Special Report

U.S. Structured Finance: 2010 Outlook

Analysts

John Olert
+1 212 908-0663
john.olert@fitchratings.com

Huxley Somerville
+1 212 908-0381
huxley.somerville@fitchratings.com

ABS
John Bella
+1 212 908-0243
john.bella@fitchratings.com

Michael Dean
+1 212 908-0556
michael.dean@fitchratings.com

CMBS
Mary MacNeil
+1 212 908-0785
mary.macneil@fitchratings.com

Robert Vrchota
+1 312 368-3336
robert.vrchota@fitchratings.com

RMBS
Grant Bailey
+1 212 908-0544
grant.bailey@fitchratings.com

Structured Credit
Kevin Kendra
+1 212 908-0760
kevin.kendra@fitchratings.com

Summary

Even though the U.S. economy appears to be on a path towards recovery (albeit a slow one), Fitch Ratings expects weaker collateral performance across all structured finance sectors next year. Fitch expects the pace of downgrades to slow in areas such as RMBS, CMBS, and CDOs given the magnitude of ratings downgrades and the prospective stresses built into the actions taken to date. At the same time, sectors that have remained resistant to the downturn (consumer ABS) will likely see more negative pressure on collateral and, potentially, ratings on a relative basis, as fundamental improvement to key aspects of consumer health remain elusive.

Sector Highlights

Highlights from Fitch's sector outlooks include the following:

U.S. ABS

- Even with escalating delinquencies and losses in the face of persistently elevated unemployment, the ABS sector will continue to demonstrate a higher level of rating stability with limited downgrades, largely in lower rating categories. This relative rating stability is the result of structural features that enable rapid deleveraging, conservative loss expectations and stresses derived from prior recessionary environments, consistent collateral attributes, straight-forward transaction structures, and ongoing involvement or retained interest by the originators.
- Ratings on credit card ABS remained stable in 2009 as issuers stepped in to support the trusts to mitigate steadily declining collateral performance. Although ratings in 2010 are expected to be stable, performance will be strained due to regulatory and legislative changes, which will limit issuers' ability to employ dynamic risk-based pricing strategies. Additionally, based on its expectation that unemployment rates will hover above 10%, Fitch expects chargeoffs to revisit the 12% level in 2010. As a result, excess spread will continue to narrow, with three-month rolling averages expected to hover between 4% and 5%, causing intermittent spread account trapping. Despite these pressures, early amortization risk will remain remote.
- On a positive note, Fitch expects the wholesale vehicle market will remain more balanced going into 2010. As a result, Fitch expects that 2010 annualized net losses will be between 2.0% and 2.25%, below the levels witnessed between 2007 and 2009. This forecast is within Fitch's current ranges. Therefore, 'AAA' auto ABS ratings will remain stable. Any negative rating migration will be limited to the lower, subordinate tranches of notes.

U.S. RMBS

- The RMBS sector will face increased delinquencies and loss severities in 2010 as temporary government support programs expire and re-defaults on modified loans increase the supply of distressed housing inventory in the market. Fitch predicts that national home prices will decline approximately another 10%. Also, as modifications have focused on reducing monthly payments as opposed to addressing borrowers' negative equity position, Fitch expects that re-default rates after 12 months will remain high. Based on re-default rates on similar modification performed prior to the

Home Affordable Modification Program (HAMP), Fitch predicts that re-default rates will be approximately 50% for prime and 65%–75% for Alt-A and subprime.

- The number of severely delinquent borrowers remaining in non-agency RMBS pools has grown to approximately 1.7 million, the highest level on record. Fitch estimates that, of the currently-paying borrowers in pools issued from 2005–2008, approximately 50% owe more than their homes are worth. In 2010, the existing negative equity position of many performing borrowers combined with a further rise in unemployment is expected to prevent any material improvements in roll rates from performing to delinquent.
- While Fitch expects downgrades to continue to outnumber upgrades in RMBS in 2010, the magnitude and severity of negative actions will moderate substantially compared to prior years. This prediction is based on the extent of the downgrades to date and the fact that the current ratings already assume further stress. Interestingly, subprime RMBS could prove to have the most stable ratings of the three major mortgage sectors next year. Actual performance has been in line with expectations since mid-2009.
- Generally, high recovery rates are expected on the senior RMBS bonds downgraded to distressed rating categories due to a high likelihood of default. The average recovery rate for prime, Alt-A, and subprime average 95%, 80%, and 50%, respectively. To guide investors on the prospect of a distressed asset's recovery, Fitch provides recovery ratings (RR); to date, more than 22,000 RRs have been assigned to distressed RMBS bonds.

U.S. CMBS

- Protracted illiquidity in the debt markets remains one of Fitch's primary concerns for CMBS. Refinance risk across all CMBS property types remains elevated, making even stabilized, low-leverage fixed-rate loans less likely to repay in a timely manner. Vying for a limited amount of available capital will be approximately $475 billion of commercial real estate loans maturing in 2010, of which maturing CMBS loans represent approximately 10%, with the balance comprised of maturing commercial real estate loans held by banks and life insurance companies.
- Loans securitized in 2006–2008 vintage transactions will continue to reflect higher levels of loss than pre-2006 transactions. However, due to the prospective nature of its rating actions taken on these deals in the third quarter of 2009, Fitch does not expect any additional widespread near-term negative rating migration for the 76 recently reviewed transactions. More than 80% of the bonds were affirmed in this review.
- Fitch expects that operating cash flows will continue to decline across all property types for the next 18–24 months. This will result in negative rating actions for pre-2006 fixed-rate transactions, though rating actions among these older vintages will not be as severe as those taken in the 2006–2008 vintage conduit transactions due to seasoning, defeasance, and the loans generally not underwritten as aggressively as those originated at the peak of the market. Fitch anticipates that most rating actions on pre-2006 vintage deals will occur on subordinate bonds rated lower than 'AAA'. Large-loan floating-rate deals will also be susceptible to downgrades in 2010.
- Although still low, delinquencies have risen significantly throughout 2009 for all property types. Fitch anticipates that delinquencies will reach 6% by the first quarter of 2010 and could peak at 12% in 2012. With the expected increase in commercial real estate loan defaults, Fitch's outlook for U.S. CMBS is negative.

U.S. Structured Credit

- Fitch expects continued declining asset performance for every major U.S. CDO sector in 2010. Recently reviewed CDO notes that have retained high investment-grade ratings maintain sufficient cushion to Fitch's portfolio loss expectations, while mezzanine investment-grade and speculative grade tranches will generally be more susceptible to rating volatility from variability in these loss expectations.

- Corporate CDOs have performed relatively better than any of the structured credit asset classes, even while corporate debt markets experienced elevated levels of default and softness in U.S. high-yield corporate recoveries in 2009. Defaults are expected to remain elevated relative to historical averages in 2010 but lower than those experienced in 2009. As a result, Fitch expects that total defaults will fall just short of its initial 2009 projection of 15%–18%. The biggest challenge facing corporate debt markets in the coming years will be the availability of refinancing opportunities. It is unlikely the high yield bond market will have the capacity to refinance the volume of debt that is scheduled to mature in 2013 and 2014.
- A significant percentage of the 142 U.S. banks that have failed since July 2008 are within bank TruPS CDOs, contributing to the rising trend in defaults and deferrals within these CDOs. With approximately $3.8 of $33 billion of bank TruPS issued in CDOs defaulted and another $4.7 billion deferring, Fitch anticipates at least $3 billion of additional bank TruPS defaults by year-end 2010.

U.S. ABS

Similar to many sectors across the capital markets, the U.S. ABS market had its share of challenges throughout 2009. A severe economic recession, financial institution bailouts, auto manufacturer bankruptcies, rapidly rising unemployment and corresponding consumer credit quality deterioration, legislative and regulatory initiatives, market disruptions, and government interventions all influenced the ABS sector during the year. The cumulative effect was a disjointed yet still-functioning market at year end. Additionally, U.S. ABS ratings continued to display resistance to all of the turbulence and rapidly deteriorating collateral performance measures across nearly all asset classes throughout the year.

Fitch expects similar trends to prevail in 2010. Certain sectors directly correlated to U.S. consumers will experience mounting delinquencies and losses in the face of persistently elevated unemployment. However, ABS will continue to demonstrate a relatively higher level of rating stability with limited downgrades, largely in lower rating categories. Fitch believes the resilience of ABS ratings is driven by several factors, including:

- Structural features inherent in most ABS transactions that enable rapid deleveraging.
- Conservative loss expectations and stresses that were derived from prior recessionary environments.
- Stable or increasing credit enhancement levels over time.
- Consistent collateral attributes and straight-forward structures.
- Ongoing involvement or retained interest by originator; i.e. few originate-to-sell models.

Recent trends in ABS also include a prevalence of tighter underwriting standards, higher credit enhancement levels, and, to a certain extent, proactive support provided by issuers on both the collateral and structural front. In addition, ABS issuers have had a long history with underwriting subprime loans, particularly in consumer ABS, and the shift away from issuing subprime-only backed transactions has helped insulate this sector from large-scale downgrades.

The direct implications of a stagnant housing market and subprime mortgage problems on ABS have been and will continue to be limited from a ratings standpoint. However, the severe economic recession and its impact on consumers now outweigh the effects of the housing downturn. Employment remains the pre-eminent driver behind delinquency and default trends in consumer ABS. These performance measures have worsened in tandem with the rapid increase in unemployment. With the unemployment rate expected to hold above 10% throughout 2010, consumer credit quality measures will be pressured further, and historical correlations will be tested.

New challenges for the ABS market in 2010 will center around recent accounting, legislative, and regulatory developments. While not necessarily credit-related, these changes will shape the future of the market and its participants. However, for the time being, Fitch continues to expect ABS ratings to remain stable, particularly at the senior levels, despite the ongoing challenging environment as indicated in the sector discussions below.

2010 U.S. ABS Ratings Outlook

Market Sector/Asset Class	Broad Rating Category	Rating Outlook	Outlook Comments
Credit Cards Prime	AAA AA to BBB	Stable Negative	• Expected higher chargeoffs reflected in credit enhancement levels. • The dynamic between elevated delinquencies, a shrinking denominator, and potentially higher bankruptcies could cause rapid acceleration in credit card defaults. • Compliance with recent legislation could compress yield, reducing trusts' ability to absorb the impact of higher losses. • Increased scrutiny of interchange policies could ultimately weaken this source of revenue.
Student Loans FFELP	AAA AA to A	Stable Negative	• The U.S. government continues to guarantee at least 97% of principal and interest. • Parity levels came under pressure throughout the crisis and will be slow to recover going forward, leaving less of a cushion to those tranches.
Private	AAA to BBB	Negative	• Excess spread generation remains impaired for certain auction-rate transactions and could have long-term impact on parity. • Negative performance trends, such as increased use of deferment and forbearance, higher periodic and cumulative losses, and a deceleration in recoveries will challenge liquidity and excess spread. • Legislative attention on private student loan terms and dischargeability is a concern. • Operational disruptions may occur sporadically as servicers continue to consolidate.
Prime Auto Loan	AAA to BB	Stable	• Loss frequency is the biggest concern and will pressure loss rates. Loss severity is less of a concern in 2010 but still susceptible to economic weakness, auto manufacturer/brand weakness, and volatility. • Transactions benefit from structural features including cash reserves and overcollateralization floors, allowing rapid amortization and building credit enhancement. Subordinate tranches are more exposed to the current unemployment condition of the economy. • The 2009 vintage is performing better than those of the prior two years given the improved credit quality, lower advance rates, and tighter loan terms.

Prime Credit Cards

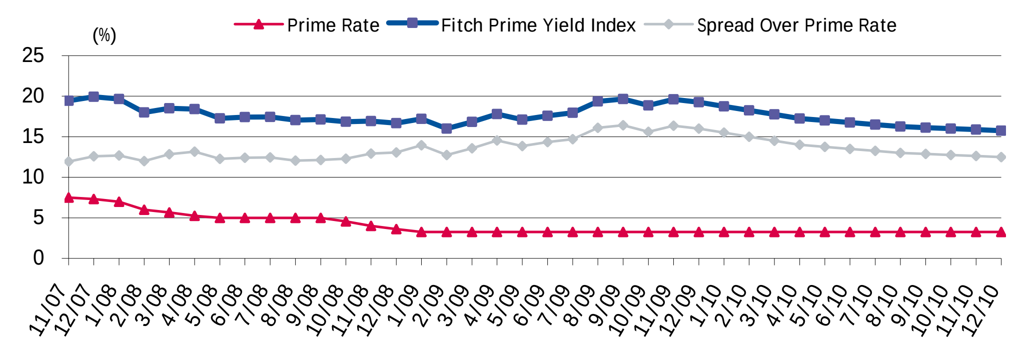
Ratings Outlook: Stable for 'AAA' Bonds, Negative on Bonds 'AA' and Below
Asset Performance Outlook: Declining

Ratings on credit card ABS remained relatively stable this past year as issuers stepped in to support the trusts to mitigate steadily declining collateral performance. Several programs benefited from increases in credit enhancement and the implementation of a discount option to help preserve ratings. However, the credit card sector is not out of the woods yet. In addition to compliance deadlines for the recent legislative changes and swelling scrutiny over interchange rates, 2010 will bring heightened competition as issuers refocus on profitability and shifting up in the credit spectrum. It will be a tough sell.

As a result of regulatory and legislative changes, issuers will no longer be able to employ the dynamic risk-based pricing strategies that have enabled them to extend loss-leading promotional annual percentage rates (APRs) on a large scale. Through late 2008 and much of 2009, issuers have executed sweeping changes in terms to large portions of their portfolios in order to rebalance the sources of revenue so as to prepare for the 2010 environment. The current economic situation has put a damper on the extension of new or additional credit. However, even after issuers begin to test the waters again, the need to instill more disciplined underwriting at origination means that there will be a significant reduction in the pool of qualified prospects. With the new rules, certain types of customers that had previously been profitable will no longer be so within an acceptable period of time without applying eye-popping interest rates from the start.

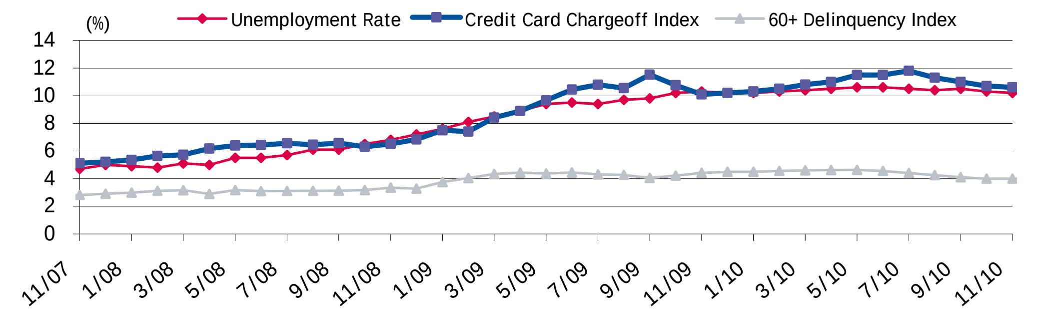
Fee income is likely to diminish from current levels as the opportunity to charge nuisance fees, such as late fees and overlimit fees, is constrained by regulatory changes. Some or all of this revenue may be offset by the reintroduction of annual fees, which remain a concept consumers are reluctant to embrace except for premium rewards products. Interchange revenue is expected to remain stable in the near term; however, these merchant-paid fees are under increased scrutiny. Yield is currently averaging about 18% and will exhibit increases as interest rates rise, although Fitch projects that the spread between gross yield and prime rate will recede from recent record highs of 16% toward the longer-term historical average of 12%–13%.

U.S. Prime Rate versus Fitch Prime Credit Card Index Gross Yield



Given recent trends in delinquencies, bankruptcies, and receivables shrinkage, Fitch expects chargeoffs to re-visit the 12% level in 2010 as the unemployment rate peaks at 10.5% by mid-2010 and remains elevated. Credit card chargeoffs have typically exhibited a strong positive correlation with the unemployment rate, and the marginal effect of unemployment on chargeoffs is expected to intensify as the number of jobless climbs. Although delinquencies have stabilized (albeit at historically high levels), ensuing chargeoffs may be amplified as the denominator continues to shrink. Therefore, higher chargeoffs may persist on a coincident percentage basis even as consumer credit quality begins to improve. While losses due to bankruptcy have become less conspicuous, they represent a potential hazard. Bankruptcy filings have migrated back to average historical levels after bottoming out in 2006, and a sizable uptick could cause a rapid acceleration in losses.

U.S. Unemployment Rate versus Fitch Prime Credit Card Chargeoff and 60+ Day Delinquency Index



As a result, excess spread will continue to narrow, with three-month rolling averages hovering between 4% and 5%, causing intermittent spread account trapping. That said, early amortization risk will remain remote.

U.S. Auto Loan ABS

Rating Outlook: Stable

Asset Performance: Declining

Fitch expects U.S. auto loan ABS performance will continue to be impacted by high loss frequency in 2010, with a 10.5% unemployment rate expected by mid-2010 and loss rates under pressure. Poor consumer health will continue to put a strain on loss frequency in 2010. As a result, Fitch expects the net loss rate will be below 2.25%, the highest level witnessed between 2007 and 2009. This forecast is within Fitch's current ranges.

On a positive note, loss severity should be less of a factor on performance in 2010, due in part to the notable improvement of the wholesale vehicle market this past year. Fitch expects the wholesale vehicle market will remain more balanced going into 2010. However, this could change if there is volatility or unexpected weakness in the economy beyond current expectations. In this scenario, the health of auto manufacturers and their brands may be adversely affected, which has negative potential implications for used car prices and loss levels.

Despite the levels of delinquencies and losses, 'AAA' auto ABS ratings will remain stable in 2010. The 2009 vintage is displaying lower cumulative net losses (projected between 2.5% and 3% through the life of the vintage) than the 2007 and 2008 vintages (projected to be between 3.0% and 3.5%), as collateral from this vintage has better credit quality, lower advance rates, and tighter loan terms. Additionally, 2009 transactions have higher credit enhancement levels than in deals originated in 2007–2008, driven by higher loss proxies derived from utilizing the weakest vintages from the past two–three years and the last recession in 2001. Fitch expects that the 2010 vintage will have cumulative net loss rates below 2.5% based on the tighter underwriting standards in place.

Prime auto ABS ratings performance is expected to be stable in 2010 despite poor asset performance. Consistent with 2009, the impact on ratings in 2010 should be limited to the lower, subordinate tranches of notes. Despite this, structural features such as cash reserve accounts, higher enhancement floors levels, and rapid amortization, all resulting in building credit enhancement, are expected to shield transaction rating volatility from declining asset performance in 2010.

Student Loans: FFELP

Ratings Outlook: Stable for 'AAA' Bonds, Negative on Bonds 'AA' to 'A'

Asset Performance Outlook: Stable

The proposed abolition of FFELP on July 1, 2010 seemed like a done deal for a while. However, legislators are now grappling with how to end the program and disburse all student loan entitlements through the Direct Loan Program. Trust performance on FFELP loans has remained stable through 2009 and will remain stable next year. Similar to last year, voluntary prepayments and consolidations remain slow, as there is less incentive and opportunity to refinance. Fitch expects the level of claims, deferment, and forbearance to peak as the unemployment rate reaches 10.5% by mid-year and remains elevated. However, the Ratings Outlook is Stable for senior classes of FFELP collateral as a result of the U.S. government's guarantee of at least 97% of principal and interest. The outlook for subordinate class ratings is more negative as parity levels came under pressure throughout the crisis and will be slow to recover going forward, leaving less of a cushion for those tranches.

The spread between the three-month LIBOR (used to fund the debt) and the 90-day 'AA' financial commercial paper (CP) and 91-day Treasury bill rates exhibited considerable volatility and historically wide levels over the past year before subsiding to more normal levels in the third quarter of 2009. Fitch has established more rigorous basis risk stresses, which are now being applied to both new and existing transactions as they come up for review. The House's version of the Student Aid and Financial Responsibility Act (SAFRA) includes a proposal to change the basis of special allowance payment (SAP) rates from AA Financial CP to one-month LIBOR. As the coupon rate on many student loan ABS transactions is based typically on three-month LIBOR, a change that will likely result is reduced basis risk. It is unclear whether this provision will remain as the bill makes its way through the legislative process.

Several subordinate tranches of student loan ABS deals remain on Rating Watch Negative as Fitch monitors the long-term impact of the auction-rate dislocation on trusts' parity levels. In 2009, a number of transactions containing auction-rate debt were refinanced, and Fitch expects more volume as a result of refinancings in 2010.

Student Loans: Private

Ratings Outlook: Negative

Asset Performance Outlook: Negative

Like many other consumer financial products, private student loans are facing the prospect of increased legislative intervention. Although currently offered products have more selective underwriting and conservative terms, the aggressive pricing and terms of previously offered private student loan products have attracted negative publicity. Earlier this year, Congress considered a proposal to give private student loan borrowers access to government guaranteed consolidation loans. In general, loss severities are lower on private student loans than on unsecured consumer loans, as private student loans have generally been represented to be nondischargeable in bankruptcy court. However, Congress recently held hearings to determine if there should be more circumstances under which private student loans could be discharged. Both initiatives could have a material impact on ratings, though discussions are still preliminary and subject to change.

Fitch expects continued deterioration in performance for private student loans as delinquencies continue to climb and losses increase. A sustained downturn could have lasting adverse cumulative effects on certain trusts as defaults rise further and recovery efforts remain challenging due to economic conditions. In line with recent history, private student loan rating actions are expected to remain issuer, product, and structure specific. Transactions backed by direct-to-consumer originated collateral and those with premium proceeds structures are most vulnerable to downgrades, or additional downgrades in certain instances, in the coming year, as this product tends to be more risky. Private student loan transactions backed by school channel origination collateral and those issued by state-related entities are less likely to see ratings actions in the coming year.

Prospects for New Issuance

With recent clarification from the FDIC, credit card ABS issuance is expected to be steady through the first quarter of 2010. While the Term Asset-Backed Securities Loan Facility (TALF) helped credit card ABS get back on its feet earlier this year, there has been sufficient investor interest to make 'AAA' non-TALF issuance economically attractive again.

At present, many FFELP originations are being funded via Straight-A or ECASLA (Ensuring Continued Access to Student Loans Act of 2008). Straight-A is a government-backed conduit for nonconsolidated FFELP loans originated later than 2003; it ramped up to almost $30 billion in outstandings within six months after its launch in May 2009. The program size is capped at $60 billion and will be in place until 2014. In order to be eligible, loans must have been fully disbursed by Sept. 30, 2009, so Fitch expects to see only limited volume in 2010. ECASLA continues to provide liquidity for nonconsolidated FFELP loans disbursed after 2008; this program will fund loans disbursed through Sept. 30, 2010. Both programs' end dates appear tied to the expected end date of the FFELP program; it isn't known whether these programs will be extended if the FFELP termination date is postponed.

TALF effectively defrosted the private student loan market in 2009. At the same time, investors began to re-enter tentatively and issuers tightened up underwriting criteria. Whereas, in the past, volume had been comprised largely of deferred payment loans, issuers are relying more heavily on interest-only and immediate-repay loans. Fitch sees this trend continuing through 2010, as tangible benefits result from receiving payments on in-school loans. However, as issuers become more selective in extending credit to borrowers, loan volume and securitization activity may remain low compared to that of previous years.

Auto loan ABS issuance in 2010 will likely be driven by a number of factors, including lenders' financial strength, funding needs, and efficiency of the overall ABS markets. A loose correlation between new vehicle sales and ABS auto volume exists, so with a small rise in new vehicles expected in 2010, ABS issuance is likely to follow suit.

U.S. RMBS

Massive government intervention has helped avoid a worst-case scenario in the housing and mortgage markets and has precipitated early signs of recovery in 2009. However, barring expanded and continued government support, the RMBS sector will likely face further home price declines and increased loan delinquencies in 2010, as temporary government support programs expire and as re-defaults of modified loans increase the supply of distressed housing inventory in the market. These factors, together with the amount of distressed properties currently awaiting foreclosure and liquidation, indicate that a housing recovery will be prolonged.

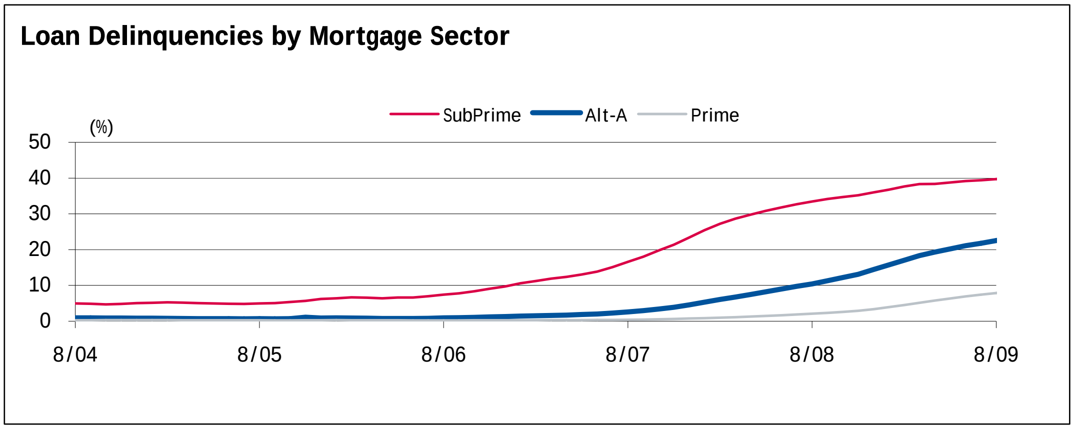
The most prominent sign of recovery in the housing markets has been reported national home price increases beginning in the second quarter of 2009. Prior to the recent rise in home prices, national values had dropped approximately 32% from their peak according to the Case-Shiller index. Despite the recent positive movements in home prices, Fitch expects a further approximately 10% national decline by the end of 2010 (weighted by outstanding non-agency loans). Recent positive home price movements have been temporarily supported by low mortgage rates, homebuyer tax credits, and government-directed loan-modification programs, which have limited the amount of distressed properties for sale. The support from these three factors is expected to weaken in 2010.

Mortgage rates will likely rise after the first quarter of 2010 as the Federal Reserve ends its $1.25 trillion MBS purchase program, which has helped keep rates low and has been in place for the past year. The homebuyer tax credit, which has incrementally attracted new buyers and helped improve market sentiment, will expire on April 30, 2010. While the surge of trial loan modifications in 2009 temporarily constrained distressed inventory, the long-term effectiveness of the loan modification effort remains uncertain.

The increase in trial loan modifications in 2009 was driven by the Treasury Department's HAMP. Announced in February, HAMP was designed to provide guidance and incentives to servicers to reduce payments for borrowers who are more than 60 days delinquent or at imminent risk of default. Through October, servicers had extended more than 650,000 trial loan modifications but have had very limited success in converting trial modifications into permanent modifications. To convert into a permanent modification, borrowers must submit required documentation and have made the required number of modified payments at the end of a three-month trial period. In some cases, fewer than three modified payments during the trial period are necessary to make the modification permanent. As of September 2009, only 1,711 permanent modifications had been completed under the program. The administration states it will not release updated permanent modification figures until December.

The effectiveness of loan modification efforts has significant implications for 2010. As servicers have delayed foreclosure and liquidation on borrowers to determine whether they qualify for a loan modification, the number of severely delinquent borrowers remaining in non-agency RMBS pools has grown to approximately 1.7 million, the highest level on record. In an effort to improve the trial-to-permanent conversion rate, the Treasury recently loosened documentation requirements and timelines, but at this point it appears a significant portion of the HAMP trial modifications will not qualify as permanent modifications. Additionally, while re-default rates on completed HAMP modifications are not yet available, re-default rates on similar modifications performed prior to HAMP have been high. Based on historical behavior, Fitch projects re-default rates after 12 months of approximately 50% for prime and 65%–75% for Alt-A and subprime.

As indicated in Fitch's Oct. 20, 2009 report, "U.S. RMBS Servicers' Loss Mitigation and Modification Efforts Update", available on Fitch's Web site at www.fitchratings.com, a likely driver of the high re-default rates is that the modifications have primarily focused on monthly payments while not addressing borrowers' negative equity position. Fitch estimates that less than 5% of modifications performed in 2009 involved a principal balance reduction of the loan, leaving many borrowers with lower payments but still owing more on their mortgages than their homes are worth. Borrowers may be unwilling to continue making payments on a home where they see little or no possibility of timely equity return.



2010 U.S. RMBS Ratings Outlook

Market Sector/Asset Class	Rating Outlook	Outlook Comments
Prime	Negative	• The most rapidly deteriorating of the three major sectors, prime delinquencies have increased more than 3.0x over the past year. • Pre-2005 senior classes will likely face negative rating pressure in 2010. While the majority of senior classes issued since 2005 have already been downgraded to non-investment grade, only 5% of senior classes issued prior to 2005 have been downgraded to date, although 40% are currently on Rating Outlook Negative. Any rating revisions of pre-2005 senior classes are expected to be much more modest than those that have been experienced in more recent vintages.
Alt-A	Negative	• Similar to prime, approximately 60% of Alt-A senior classes issued prior to 2005 are on Rating Outlook Negative and will likely face negative rating pressure in 2010. And as with prime, potential rating revisions are expected to be more modest than those experienced in more recent vintages.
Subprime	Negative	• Subprime could prove to have the most stable ratings of the three major mortgage sectors in 2010. Actual performance has been in line with expectations since mid-2009. • Performance in 2010 will be heavily dependent on the effectiveness of loan modifications. Close to 30% of subprime borrowers have had their loans modified to improve affordability.

RMBS Asset Performance Outlook: Declining

Negative equity for non-agency RMBS loans will be a primary driver of collateral performance in 2010 for all borrowers, even those that have been able to stay contractually current on their mortgage payments. Fitch estimates that, of the currently paying borrowers in pools issued from 2005–2008, approximately 50% owe more on their homes than they are worth. Of those performing borrowers in a negative equity position, Fitch estimates their average combined-loan-to-value ratio to be approximately 130%. While negative equity certainly does not always translate into a mortgage default, it increases the likelihood of default by reducing the incentive to pay and by severely limiting borrowers' options should they encounter any type of financial difficulty.

In 2010, the existing negative equity position of many performing borrowers combined with a further rise in unemployment is expected to prevent any material improvement in roll rates from performing to delinquent. Additionally, Fitch expects loss severities on liquidated loans to increase modestly, consistent with its view of an increased share of distressed inventory and further home price declines in 2010. Fitch's expectation of continued negative pressure on roll rates and loss severities is reflected in the average loss projections shown in the table below. Specific mortgage pool and bond projections can be found in the regularly updated report "RMBS Loss Metrics," available on Fitch's Web site at www.fitchratings.com.

Average Projected Mortgage Loss By Vintage

(As % of Original Pool Balance)

Mortgage Sector	Pre-2005	2005	2006	2007
Prime — Fixed-Rate and Hybrid ARM	0.4	2.5	5.9	8.5
Alt-A — Fixed-Rate and Hybrid ARM	1.4	7.9	17.2	24.3
Alt-A — Option ARM	—	19.9	38.4	40.9
Subprime	5.8	16.9	38.8	46.9

ARM – Adjustable-rate mortgage.

RMBS Rating Outlook: Negative

The performance of the collateral to date and the expectation of continued stress into 2010 have resulted in significant rating revisions across all RMBS sectors. More than 90% of the senior classes initially rated 'AAA' and issued between 2005 and 2008 have been downgraded. Although less than 1% of the downgraded senior classes have defaulted to date, approximately 75% of the classes have ratings below 'B', reflecting an expectation of a principal impairment in the future. While Fitch expects downgrades to outnumber upgrades in 2010, the magnitude and severity of negative actions will decline substantially compared to prior years given the extent of the downgrades to date and the fact that the current ratings already assume further stress.

The senior RMBS classes that have been downgraded to distressed rating categories due to a high likelihood of default are generally expected to have high recoveries. Average projected principal recoveries as a percentage of the current face amount for senior classes expected to incur some amount of impairment are as follows:

- 95% for prime.
- 80% for Alt-A.
- 50% for subprime.

These recovery averages do not include classes that are expected to recover 100% of their principal and have long-term ratings above 'B'. Bond-specific recovery projections can be found in the regularly updated report "RMBS Loss Metrics," available on Fitch's web site at www.fitchratings.com.

Prospects for New Issuance

The high projected recoveries of downgraded senior RMBS classes drove increased re-securitization, or RE-REMIC, activity in 2009. Bondholders looking for regulatory capital relief, improved liquidity, or added credit protection to avoid other-than-temporary-impairments have repackaged senior classes into new 'AAA' classes with significantly greater credit protection. Statement of Financial Accounting Standard (SFAS) 166, which will become effective at the start of 2010, will likely reduce the incentive for those bondholders seeking regulatory capital relief and result in marginally slower RE-REMIC activity. Despite the accounting change, Fitch expects continued RE-REMIC activity into 2010, with volume declining in the second half of the year as the expected improvement in market fundamentals reduces the incentives to repackage RMBS classes.

Fitch also expects to see the beginning of a slow return to the securitization of residential whole loans next year. There has been interest in securitizing seasoned loan portfolios acquired through mergers or through the acquisition of a former lender. Additionally, in recent months, there have been increased inquiries from issuers interested in credit enhancement levels for potential transactions collateralized by newly originated jumbo prime fixed-rate loans with full income documentation. Last year, Fitch announced new operational risk criteria for rating new residential whole-loan transactions, including an originator review, a third-party loan-level review, and stricter standards for representations and warranties. Also, all new transactions after Feb. 1, 2010 will report loan-level data on a monthly basis in a uniform manner as defined by the American Securitization Forum's Disclosure Package.

While restoring investor confidence in an asset class that badly underperformed in recent years remains a challenge, several other factors will likely limit the number of non-agency residential mortgage securitizations next year. New accounting requirements effective Jan. 1 will result in consolidation of many securitized loans and a corresponding increase in capital requirements for most potential issuers, increasing the cost of securitization as a financing option. Additionally, the temporarily expanded GSE conforming loan balance limit of up to $729,750 has been extended through 2010, which will direct more mortgage volume to Fannie Mae and Freddie Mac rather than private-label securitization.

While whole-loan residential mortgage securitization is likely to remain limited in 2010, the heightened standards and increased transparency of new transactions should help further the process of restoring confidence in the sector.

U.S. CMBS

Even with recovery beginning in the broader economy, Fitch expects commercial real estate fundamentals to continue deteriorating over the next 18–24 months. Protracted illiquidity in the debt markets remains one of Fitch's primary concerns, as CMBS issuers and bank and portfolio lenders continue to limit the origination of new loans. Refinance risk across property sectors and loan types remains elevated, making even stabilized, low-leverage fixed-rate loans less likely to repay in a timely manner. Vying for a limited amount of available capital will be approximately $475 billion of commercial real estate loans maturing in 2010, of which maturing CMBS loans represent approximately 10%, with the balance comprised of maturing commercial real estate loans held by banks and life insurance companies.

Fitch continues to expect loans securitized in 2006–2008 vintage transactions to reflect higher levels of loss than pre-2006 transactions. However, Fitch's third quarter 2009 review of the 2006-2008 vintage conduit deals resulted in affirmations on 80% of the rated bonds by balance, as almost all super senior and mezzanine 'AAA' rated classes were affirmed. Due to the prospective nature of its rating actions, Fitch does not expect any additional widespread near-term downward movement in the ratings for the 76 transactions reviewed. A few transactions may be susceptible to downgrades if significant negative performance issues arise beyond Fitch's expectations.

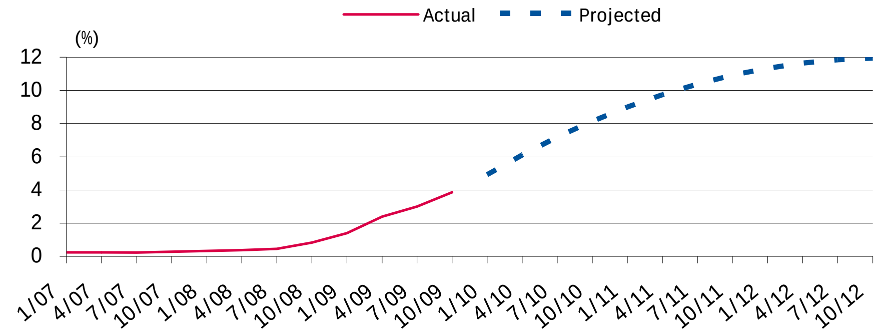
Fitch assigned a Negative Rating Outlook to 994 bonds from the 76 transactions (totaling $43.9 billion), including most junior 'AAA' rated classes. Since the rating actions were based on expected losses, which incorporate a percentage of maturity defaults, the Negative Rating Outlooks reflect the increased risk of downgrades should market conditions and loss expectations not improve as the loans move closer to maturity (on average seven years from today).

For pre-2006 transactions, Fitch currently has $10.8 billion from fixed-rate transactions and $3.3 billion of the $30 billion of outstanding large loan floating-rate transactions on Rating Watch Negative. Fitch expects that operating cash flows will continue to decline across all property types for the next 18–24 months, which will result in negative rating actions for pre-2006 fixed-rate transactions. Fitch anticipates that most rating actions on pre-2006 vintage deals will occur on subordinate bonds rated lower than 'AAA'.

Large-loan floating-rate transactions, pre-2000 vintage transactions, and deals originated in the latter half of 2005 will be most susceptible to downgrades due to a number of issues, including transitional assets not meeting business plans, adverse selection, and aggressive underwriting. However, the magnitude of these negative rating actions is not expected to be as significant as that of recent actions on the 2006–2008 vintage conduit deals due to seasoning, defeasance, and loans generally not underwritten at the peak of the market.

Although still low, delinquencies have risen significantly throughout 2009 for all property types. As of the end of October 2009, the Fitch Loan Delinquency Index (LDI) was 3.86%, up from the trough of 0.27% in January 2008. Fitch anticipates that delinquencies will reach 6% by the first quarter of 2010 and could peak at 12% in 2012. With the expected increase in commercial real estate loan defaults, Fitch's outlook for U.S. CMBS is negative**.**

U.S. CMBS Loan Delinquencies Continue to Rise



2010 U.S. CMBS Ratings Outlook

Market Sector/Asset Class	Broad Rating Category	Rating Outlook	Outlook Comments
Multiborrower	AAA	Stable	• Super senior and mezzanine bonds will remain well protected due to sufficient credit enhancement, while junior bonds remain more susceptible to downgrades.
	AA to A	Negative	• Downgrades may occur if actual losses surpass Fitch's potential loss assumptions.
	BBB to BB	Negative	• Recent vintage subordinate tranches have been downgraded during Fitch's recent review of 2006–2008 transactions. • Older vintage subordinate tranches may experience downgrades due to maturing loans with weak performance that face significant challenges to refinance.
Large Loan	AAA	Stable	• Most senior bonds will experience stable performance due to the availability and anticipated exercise of remaining extension options, which will push final extended maturity dates for most loans past 2010.
	AA to A	Negative	• Downgrades may occur in the 'AA' to 'A' rating categories, primarily in older vintage transactions where only the weaker performing assets remain.
	BBB to BB	Negative	• Lower-rated tranches will experience downward pressure on ratings due to economic conditions, causing many assets to fall behind in their stabilization plans or making execution of the original business plans less feasible. • Transactions with loans approaching final maturity dates may see downgrades due to the limited refinancing available.

Potential loss assumes sustained performance declines over the life of the transaction and includes 100% of Fitch-calculated losses. Recognized loss includes 100% of the stressed-term losses and initially 25% of the stressed-maturity losses. For more information, see Fitch Research on "Surveillance Methodology for Recent Vintage U.S. CMBS," dated July 7, 2009, available on Fitch's Web site at www.fitchratings.com.

Multiborrower Fixed-Rate Transactions

Rating Outlook: Stable for 'AAA' Bonds, Negative on Bonds 'AA' and Below

Fitch's recent review of fixed-rate conduit deals from the 2006–2008 vintages incorporated the expected increase in commercial real estate delinquencies. As loans near maturity and refinance risk becomes more identifiable, Fitch may take further rating actions on fixed-rate multiborrower CMBS. Fitch believes that the super senior and mezzanine 'AAA' rated classes are likely to be affirmed unless actual losses surpass Fitch's potential loss assumptions. Fixed-rate transactions issued in 2005 may also prove susceptible to downgrades, due to lower coupons, higher leverage, and more relaxed underwriting standards by lenders. While Fitch expects loans originated prior to 2005 to perform better than more recent vintages, all transactions are now susceptible to the severe economic conditions experienced over the past few years. Newly enacted REMIC rules that equip special servicers with additional flexibility during workouts remain an unknown variable that may or may not alleviate pressure on maturing loans.

Large Loan Floating-Rate Transactions

Rating Outlook: Stable for 'AAA' Bonds, Negative on Bonds 'AA' and Below

Floating-rate transactions will be more challenged, as the underlying loans will be maturing during a time of protracted illiquidity in the debt markets. Additionally, the loans are secured by more transitional assets, many of which were underwritten to pro forma income, which is less achievable in a weakened economy. Fitch currently has $3.3 billion of floating-rate bonds on Rating Watch Negative. Floating-rate lending is not currently available, so unless these loans can refinance (albeit at a higher fixed rate), losses are likely. An additional concern for floating-rate transactions is the high percentage of loans secured by hotels (46% of Fitch's floating-rate universe). Hotels have been one of the hardest hit property types during the recession.

Fitch expects that as long as borrowers can meet their extension conditions, the vast majority of maturing loans with extension options remaining will extend in 2010 due to the continued dearth of liquidity. This may be in contrast to the adverse selection seen in years past, when large loan pools were frequently left with a higher proportion of the weakest assets over time, as better performing assets refinanced quickly. However, floating-rate transactions from older vintages that experienced such adverse selection may prove particularly susceptible to credit losses, as extension options on the remaining loans expire and maturity defaults become increasingly likely.

Specific Property Type Discussion

The number of delinquent loans has increased dramatically across all property sectors during 2009. Property types exposed to shorter-term rental agreements such as those in the hotel and multifamily sectors have been the first to experience cash flow stress. Fitch expects a continued increase in delinquencies for the other property types, as leases begin to roll and property owners renew tenants at lower rents or struggle to replace tenants who are vacating.

Multifamily Property Type

Asset Performance Outlook: Declining

Rising unemployment and slowed household formation continue to affect multifamily loans, which have the second highest rate of delinquency. According to Property Portfolio and Research (PPR), vacancy has risen to more than 8% nationwide and is expected to reach nearly 10% in 2010. Falling rents won't rebound until the supply overhang is absorbed. Demand has fallen to historically low levels in 2009. Significant additional units came online as struggling condo projects turned into rentals. Despite the delivery of almost 120,000 units in 2009 (more than the annual average over the past five years), the current lack of new construction financing should slow development in 2010 and help to restore balance to the markets over the medium term. This is good news for increasingly stable markets such as Washington, DC and Northern Virginia, New Jersey, and Stamford, as well as for stabilized properties in high-barrier markets such as New York, Boston, and Los Angeles. Markets that will continue to struggle are those hit hardest by the housing downturn, including areas like Miami, Phoenix, and Southern California.

Hotel Property Type

Asset Performance Outlook: Declining

The hotel sector has demonstrated the most volatility due to the daily resetting of rates and the discretionary nature of the operating business, with the luxury segment facing the greatest declines. Across the larger markets, revenue per available room (RevPAR) declined 17% over the past year. Fitch anticipates meaningful year-over-year RevPAR growth will not resume until late 2010 and currently estimates a full-year industrywide RevPAR decline of 3%–5% next year. Additionally, Fitch expects hotels to experience market value declines of up to 50% peak to trough, the largest declines in value of any property type. The trouble in the hotel sector has already materialized, as defaults have risen sharply. Fitch expects hotel delinquencies to continue to outpace those of other property types.

Office Property Type

Asset Performance Outlook: Declining

Though delinquencies remain low, the office sector will see stress in the coming months from high unemployment and longer-term leases coming up for renewal. Vacancies are near 17% nationwide and are expected to approach 20% in 2010. Though larger central business districts (CBDs) continue to outperform suburban markets, landlords are facing a swift decline in base rents, significant concessions, and vacant sublet space now that tenants have gained the upper hand. In 2010, Fitch expects continued struggles for markets that have been hit hardest by the recession. This includes Florida, the Southwest, Detroit, the New York/New Jersey metropolitan area, Orange County, and Los Angeles. Markets that should hold up better than average include Washington DC/Northern Virginia, Dallas/Fort Worth and Houston.

Retail Property Type

Asset Performance Outlook: Declining

The retail sector continues to struggle due to cautious consumer spending, increased vacancies, and limited store openings, which have pressured rents at retail properties. Owners are struggling with vacant big box spaces, as retailers across the country review their lease agreements for co-tenancy clause rent reductions or rights to terminate. According to PPR, vacancy has reached the 18% range but is not expected to go much beyond 20% at the peak in 2010. The retail environment in the upcoming holiday season will remain challenging, with consumers still drawn to discount, value-oriented, and needs-based retailers in community centers and luxury retailers continuing to show weakness. Completions will remain scarce over the next 18–24 months, helping to stabilize the supply/demand imbalance in the medium term. Markets reporting the highest levels of vacancy in the PPR retail forecast include New Orleans, San Antonio, Jacksonville, Memphis, and Orlando. The forecast vacancy for these markets is 24% or greater.

Industrial/Warehouse Property Type

Asset Performance Outlook: Declining

Declines in consumer spending have also greatly affected industrial and warehouse properties, with manufacturers and retailers cutting back production and inventories in the face of weakened demand for goods. According to PPR, new supply coupled with decreasing demand has pushed the nationwide vacancy rate to 12%; the figure could reach the mid-13% range next year. Warehouse and storage facilities in port cities such as Los Angeles, New York, and Seattle should continue to outperform the sector, while heavy manufacturing facilities will underperform.

Prospects for New Issuance

Several contributing factors could revive the U.S. CMBS new issuance market. One could be successful securitization through the TALF, which may help restart markets by stabilizing spreads to a level that is economically viable for both borrowers and lenders. Lenders will also need predictability in execution, from a bond pricing and regulatory perspective. Additionally, demand needs to return for subordinate bonds in the capital structure, and borrowers need to accept the new market paradigm. Borrowers must accept higher coupons, amortization, tighter loan structures, and more equity as well as lower leverage than that at the height of the market.

Several proposed regulations could serve as impediments to the return of CMBS new issuance. The Financial Accounting Standards Board's (FASB) two new accounting standards (SFAS 166 and SFAS 167) would eliminate special purpose entities for CMBS transactions, leaving the controlling classholder responsible for recording the securities' entire value. Additionally, various regulators have proposed initiatives that would have a similar impact, whereby issuers would be required to retain 5%–10% of the securities of a new issuance transaction.

U.S. Structured Credit

With declines in asset performance for every major U.S. CDO sector forecast for 2009 now fully materialized, Fitch expects this trend to continue in 2010. Throughout the course of 2009, Fitch adjusted its CDO ratings to reflect the relative increase in portfolio loss expectation for each asset category. CDO notes reviewed this year that retained high investment-grade ratings have sufficient cushion under Fitch's portfolio loss expectations. Conversely, tranches with mezzanine investment-grade or speculative grade ratings will generally be more susceptible to rating volatility in Fitch's loss expectations.

Corporate debt markets experienced elevated level of defaults and softness in U.S. high-yield corporate recoveries in 2009. While defaults and recoveries speak directly to losses on existing portfolios, the biggest issue facing the corporate debt markets, in the coming years, will be the availability of refinancing opportunities. High-yield (HY) bond issuance has supplied some new credit to the markets to take out existing leveraged loans in 2009. However, it is unlikely that this market will have the capacity to refinance the absolute volume of debt that is scheduled to mature in 2013 and 2014.

Traditional bank lending and institutional investors may make up some of this shortfall if capital availability improves. However, it is probable that a deficit will persist unless the new issue CDO market and structured credit investor returns. Limited capital availability in the longer term may pose a threat to corporate performance, as issuers struggle to refinance pending maturities. The stress on corporate issuers to refinance may play a meaningful role in the medium- to longer-term performance of HY loan CDOs and middle market (MM) CLOs.

The negative trend among regional banks and financial institutions is expected to continue through 2010. A significant percentage of the142 U.S. banks that have failed since July 2008 are within bank TruPS CDOs, contributing to the rising trend in defaults and deferrals within these CDOs. Additionally, some TruPS CDOs have been subject to offers to re-purchase or exchange assets from the structure at discounts to the par amount. While exchanges have had limited success to date, the existence of these offers from both issuers and third parties indicates an increasing trend of attempts to exploit ambiguities in the CDO structures. These attempts may produce losses to the structure that do not reflect Fitch's fundamental credit loss expectations and were not originally contemplated in Fitch's previous analysis.

Finally, mortgage-related CDOs remain under significant stress, with declining asset values being experienced in both residential and commercial real estate (CRE) sectors. While delinquency and defaults are currently more prevalent in the residential real estate markets, this trend is accelerating in the commercial real estate markets. Similarly, the scope and magnitude of CDO downgrades in 2009 have been more prevalent in the SF CDO sector, which has concentrated exposure to RMBS assets. Fitch expects performance of CRE CDOs to follow that of SF CDOs, given the lagging nature of the underlying CRE assets.

2010 U.S. Structured Credit Ratings Outlook

Market Sector/Asset Class	Broad Rating Category	Rating Outlook	Outlook Comments
HY and Middle-Market CLO	AAA to AA	Stable	• Credit deterioration remained in line with historic peak default periods, resulting in stable ratings for high investment-grade tranches. Fitch expects this trend to continue through 2010, but longer-term stability will depend on market response to the wall of corporate debt maturities in 2012 and beyond.
	A and Below	Negative	• These tranches remain vulnerable to losses stemming from elevated defaults, low recoveries, or both.
TruPS CDOs	AAA	Stable	• Eight 'AAA' tranches issued by bank TruPS CDOs remain with a Stable Rating Outlook as a result of their priority of payment and significant credit enhancement to protect against future losses.
	AA to B and Below	Negative	• These tranches remain susceptible to increasing default and deferral activity.
CRE CDOs			
Cusip CRE CDOs	AAA to B and Below	Negative	• Transactions backed by first-loss bonds from CMBS remain vulnerable to losses. • Transactions backed by mezzanine CMBS remain vulnerable to further downgrades on the underlying CMBS.
CREL CDOs	AAA to B and Below	Negative	• Deterioration of CRE credit fundamentals is expected through and beyond 2010. Delinquencies are expected to double from 2009.
SF CDOs	AAA to AA	Negative	• While these tranches are senior classes from earlier vintage transactions, which have substantially paid down, they remain sensitive to negative rating migration of the underlying collateral. • These tranches face the risk of failing to receive timely interest given out-of-the money interest rate hedges.
	A to BB	Negative	• Most of the classes of notes in these rating categories are from 2005 and earlier vintages. These tranches are sensitive to negative rating migration of underlying collateral and out-of-the-money interest rate hedges.
	B and Below	Negative	• While more than 80% of tranches outstanding are currently rated 'CCC' and lower, many are expected to be downgraded further to reflect the increase in default probability from possible to inevitable.

High Yield and Middle Market CDOs

Rating Outlook: Stable for 'AAA' to 'AA' Bonds, Negative on Bonds 'A' and Below

Asset Performance Outlook: Declining

According to Fitch's U.S. High Yield Default Index, the default rate reached 13.5% in mid-November 2009. Fitch expects that the default rate will end the year just short of the agency's 2009 forecast of 15%–18%. Fitch noted that the pace of U.S. HY corporate downgrades moderated in the second half of 2009. In addition, HY issuance, nearly absent in the first quarter of the year, rebounded in the second and third quarters. The level of defaults in 2010 and beyond depends on the state of the U.S. economy, the overall health of the capital markets, and the lending capacity of U.S. financial institutions. As the volume of maturities of HY and MM CLOs picks up pace after 2013, Fitch is concerned about the potential tail risk in these portfolios if sufficient credit is not available to refinance underlying loans.

Throughout 2009, Fitch highlighted the softness in U.S. HY recoveries, which have been well below levels recorded in recent years and reminiscent of the 2001–2002 default cycle. Structural issues associated with the leveraged loan issuance boom of 2005–2007 and the current recessionary environment have depressed firm valuations. This has resulted in loan recovery rates that are lower than those observed in the last economic downturn. As corporate balance sheets right-size, and the economic environment improves, Fitch expects that recoveries will trend towards longer-term historical averages, as observed after the 2001–2002 HY default cycle. However, it is important to note that while average loan recoveries may trend higher, recovery rates will likely remain widely dispersed depending on industry-, firm-, and instrument-specific fundamentals.

Fitch expects there may be limited rating volatility in the HY and MM CDO sectors over the medium-term. Approximately 30% of the active ratings on HY and MM CDOs are currently on Rating Outlook Negative, of which more than half are investment-grade ratings. Rating movement over the next one–two years will be more pronounced at the mezzanine and junior tranches, as losses are more meaningful at the bottom half of the capital structure. The degree of impact will be driven by the transaction's historical portfolio losses, additional compression in observed recoveries, which are already below historical average recovery rates, and ongoing credit migration.

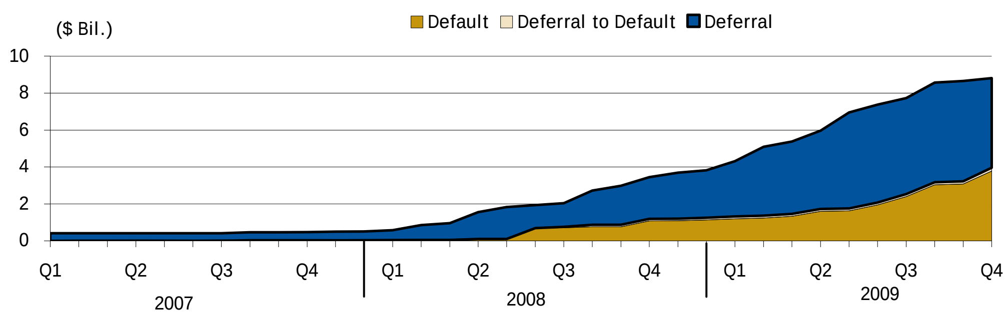
Trust Preferred CDOs

Rating Outlook: Stable for 'AAA' Bonds, Negative on Bonds 'AA' and Below

Asset Performance Outlook: Declining

At the early stages of this credit cycle, REIT TruPS experienced the most stress, with significant percentages of REIT and homebuilder defaults. In 2009, this trend shifted to banks' TruPS and is expected to continue through 2010. Approximately 19.4% of TruPS and other debt instruments issued into TruPS CDOs are currently defaulted or deferring interest payments. In aggregate this represents approximately $11.1 billion of the $53.8 billion currently outstanding. This aggregate default and deferral activity includes issuance from banks ($8.8 billion), insurance companies ($400 million), REITs, and homebuilders ($1.9 billion). The chart below shows the overall default and deferral activity of banks that financed through TruPS CDOs. With approximately $4.0 of $33 billion of bank TruPS in CDOs defaulted and another $4.8 billion deferring, Fitch anticipates at least $3 billion of additional bank TruPS defaults by year-end 2010.

Cumulative Default and Deferral Activity in Bank TruPs in CDOs



At this time, the junior-most tranches in many of the TruPS CDO structures are absorbing losses from defaults and deferrals. Fitch believes the spillover effect of future increased defaults could impact the credit strength of the senior notes. However, the large increase in relative credit enhancement resulting from underlying TruPS pre-payments and excess interest diversions paying down these notes could mitigate the underlying credit deterioration.

Many bank TruPS CDOs also face structural challenges that may lead to future negative rating actions. Interest-rate hedging strategies employed at the onset of the deals have moved into deep out-of-the-money positions, as three-month LIBOR has dropped to nearly 30 basis points (bps). As such, TruPS CDOs owe their respective hedge counterparties increasingly large swap payments each quarter. Coupled with the loss of interest income from growing defaulted and deferring TruPS, the out-of-the-money hedge positions have further decreased the amount of interest available to service the notes. As a result, several timely senior classes may default next year.

Commercial Real Estate CDOs

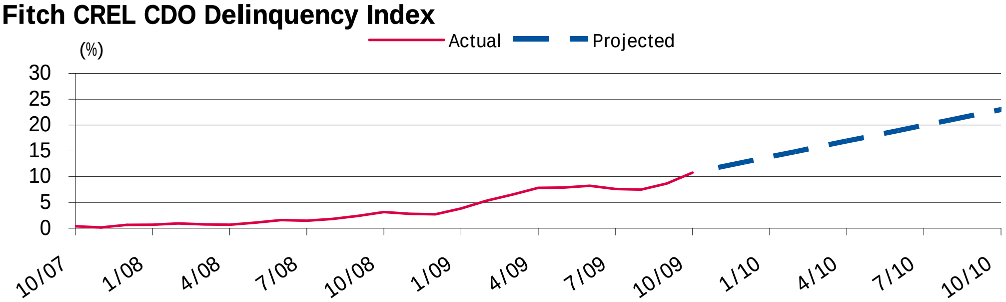
Rating Outlook: Negative

Asset Performance Outlook: Declining

CRE CDOs can be secured by CMBS securities (CRE CUSIP CDOs) or by unrated whole loans, subordinate B-notes, mezzanine debt, or bank loans (CREL CDOs). The CMBS sector currently has a Negative Outlook, and Fitch placed $10.8 billion from pre-2006 vintage fixed-rate CMBS transactions and $3.3 billion of the $30 billion of outstanding large-loan floating-rate CMBS on Rating Watch Negative. As such, Fitch anticipates further negative rating migration for CUSIP CRE CDOs into 2010 as the CMBS ratings are resolved. Fitch currently has 131 tranches from 23 CUSIP CRE CDOs on Rating Watch Negative due to exposure to the 2005–2008 CMBS vintages. Once the review process is completed, expected by the first quarter of 2010, Fitch expects to downgrade most senior bonds to below investment grade.

For CREL CDOs, continued capital market dislocations and weakening real estate fundamentals will result in further declines in loan performance. The CREL CDO Delinquency Index surpassed 10% for October 2009, which is more than triple the rate in October 2008. Fitch anticipates the year-end 2010 default rate will approach 25%. Fitch expects higher default rates and lower recoveries for CREL CDO loans as they mature into the trough of the current commercial real estate cycle. As a result, Fitch placed its entire rated CREL CDO universe on Rating Watch Negative. The review process is anticipated to be completed by the end of the first quarter of 2010. Upon resolution of the Rating Watch Negative status, few classes are expected to receive ratings higher than ‘BBB’, with most classes expected to be downgraded below investment-grade status.

Fitch CREL CDO Delinquency Index



The Fitch CREL CDO Loan Delinquency Index (LDI) includes loans that are 60 days or greater delinquent, performing matured balloons, and the current period's repurchased loans from Fitch-rated CREL CDOs. Fitch currently rates 35 CREL CDOs encompassing approximately 1,100 loans and 330 rated assets with a balance of $23.8 billion.

Structured Finance CDOs

Rating Outlook: Negative
Asset Performance Outlook: Declining

These portfolios are generally characterized as having high concentrations of RMBS assets from various vintages and credit qualities. Despite recent positive home price data, Fitch expects prices to fall another 10% as the government withdraws its temporary support of this market. As a result, Fitch expects continued increases in delinquency rates and defaults due to the negative equity positions of many homeowners from home price declines. However, Fitch expects the rating downgrade trend to stabilize, as these negative performance assumptions have been incorporated into Fitch's current rating actions.

As Fitch continues to review its SF CDOs with exposure to these recent downgrades, more downgrades of SF CDOs are expected in the first half of 2010. Affirmations for investment-grade-rated tranches are more likely for the most senior tranches that have benefited from significant deleveraging, resulting in par coverage commensurate with Fitch's investment-grade rating stresses. However, even transactions with senior classes that have enough principal coverage to maintain investment-grade ratings may face challenges in 2010 and beyond. Many of these transactions have an out-of-the money interest rate swap. Similar to the experience in TruPS CDOs, failing interest rate hedging strategies further exacerbate the reduction in the interest proceeds available to pay CDO notes. This in turn often leads to principal being used to pay interest to some classes of notes. In the situations in which the timely classes have to rely on principal proceeds to receive timely interest, their ability to remain timely hinges on how these performing assets amortize and how quickly the notional balance of the interest rate swaps step down.

Further, SF CDOs continue to trigger events of default (EODs). These may result from coverage-based triggers or senior classes' interest shortfall. If the controlling class in an EOD CDO chooses to accelerate maturity, depending on the transaction documents, such action may stop interest distributions to all but the controlling class until the latter is paid in full. This would constitute a default for all other timely classes, with Fitch's rating reflecting such default by a downgrade to 'D'.

Prospects for New Issuance

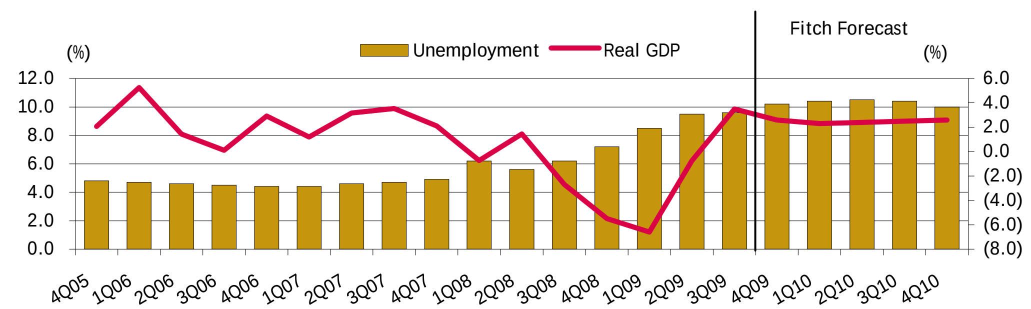
Prospects for new issuance are primarily in the HY and MM CLO market. Expectations are limited to balance sheet securitizations in the near term, as current market conditions make arbitrage opportunities less attractive. Any new issuance will likely employ significantly less leverage and price meaningfully wider than prior variations of the HY and MM CLO product. Until primary market conditions improve, Fitch expects the secondary market for HY and MM CLO exposure to remain fairly active.

U.S. Economic Trends & Outlook

While the recession that began in the fourth quarter of 2007 appears to be over, the U.S. economy is on a slow path towards recovery. The U.S. economy grew at an annual rate of 2.8% in the third quarter of 2009, after contracting at a revised 0.7% in the second quarter of 2009, according to (second estimates) from the Bureau of Economic Analysis (BEA). The rise in real GDP was the first since the second quarter of 2008. The gains can be largely attributed to renewed strength in consumer spending, which rose at a 2.9% annual rate, reflecting the Cash for Clunkers program.

Even as Fitch expects growth to extend upwards through the end of 2009, much of the rebound in activity can be attributed to the effects of short–term fiscal and monetary stimulus provided by the Federal Reserve, the U.S. Treasury, and other regulatory authorities. These measures have helped to stimulate the economy and promote stability in financial markets, boosting consumer spending and creating a turn in the inventory cycle and improved financial conditions. However, serious questions remain as to whether the private sector has picked up sufficient organic steam to keep the economy moving forward on its own as some of these measures are slowly removed in 2010. Unemployment continues to rise, and this will likely weigh on consumer spending for several quarters. In addition to concerns about employment, rising delinquencies and foreclosures as well as tighter credit conditions pose significant risks to already-stressed households.

Unemployment and Real GDP Growth Forecast



Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, Fitch estimates.

According to Fitch's most recent Global Economic Outlook (GEO) dated Oct. 1, 2009, the agency projects that growth will level off from its current rate in the fourth quarter of 2009 but will likely remain on a steady upward trajectory, averaging 2.0%–2.5% in 2010. Although the pace of job losses is slowing, unemployment continues to rise, hitting 10.2% in October, the highest level since 1983. Fitch expects that unemployment will continue to rise, peaking at 10.5% in mid-2010.

Consumer spending rose strongly in the third quarter of 2009 led by an increase in new car and truck sales, reflecting the federal Cash for Clunkers program. While it appears that spending has leveled off, income growth continues to trail behind. Without a significant improvement on the labor front to propel income, consumer spending will weaken in the first half of 2010, especially as the effects of the fiscal stimulus begin to wear off.

The U.S. manufacturing sector grew in the third quarter of 2009, as new orders from customers jumped to the highest level since late 2004. Although companies have started to rebuild depleted inventory levels, new orders and investments will remain lean in the first half of 2010 as firms strive to protect cash flows and respond to new revised lower consumer demand.

Core consumer prices, which fell sharply at the end of last year due to the economic crisis and a drop-off in oil prices, have remained relatively steady in 2009. The Consumer Price Index was down 0.2% on a year-over-year basis through October 2009. Current labor market conditions and consumer demand fundamentals suggest that price gains will likely remain muted. In 2010, Fitch expects prices to increase marginally by 0.8%. In fact, although monetary and fiscal stimulus raise long-term inflationary concerns as the Federal Reserve carefully crafts a policy to remove liquidity from the system, high unemployment and subpar growth threaten to push inflation lower.

Consumer borrowing continues to decelerate sharply as households curtail spending and increase savings. U.S. consumer credit declined at an annual rate of 3.3% in the third quarter of 2009, compared with a 9.7% decline in the previous quarter. Revolving credit decreased at an annual rate of 7.3%, and nonrevolving credit decreased at an annual rate of 0.9%.

Household net worth increased in the second quarter of 2009 as equity prices registered significant gains. The increase, the first since the peak reached in the third quarter of 2007, before the recession began, has helped offset the effect of stagnant or declining house prices. Although the stabilization in home prices and gains in financial markets should help blunt the negative effects on spending, it is unlikely that either will return to the levels experienced during the heady days prior to the crisis. They are thus unlikely to be a sustainable source to finance household spending.