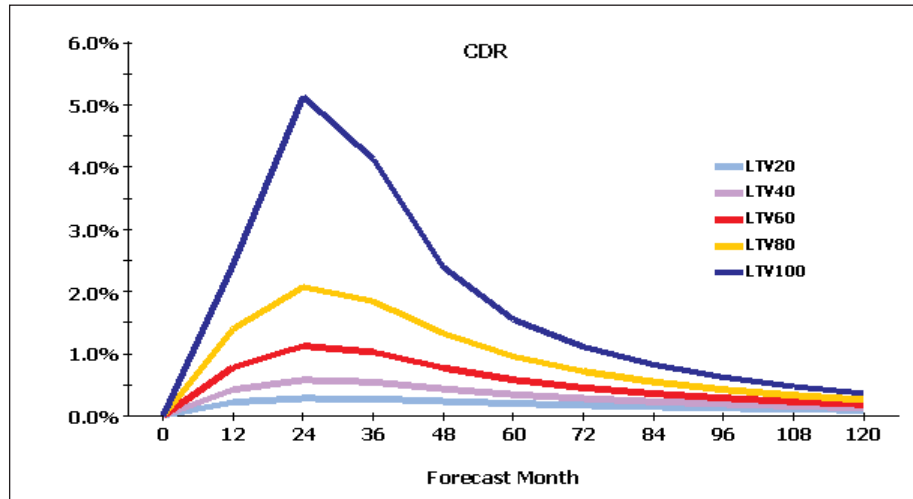
The model is unified across credit sector and product type, and it relies on observed loan characteristics (i.e., data available in the typical servicing system file) to make its projections. As a result, users are not required to make potentially arbitrary judgments about whether a loan falls into jumbo, Alt-A, High LTV, or Subprime credit sectors, and users can apply the model to pools of loans containing a wide mix of underlying collateral.

LOAN DYNAMICS MODEL™ OUTPUTS

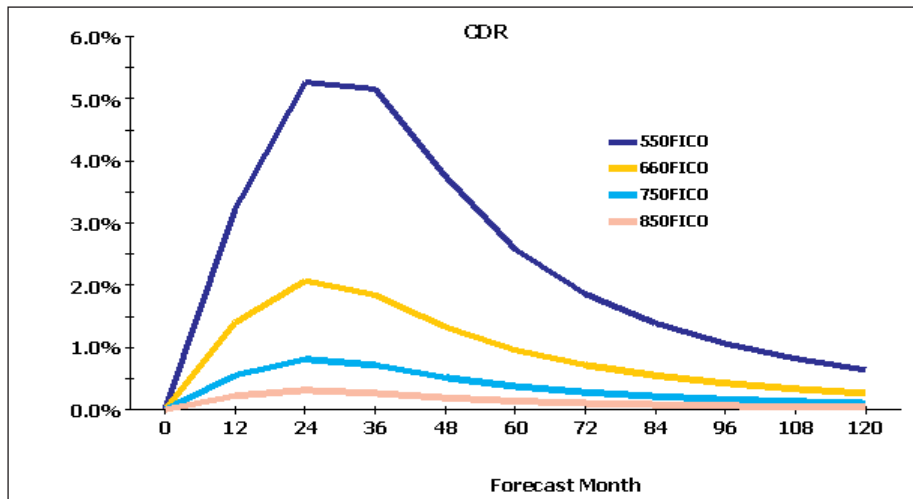
Prepayment Speeds
for Variations in
SATO Residuals



Default Ramp for
Variations in LTV



Default Ramp for
Variations in FICO



MODEL AVAILABILITY

We offer the Loan Dynamics Model™ as a C++ subroutine, which can be delivered either as a Windows dynamic link library (DLL), a Unix shared object or through a sophisticated Excel interface. The subroutine is ready for integration into customers' internal systems, and we are working with our vendor partners to make the model available within their analytical tools. We are happy to help with this integration process and offer high-quality customer support on an ongoing basis to enable clients to take full advantage of these cutting-edge behavioral models.

ADDITIONAL CREDIT-RELATED PRODUCTS

The Loan Dynamics Model™ is an important initial step in our march toward building a sophisticated, universally accepted Credit Product Line, which will enable investors and issuers to gain a full understanding of how the credit and prepayment profile of a mortgage will impact loan and security performance. The Credit Product Line includes the following tools:

- HPI Generator - produces a Monte Carlo path of projected HPI at both a national and state level. While it is consistent with the AD&Co Interest Rate Model, the HPI generator can accommodate other firms' interest rate models as well.
- Implied Default Model - draws on AD&Co's advanced OAS technology to compute the value of ABS tranches under a range of prepayment and default scenarios, relating bond prices to a distribution of defaults and losses. In the near future, the implied model will be integrated with the newly released Loan Dynamics Model™.

CREDIT RESEARCH

The Pipeline is our monthly newsletter in which our knowledgeable development and consulting team address recent trends, changes and advances in the marketplace. In it, we have written several credit-related articles that chronicle the path to the development of our Loan Dynamics Model. These articles are available in *The Pipeline* by visiting our website at www.ad-co.com.

The Implied Expected Defaults of ABX 06-2 by Andrew Davidson, Nov 2006

Active-Passive Vasicek by Alex Levin, Nov 2006

A Framework for Market-Implied Defaults by Anne Ching, Mar 2006

Data Availability and Its Implications for Behavioral Models by Kyle Lundstedt, PhD, Sept 2005

Modeling Mortgage Risk: Definitional Issues by Kyle G. Lundstedt, Ph.D., Apr 2005

The Competing Risks of Mortgage Prepayment and Default by Kyle G. Lundstedt, Ph.D., Feb 2005

Forecasting Conditional Default Rates for Manufactured Housing ABS by Anne Ching, Oct 2003

MODEL LINEUP

Kyle Lundstedt, Ph.D. led the company's credit model efforts and created the framework for estimating the transition equations underlying the model. Kyle has significant expertise in developing customized competing risks models for large financial institutions. Prior to joining AD&Co., Kyle was a Managing Director and co-founder of VaRisk, a research firm that builds customized valuation and risk management tools for financial institutions. Kyle also was Vice President of Analytics for LoanPerformance, where he and his eight member staff designed and developed the Risk Model, a tool for predicting mortgage prepayment, default, and loss distributions.

John Ferrante is a senior software engineer and was responsible for managing and developing the database of Non-Agency loans used in the estimation of the behavioral equations. John co-founded and acted as Senior Software Engineer for VaRisk with Kyle Lundstedt. Prior to VaRisk, John was a Senior Software Engineer with Loan Performance, improving their 'Risk Model' and building various financial tools, including interest rate generators, prepayment models, and data analysis functions for large lending institutions.

Will Searle, the lead programmer, wrote the code for the library to enable universal integration of the model. An experienced c++ coder, Will has written the majority of the company's prepay library and contributes to the company's valuation libraries. In addition to coding the company's models, he provides technical support to both end-users and vendors.

Anne Ching, a senior analyst, implemented the beta version of the model and is responsible for ongoing testing of the model performance. Anne has a diverse background in both investment management and credit risk analysis. As a consultant for AD&Co, Anne applies her knowledge of fixed-income markets and expertise in credit risk analysis to the mortgage sector, particularly in the area of sub-prime residuals. Anne has worked on projects involving valuation of sub-prime residuals and other portfolio monitoring activities.

Herb Ray is a senior database developer and administrator and was instrumental in the SQL implementation of the credit model. Herb has extensive experience in IT consulting, doing database development, chiefly in the investment banking industry. The last five years of his consulting work was primarily in equities research automation. Before that, Herb was at Bankers Trust for over six years developing the automation of credit policy and credit portfolio reporting.

CONTACT US

We are committed to further development and enhancement of the Loan Dynamics Model™ and other credit valuation tools. Please contact Rob Landauer (rob@ad-co.com) for more information.

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LOAN DYNAMICS™