Asset Securitization report

The Premier Guide to Asset and Mortgage-Backed Securitization

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PUBLISHED BY THOMSON MEDIA | VOL. 3 / NUMBER 26 | JUNE 30, 2003

Coming off hot IPO, Accredited plans not to conform to typical home equity ABS issue standard

Now that IPO market darling **Accredited Home Lenders** has gone public with one of the most successful initial equity offerings in recent memory, don't expect the non-prime mortgage lender to flood the securitization markets with its collateral, as its peer group has done. In an exclusive interview, co-founder **Ray McKewon** sat down with *ASR* and explained that Accredited plans to stick to its plan of diversified origination, funding and disposition sources.

What's more is that, according to McKewon, while most expect the growth of the mortgage sector — fueled by the current refinance tsunami — to rapidly cease once interest rates rise, Accredited will be at a competitive advantage due to its strategy of loan quality over quantity. "Unlike most mortgage lenders, we don't make loans for the sake of selling the loan and booking a gain," he said. "We don't make a loan unless there is a borrower benefit and we pay our brokers a premium to find these loans, rather than just buy anything originated."

Roadshows typically abound with selling the right "story." But suffice to say, there hasn't been a page-turner like Accredited in quite some time. Formed in 1990, Accredited had been venture-backed from 1995 through its February IPO, and has caught the wave that has made mortgage lenders the hottest sector of the equity markets. Since going public at $8 a share, Accredited's stock (NASDAQ: LEND), has more than tripled to a peak of over $26. Rather than throw all of its eggs into one basket, Accredited plans to maintain a steady balance between its liquidity sources, because, "eventually all markets, no matter how hot they are, return to normal," added McKewon.

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The collateral composition for Accredited has consistently expanded and improved, a conscious move made well before the majority of the mortgage-lending world decided to expand geographically and migrate upward in FICO. The average FICO for an Accredited-originated loan is 630, with an average loan-to-value ratio of 87.60%. While one-third of its loans are originated in California, the Midwest makes up 23.5%; the Northeast, 16.25%; and the Southeast, 14.25%.

But the story doesn't start with a stunning IPO. Going back to 1990, Accredited began in San Diego, Calif. with co-founders McKewon and **Jim Konrath**, who had previously been the CEO of **Security Pacific Financial Services.** McKewon, with a venture capital background, helped secure financing for a new non-prime mortgage bank that originated retail and wholesale loans.

With the capital markets not looking favorably upon equity IPOs over the past two years, Accredited had to shelve its planned stock sale numerous times. As its 10-year VC investment agreement neared its maturity, and with its investors seeking a return on investment, Accredited went ahead with its offering, despite the negative sentiment and a reduced asking price. "Accredited," McKewon said, "was envisioned as a public company from the beginning."

Accredited co-founders Konrath (L), with mortgage background, and McKewon, with venture capital background.

In 1994, Accredited obtained its first warehouse line and received its first capital infusion, a $2.42 million early-stage financing round from **Crosspoint Venture Partners**. The following year **Enterprise Partners**, another venture firm, pumped $1.8 million in start-up financing as well. In 1996, Accredited completed its first securitization, a $92 million transaction via **Lehman Brothers**.

While Accredited has successfully brought five securitizations backed by its mortgage originations, all through Lehman, it finds better execution in the whole loan market. "In 1996, 1997, we were set upon establishing a quarterly ABS program," McKewon recalled. "But Aames [Financial] offered us $108.25 for a portfolio, which they would immediately turn around and book

$112.0. We have utilized whole loan sales ever since."

Currently, Accredited's whole loan sales program totals roughly $3 billion of its $4.3 billion of originations last year sold to larger institutions. Accredited's strategy, however, isn't to sell to the highest bidder or into the hottest market, but to keep in line with the mix that got Accredited where it is today.

Accredited sells its loans to a diverse group of finance companies, making sure to equally distribute its collateral to the street. In addition to investment banks **Morgan Stanley**, **Credit Suisse First Boston** and **Lehman Brothers**, Accredited sells to large mortgage lenders, such as **Countrywide Home Loans**, and **GMAC-RFC**. Additionally, the company's collateral appears in securitizations offered by **Saxon Capital Inc**., **C-BASS** and **Household Finance**.

Throughout the years, the company has maintained six warehouse loan facilities totaling more than $1.4 billion, most recently closing a $200 million facility with **Goldman Sachs**. By the 3Q01, Accredited hopes to add an additional $600 million in warehousing capacity.

"We are a bit of a hybrid," said McKewon. "We can sell some of our originations in the whole loan market, securitize some or even hold on to some." Accredited does not "cherry pick" the loans it retains on its books or sells into the market. "If you sell lower quality product into the capital markets, eventually they will turn their back on you," he added.

Considering the record low interest rate environment, Accredited's senior management has been doing a lot of "story telling" recently, to outline the way in which this sub-prime lender will fare once rates begin to rise. "We're sub-prime, non-prime lenders. When interest rates go up the universe of prospective borrowers actually expands," McKewon said. In a higher interest rate environment, borrowers, in general, face increasingly restricted access and Accredited stands to pick up on the new pool of customers created.

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Accredited targets borrowers who legitimately need the loan, rather than those looking to take advantage of low mortgage rates. McKewon envisions Accredited making loans that have a public good. More than half — 54% of the company's business — are debt consolidation loans, helping to retire high interest credit card obligations and reducing household finance payments.

Accredited also originates direct-to-consumer loans and conducts business as **Axiom Financial Services** and **Home Funds Direct**.

Accredited's stock has seen a bull run of its own. That $77.2 million IPO had a rough start, however, closing 9.4% lower its first day of trading. Accredited had initially hoped to be a part of the class of 2002, not 2003, McKewon noted. Against the backdrop of a fickle Nasdaq, conflict abroad and with one analyst initially forecasting low earnings, McKewon admits the IPO roadshow produced a mixed picture.

Yet after 14 years McKewon said the company, and its venture backers, couldn't wait any longer and thus plunged into the market February 14. **Friedman Billings Ramsey Group,** along with an additional 10 firms, ran the books on the IPO. Now Accredited has increased its earnings expectations, reporting on June 9 that for the second quarter of 2003 the company anticipates $1.20 to $1.25 EPS, revised from an initial $0.80 to $0.90. For the full year, Accredited is forecasting $3.50 to $3.75 EPS. The company sited its origination volume increased and net interest margins remained high. — CMO/KD

INCREASED DIVERSITY FOR ACCREDITED WHOLE LOAN SALES

Top Ten Whole Loan Sales in 2001

Investor	Loans (in mln)	% of loans sold
Household	$510.0	26.3%
CSFB	$446.0	23.0%
GMAC/RFC	$321.0	16.0%
Countrywide	$178.0	9.2%
Equicredit	$134.0	6.9%
Equity One	$104.0	5.3%
Saxon	$94.0	4.9%
Key Bank	$39.0	2.0%
Citi/Assoc.	$31.0	1.6%
Lehman	$27.0	1.4%

Top Ten Whole Loan Sales in 2002

Investor	Loans (in mln)	% of loans sold
Household	$766.0	19.8%
Morgan Stanley	$625.0	16.2%
CSFB	$557.0	14.4%
Countrywide	$300.0	7.8%
Lehman	238	6.1%
C-Bass	$219.0	5.7%
Banco Popular	$87.0	2.3%
Saxon	$81.0	2.1%
GMAC/RFC	$77.0	2.0%
Citifinancial	$14.0	0.3%

Financing treatment securitizations: FY02: $749 million Q2 03: $303 million

Source: Accredited Home Lenders Inc.