



Specified Pay-ups in Pricing & Execution – Whole Loan®

Did you know that Fannie Mae's [Pricing & Execution – Whole Loan®](#) (PE – Whole Loan) allows lenders to receive a specified pay-up value for loans that typically would only be available to loans that were being delivered into a mortgage-backed security (MBS)? PE – Whole Loan allows lenders to enter into commitments of up to 60 days and offers this execution for both Mandatory and Best Efforts commitments.

By using the specified product grids in PE – Whole Loan and the available 60-day lock periods, you have a simple and cost effective way to hedge the value of your specified pool pay-ups without employing a multitude of hedge ratios and extensive analysis. Plus, with a Best Efforts commitment, you're also eliminating the exposure to fallout. Here's how it works:

The Basics

- ⦿ MBS pools typically receive specified pay-ups when the underlying loans have characteristics that make the borrower less likely to refinance as compared to other loans with similar note rates. For example, a loan with an initial loan balance of less than \$85,000 creates lower financial incentives for the borrower to refinance on a drop in interest rates as compared to a loan with an initial loan balance of \$300,000.
- ⦿ Given the projected stable behavior of these loans, investors are willing to pay a premium above generic To Be Announced (TBA) security prices for pools of loans of this type. The premium over a TBA security is referred to as the **specified pool pay-up**.

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Volatility of specified pool pay-ups

- ⦿ Specified pool pay-ups are volatile and change with market conditions. In general, as MBS prices are rallying, specified pool pay-ups tend to increase; inversely, as MBS prices are declining, specified pool pay-ups tend to decrease. Also, similar specified pool pay-ups generally increase into higher coupons as investors look for greater prepayment protection on premium coupons, and they generally decrease into lower coupons as they approach par. For example, an \$85,000 max (a specified pool in which all loans have an initial loan balance of \$85,000 or less) 4.0% pool will likely have a higher pay-up than an \$85,000 3.5% pool. Additionally, as long as the specified pool is eligible for delivery into a TBA trade, the pay-up will not become negative.
- ⦿ Technical factors such as supply, demand, TBA roll levels, and other conditions can all impact the value of specified pool pay-ups. For example, the 2016 U.S. presidential election, which led to a one and a half point drop in MBS pricing, also resulted in a collapse in specified pool pay-ups – see Table 1 below. Lenders that priced the value of the specified pool pay-ups into their rate sheets without hedging the additional pay-up exposure would have experienced significant losses.



FN 30yr 3.5's:	Pre- election	Post- election
TBA Price	104-29	103-12
85k pay-up	54	38
110k pay-up	43	27
150k pay-up	33	19
175k pay-up	24	11

Table 1: Loan balance pay-ups pre- and post- 2016 Presidential election; Pay-up in ticks

Hedging specified pay-ups

- ⊕ The value of specified pools can be very volatile. The imbedded prepayment protection of specified pools typically means that they have longer duration (the change in the value for a given rate change is greater) and are less negatively convex (the rate of change of the duration) than a similar coupon TBA. As a result, hedging specified pools by simply matching notional exposure with the same coupon TBA forward sale does not protect the value of the specified pool pay-up. Historically, the most effective hedge for specified pool pay-ups is a forward sale.
- ⊕ Table 2 below illustrates the impact of the price moves from Table 1 on a \$5MM pipeline of specified loans and the potential value lost if only the TBA value was hedged.

FN 30yr 3.5's:	TBA	104.90625	103.375
Story	UPB	Pre-election value	Post-election value
85K	800,000	852,750	836,500
110K	1,100,000	1,168,750	1,146,406
150K	1,500,000	1,589,063	1,559,531
175K	1,600,000	1,690,500	1,659,500
Total	5,000,000	5,301,063	5,201,938
TBA Hedge	(5,000,000)	(5,245,313)	(5,168,750)
		Spec value lost (\$)	-22,563
		Spec value lost (bps)	(45.13)

Table 2: Spec value change on \$5MM illustrative specified loan pipeline

As described, hedging specified pay-up risk with TBAs using a hedge ratio can be quite challenging. If you're looking for a simpler way to hedge your specified loans, consider using PE – Whole Loan. Questions? Contact the Capital Markets Pricing and Sales Desk, 1-800-752-0257. [Visit the PE – Whole Loan page](#) to view job aids and training courses and to launch the PE – Whole.