



Maximizing Recoveries from Defaulted Mortgages

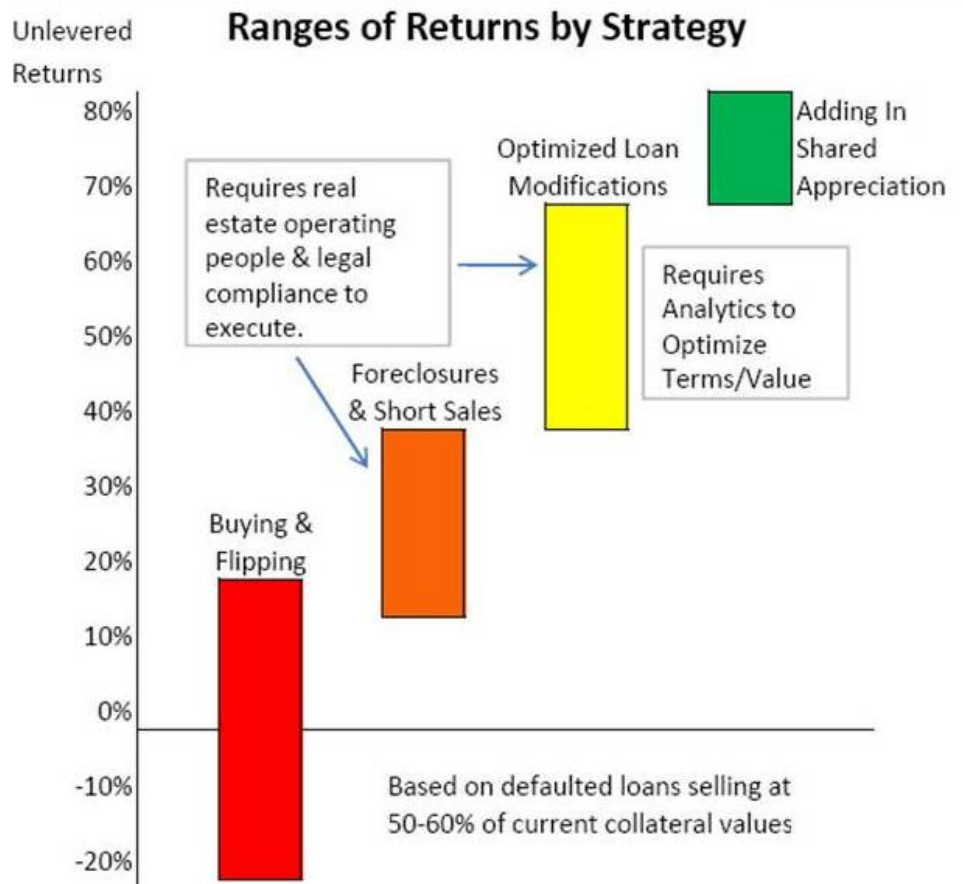
Recovery Partners is a group of finance and real estate professionals and organizations that have come together to implement a profit maximizing approach to stopping foreclosures. We use an option pricing framework to value modified loans and choose the optimal modified terms. Our modification-optimizing software, combined with efficient workflow management, delivers fast, profit maximizing turnarounds on loans otherwise headed for foreclosure. This brochure explains who we are and how we help distressed debt funds capture additional layers of value using our analytical and operational capabilities.

As illustrated in the diagram below, buying defaulted loans at a good price in the market is just the first layer of opportunity in a residential mortgage portfolio. Our example numbers correspond to a certain subset of loans and borrowers, but the point is valid generally: most of the potential upside requires a combination of sophisticated mortgage level analytics and experienced operating staff to execute the loss mitigation strategies. With these capabilities in place, bidding can be fine tuned accordingly.

For example, a loan-by-loan estimate of the foreclosure present value of the portfolio provides a benchmark for calibrating a bid whereby expected return and risk can be measured. Competitors without such detailed information are most likely to underbid (if they are prudent in managing their risk). If reckless bidders (or those with incorrect estimates of foreclosure value) bid high, you will be in a position to determine how high you can afford to bid while still meeting your minimum risk and return objectives.

Now we will briefly explain what it means to optimize a loan modification offer and then we will illustrate how we optimize modifications across a portfolio of diverse borrowers and properties.

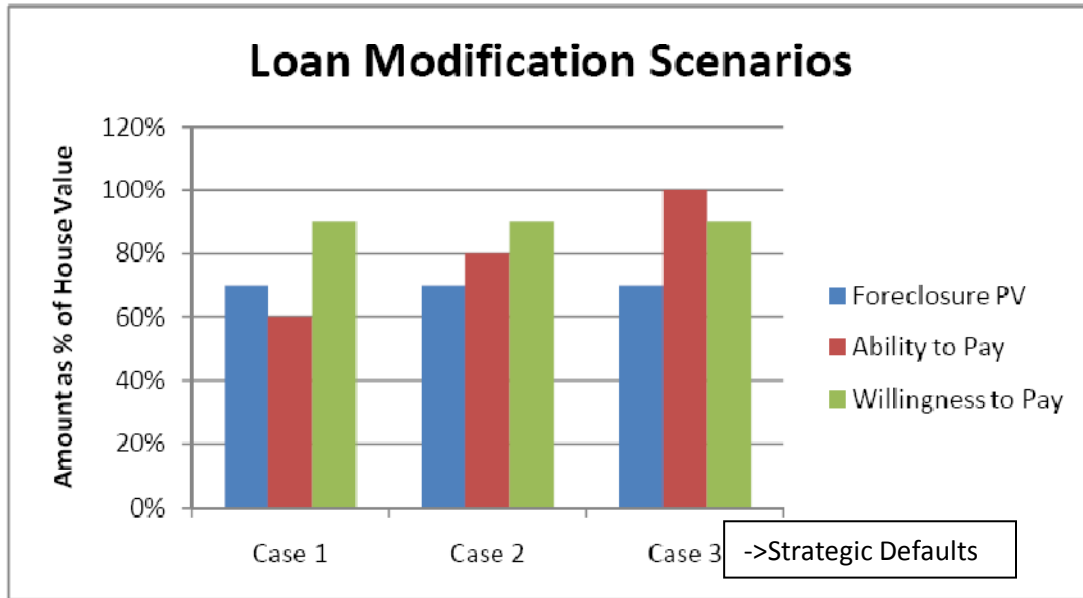
Defaulted Mortgage Investing Sources of Value





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When a residential mortgage loan defaults and the borrower provides updated income information in pursuit of a modification of terms, there are three cases to consider.



As depicted in the chart above, Case 1 requires foreclosure since the foreclosure present value exceeds the amount the borrower can afford to pay (Ability to Pay < Foreclosure PV). In Case 2 the lender maximizes recovery by setting new terms according to the maximum of the borrower’s ability to pay. The borrower will pay this amount as it is less than what he is willing to pay, if he could (Willingness to Pay > Ability to Pay > Foreclosure PV). Case 3, often referred to as “Strategic Default” is the interesting one (Ability to Pay > Willingness to Pay > Foreclosure PV). If the lender sets terms according to the maximum the borrower has the ability to pay, that will exceed what he is willing to pay and thus he defaults, and the lender collects the Foreclosure PV--which is less than what the borrower was willing (and able) to pay. This scenario may arise when the principal amount exceeds the value of the home to the borrower even though the borrower has sufficient income to keep paying.

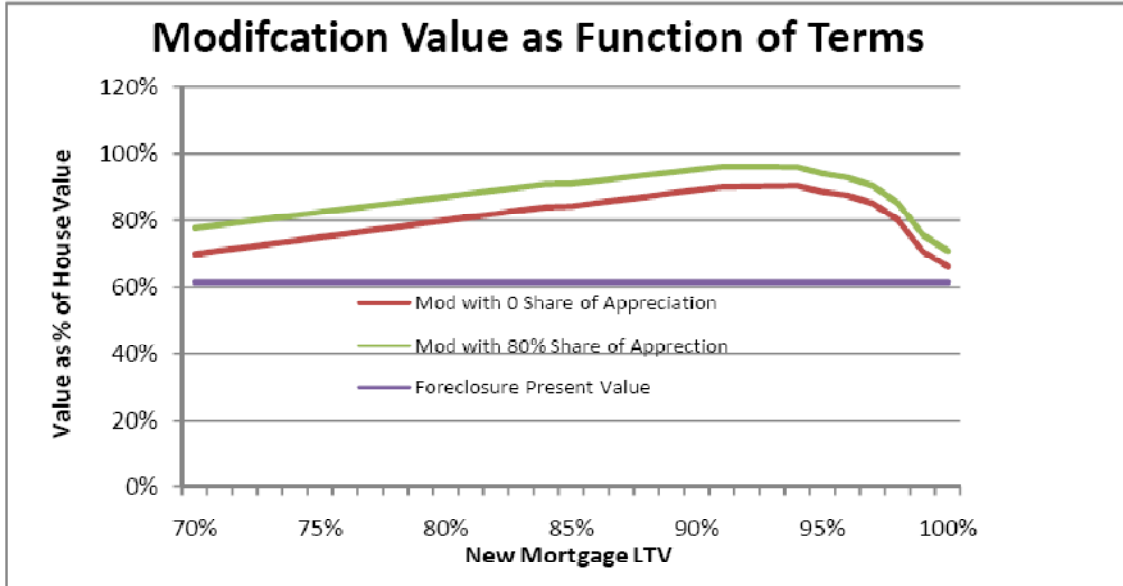
Complicating this analysis further is the possibility that the house value may be declining through time such that the willingness to pay is declining along with the borrower’s equity in the home. Not only does this increase the likelihood of later re-default, it also reduces the recovery available upon later foreclosure. For any given borrower in case 3, the value of a loan modification rises along with the loan amount but only to a critical point where the higher loan amount increases the probability of exceeding the Willingness-to-Pay threshold. Beyond this point further increases in the loan will increase the probability of re-default and drag the value back down towards the foreclosure value.

The following graphs provide two very different examples of such loan-value functions with willingness to pay defined by a negative equity limit. We’ve added in an additional component for shared appreciation rights but the result is similar with just a straight loan modification.

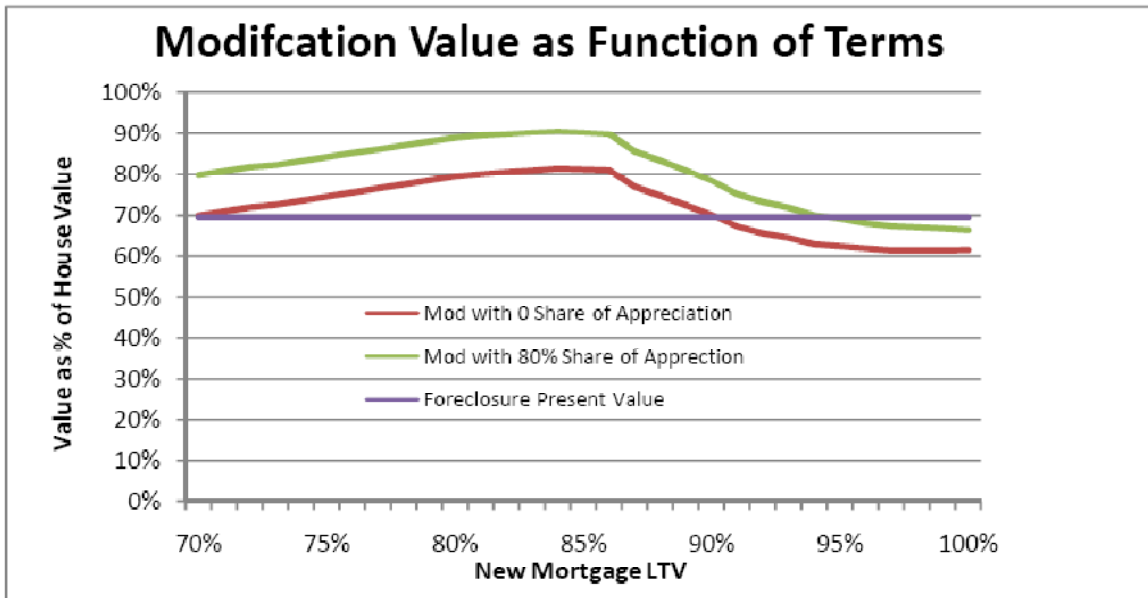


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Borrower A – Negative Equity Limit = 19% of House Value, Expected House Depreciation = 20%
 Foreclosure Present Value is 62% of House Value. **The Value Function Maximum is at LTV of 94%.**



Borrower B – Negative Equity Limit = 1% of House Value, Expected House Depreciation = 12%, Foreclosure Present Value is 70% of House Value. **The Value Function Maximum is at LTV of 84%.**



Clearly an arbitrary choice of LTV applied to both situations cannot provide maximum value. The loss in value versus optimized LTV could be very substantial. The implication is that we need to know about the property and the borrower’s ability and willingness to pay to set optimal terms to offer.



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While most modification strategies in place today seek precision in determining the foreclosure present value and the borrower's ability to pay, assessments of willingness-to-pay are either non-existent or they are judgment calls unsupported by detailed analysis. Our system uses the best analytics available in the industry, including Case-Shiller price forecasts and other third party data, to estimate all the relevant variables for each individual borrower and property. Thus we are looking at all the information we need to determine which case we have and, when we're in case 3, we can assess the value functions shown above to set value maximizing modification terms for each individual situation rather than a one size fits all approach.

Shared Appreciation Rights

Our system optionally includes the ability to recapture some upside value by requiring the borrower to enter into an appreciation sharing agreement in return for our offer of a reduction in principal. Our system provides an estimate of the value of such rights and we provide the legal documentation necessary to implement these agreements. These can be combined into the first lien or in other cases recorded as a second lien and traded separately.

Recovery Partners – Who We Are

The analytical system used to analyze loans and set optimal terms was developed by The Recovery Company. The two principals are Ray Meadows and Dr. Sanjiv Das. Impac Mortgage Holdings Inc. provides the operating personnel and expertise to use the analytical tools and execute the workouts efficiently. Our network also includes people throughout the real estate and finance industries who can provide loan purchasing opportunities and passive investors for funds using modification strategies to add value. The following provides a brief background of the analytics and operations partners.

Ray Meadows, founder of The Recovery Company, has expertise in Real Estate, Banking /Finance, and Credit Risk Analytics Systems. His graduate studies in the MBA and PhD programs at U.C. Berkeley gave him a disciplined analytical approach to solving real world problems.

After the PhD program in 1992, Mr. Meadows worked on Wells Fargo's Mortgage Backed Securities pricing model. Later he ran the bank's wholesale pricing group with responsibility for derivatives valuation and credit exposure systems. Ray supervised a group of financial engineers who developed the bank's next generation interest rate derivatives pricing and hedging software.

Ray moved to NY in 1997 to work for ING Barings, and later Citigroup, in credit risk analytics. There he built risk management tools to quantify and price credit risk, and Monte Carlo simulations for path dependent transactions. In 2002 Ray founded Berkeley Investment Advisors, a registered investment advisor focused on real estate investing. Ray is a Chartered Financial Analyst (CFA), a CPA and a licensed real estate broker.

Dr. Sanjiv Das is technical advisor to The Recovery Company--providing product and technical input and oversight. Professor Das is Chair of the Finance Department at Santa Clara University's Leavey School of



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Business. He previously held faculty appointments at Harvard Business School and UC Berkeley. He earned his Ph.D. in Finance at New York University and a M.S. in Computer Science at UC Berkeley. Dr. Das has published more than 70 academic articles, and has won many awards for research and teaching. His latest paper is “The Principal Principle: Optimal Modification of Distressed Home Loans.” He is a senior editor of *The Journal of Investment Management* and co-editor of *The Journal of Derivatives*. Prior to academia, he worked for Citibank in the Asia-Pacific region.

Impac Mortgage Holdings, Inc. went public in 1995 as a residential mortgage originator and issuer of mortgage backed securities. The company originated over \$90 billion of residential mortgages. Currently the company is the master servicer for 56,000 loans totaling \$16 billion. The firm is fully compliant with the various state and federal regulations governing the industry. The company has 14 years experience managing residential mortgage loss mitigation. After the 2007 financial crisis, Impac shifted focus to mortgage and real estate services with emphasis on the loss mitigation services.

Operational Capabilities – Outreach Call Center

The first step is to contact borrowers to initiate negotiations where there is a possibility of a loan modification providing a higher value than foreclosure. Our analytics determine the best candidates and we automatically generate contact letters with preliminary terms. Excel Mortgage Servicing, a unit of Impac Mortgage Holdings, Inc. has call centers staffed with mortgage professionals specifically trained in explaining modification offers and motivating borrowers to provide updated information and pay for the costs of modifying their loans. All borrower documents are uploaded into a proprietary tracking system upon receipt. During 2009 the call center has contacted over 19,000 borrowers and completed 7,000 loan modifications. Another 2,200 modifications are in process.

The outreach staff is dedicated to modifications and is trained in our process of trading principal write downs for appreciation sharing rights. Regular loan servicing can be maintained at the existing servicer or moved to another partner company specializing in regular servicing. The call center staff can also offer a streamlined short sale option to borrowers who do not have sufficient income to qualify for a modification (case 1). Reaching the borrower early, before they abandon the property, is crucial to maximizing value whether through modification or short sale. Where needed, skip tracing tools are used to contact difficult to find borrowers.

Operational Capabilities – Real Estate Management and Disposition

When the borrower has insufficient income for a loan modification that would exceed foreclosure value, (or they don't want to modify or do a short sale) the call center staff instructs the servicer to expedite the foreclosure process. Upon foreclosure sale, the property is handed to REO Solutions, an Impac subsidiary, who provides property management services and administers the REO sale process. They maintain an extensive network of property managers and sales agents in all 50 states. On average this unit has had 3,100



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REO properties under management over the last 12 months. Current available capacity is 500 properties per month which can be scaled as needed.

Bidding Support

Our analytics system supports bidding by analyzing the origination and servicing data on a pool of loans. We estimate loan by loan the foreclosure present value and the current non-distressed value of the property. The data can also be used to analyze the range of potential outcomes from our modification strategy or alternative modification rules specified.

Our estimates of foreclosure present value take into account current local distressed sale discounts, timing of foreclosure and sale, projected changes in prices until sale, real estate operating costs, sales costs, and your cost of capital. You bid with a loan level estimate of worst-case return on capital.

Analytical Decisioning + Efficient Execution = Maximum Recovery Value