

Accounting for securitizations treated as a financing (on-balance sheet) verses securitizations treated as a sale (off-balance sheet)

The hypothetical example below is provided for informational purposes only to assist the reader in understanding the accounting treatment of securitizations structured as financings and sales and are not a projection of our future performance, financial position or cash flows. The hypotheticals are based upon (i) assumptions that, while presented with numerical specificity, are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control, (ii) assumptions with respect to future business decisions that are subject to change, and (iii) assumptions that, while not probable, were made for the purpose of simplifying the hypotheticals. The purpose of these hypotheticals is to provide a simplified illustration of the accounting treatment of securitizations structured as financings and as sales. They are not intended to represent historical or expected securitizations or the impact of such securitizations on our historical or future performance, financial position or cash flows, which will necessarily vary from those presented in the hypotheticals and such variations are likely to be material. No representation is being made that the results of the hypotheticals will be achieved.

The accounting treatment of intercompany sales and securitizations can be complex. In the following exercise, we hope to provide some clarity on the subject. At the conclusion of this exercise, a couple of very important points should be clear. Net cash flow and net income always equal. However, timing differences arise due to GAAP accounting standards. Also, income will be split between the TRS and REIT differently, depending on the structure of securitization (sale or financing) used for accounting purposes.

The following assumptions are used to drive this exercise:

- Mortgage originations of \$1 billion per month
- Cost of Production (COP) of 2%
- COP is split evenly between costs expensed in the period of origination and deferred costs (mortgage loan premium)
- Coupon of 8.00% and lender's borrowing cost of 5.00% throughout this example
- All costs and fees outside of the mortgage origination process are assumed to be zero
- All interest rate hedging is done with swaps and the yield curve is flat
- Mortgage loans are financed at par prior to securitization
- No taxes or transactions costs
- All mortgage production is securitized
- Loans are assumed to be originated evenly throughout the month
- All REIT tests are ignored

In figure 1, we present a hypothetical TRS balance sheet and income statement for a two-month period (origination phase) leading up to sale of the originated mortgage collateral.

Figure 1			
Taxable REIT Subsidiary (TRS)			
Balance Sheet (\$ in 000's)	12/31/XX	1/30/XX	2/28/XX
Cash	100,000	81,250	65,000
Mortgage loans held for sale	-	1,000,000	2,000,000
Mortgage loan premium	-	10,000	20,000
Total Assets	100,000	1,091,250	2,085,000
Mortgage debt	-	1,000,000	2,000,000
Equity	100,000	91,250	85,000
Total Liabilities & Equity	100,000	1,091,250	2,085,000
Taxable REIT Subsidiary (TRS)			
Income Statement (\$ in 000's)	12/31/XX	1/30/XX	2/28/XX
Net interest income	-	1,250	3,750
Gain on sale of loans	-	-	-
Gains on derivative instruments	-	-	-
General & admin. expenses	-	10,000	10,000
Net Income	-	(8,750)	(6,250)

At 12/31/XX the TRS has \$100 million in cash, which equals total assets and equity. In each of the following two months, \$1 billion in loans are originated, at a cost of \$20 million (2% COP divided evenly between G&A and deferred origination costs) per month. Total interest income of \$5 million is equal to the 300 basis point spread between the coupon and financing costs on the average loan balance during the period.

FAS91 requires a deferral of origination costs and fees that are directly attributable to originating a mortgage. These deferred costs are capitalized (become part of the mortgage asset) and are referred to as the mortgage loan premium in this example. Although capitalized costs represent a cash outflow, these costs are not expensed immediately due to the matching principle used in GAAP.

During this two month period, \$35 million in cash was used (\$5 million net interest income less \$40 million in COP). The \$20 million difference between the change in cash and net income is equal to capitalized costs.

At this time, all costs and income associated with originating \$2 billion of mortgage loans have been accounted for. It is now time to permanently finance these assets by way of securitization.

Securitization

During the origination process, mortgage loans are financed on short-term credit lines (warehouse lines). The asset-backed securitization (ABS) market is the vehicle used to obtain long term financing. Although structures can be complex, bonds collateralized by the mortgage loans are issued to provide matched funding.

Securitizations can be treated as a financing or a sale for accounting purposes. When a securitization is treated as a financing for accounting purposes, the loans and associated debt remain on the balance sheet (on-balance sheet financing). Alternatively, when the securitization is treated as a sale for accounting purposes (off-balance sheet financing), the only asset remaining on the balance sheet is the security retained, sometimes referred to as the residual interest.

Securitization treated as a financing for accounting purposes

When using this structure, a pool of loans is sold by the TRS to the REIT prior to securitization. The sale of assets to the REIT is no different than an arms length sale to any unrelated party. Therefore, the gain recognized by the TRS, is the same as if the sale of loans was to an outside entity. We will work through an example in figure 2.

	% of Par		Mortgage Collateral Sold		Fair Value (\$000's)
Net whole-loan price (A)	102.25	X	2,000,000	=	2,045,000
Collateral - par value (B)	100.00	X	2,000,000	=	2,000,000
Unamortized deferred acquisition costs (C)	1.00	X	2,000,000	=	20,000
Carrying value (B+C=D)	101.00	X	2,000,000	=	2,020,000
Gain on sale of assets (A-D)	1.25	X	2,000,000	=	25,000

Since the TRS is selling loans to a related party (the REIT), pricing must reflect the current market for similar assets. In other words, the pricing must reflect that which would be received in an arms length transaction. In this case, the cash execution in the market at the time of sale is 102.25% of par (net of reserves), or \$2.045 billion.

The cost, or capitalized cost, of the loans sold is par value plus deferred acquisition costs. As described in figure 1, \$20 million of origination costs (net of any deferred origination fees) were directly attributable to originating a loan and were therefore capitalized. These costs, when added to the par value of the loans originated (\$2 billion), become the capitalized cost of the loans sold. In this case, the capitalized cost is \$2.02 billion, or 101.00% of par.

When capitalized costs are subtracted from the sale price, the TRS has a gain of 1.25% of par, or \$25 million.

The impact of this transaction to the TRS's stand-alone balance sheet and income statement are provided in figure 3.

Figure 3					
Taxable REIT Subsidiary (TRS)					
Balance Sheet (\$ in 000's)					
	12/31/XX	1/30/XX	2/28/XX	3/1/XX	
Cash	100,000	81,250	65,000	110,000	
Mortgage loans held for sale	-	1,000,000	2,000,000	-	
Mortgage loan premium	-	10,000	20,000	-	
Total Assets	100,000	1,091,250	2,085,000	110,000	
Mortgage debt	-	1,000,000	2,000,000	-	
Equity	100,000	91,250	85,000	110,000	
Total Liabilities & Equity	100,000	1,091,250	2,085,000	110,000	
Taxable REIT Subsidiary (TRS)					
Income Statement (\$ in 000's)					
	12/31/XX	1/30/XX	2/28/XX	3/1/XX	Total
Net interest income	-	1,250	3,750	-	5,000
Gain on sale of loans	-	-	-	25,000	25,000
Less: General & admin. expenses	-	10,000	10,000	-	20,000
Net income	-	(8,750)	(6,250)	25,000	10,000

The financials through 2/28/XX should be familiar, given that we arrived at them in figure 1. The financial data in column 3/1/XX reflect the effect of selling mortgage loans to the REIT. As we concluded in figure 2, the TRS received \$2.045 billion in proceeds from the sale of \$2 billion in loans. \$2 billion was used to re-pay short-term financing received during the origination process, leaving \$45 million in net cash proceeds. This brings the cash balance on 3/1/XX to \$110 million.

Again, as we found in figure 2, the gain-on-sale recorded from the transaction was \$25 million, as reflected in the TRS's income statement. Remember, that this gain is net of the \$20 million in capitalized cost, or mortgage loan premium, found on the 2/28/XX balance sheet. Since these loans have now been sold, they are eliminated from the 3/1/XX balance sheet.

At this point, we are essentially finished with the TRS on a stand-alone basis. Next, we will examine the REIT's stand-alone balance sheet, as a result of the simultaneous purchase and securitization of \$2 billion in mortgage loans. Then, we will walk through the REIT's income statement as the securitization winds down over time.

Like the TRS, figure 4 shows a beginning cash balance on the REIT’s balance sheet of \$100 million. On 3/1/XX, the REIT purchases \$2 billion in par value of loans from the TRS for a price of \$2.045 billion. In addition, the REIT simultaneously securitizes the loans and receives \$1.98 billion in proceeds from third-party bond investors. Notice, that the REIT received \$1.98 billion in financing on \$2 billion of mortgage collateral, leaving excess collateral, or over-collateralization (OC), of \$20 million. Therefore, cash is reduced by \$65 million, or the REIT’s equity investment in the transaction.

Figure 4

REIT Parent Balance Sheet (\$ in 000's)	2/28/XX	3/1/XX
Cash	100,000	35,000
Mortgage loans held in portfolio	-	2,000,000
Mortgage loan premium	-	45,000
Total Assets	100,000	2,080,000
Asset-backed bonds	-	1,980,000
Total Liabilities	-	1,980,000
Equity	100,000	100,000
Total Liabilities & Equity	100,000	2,080,000

In figure 5, we walk through the REIT’s balance sheet and income statement as the above transaction winds down. We start at 3/1/XX, where we left off in figure 4. Notice that a new line item has been added to the balance sheet - loan loss reserve. When a securitization is treated as a financing for accounting purposes, a reserve must be set up based on an estimate of losses inherent and probable. In this example, we have reserved for losses expected (and realized) in the next 12-months. This initial reserve also flows through the income statement as a provision for credit losses. For this exercise, we have assumed all loss provisions are realized in the following period (following 12-months). Although there is no effect on cash, the effect of provisioning for losses at the time of securitization causes the REIT to realize a \$10 million loss on 3/1/XX.

Let’s walk through the year 1 balance sheet and income statement:

Cash is equal to \$35 million on 3/1/XX. Changes in cash from period to period are a function of the excess cash-flow received, or net cash flow (after losses). This amount can be found at the bottom of figure 5 and is equal to net income plus non-cash charges (loan loss provision and premium amortization expense) less realized losses (loan loss provision in previous period). As we see with some quick arithmetic, cash flow is \$5 million higher in year 2 through years 5, than we might expect given the computation procedure above. This is because \$5 million of losses in year 2 through year 5 is covered by OC. Although there was excess cash flow in every period presented in our example, this was not true for every month of the year. In other words, there was not enough excess cash flow to repay the debt that supported the defaulted collateral in

every month in which losses were realized. When this happens, OC (which is part of the residual security owned by the REIT) is reduced by the amount of shortfall.

Figure 5

REIT Balance Sheet (\$ in 000's)	3/1/XX	Year 1	Year 2	Year 3	Year 4	Year 5	
Cash	35,000	78,000	100,750	112,563	116,900	121,775	
Mortgage loans held in portfolio	2,000,000	1,600,000	1,190,000	785,000	380,000	-	
Mortgage loan premium	45,000	36,000	26,775	17,663	8,550	-	
Loan loss reserve	(10,000)	(25,000)	(22,000)	(15,600)	(5,000)	-	
Total Assets	2,070,000	1,689,000	1,295,525	899,625	500,450	121,775	
Asset-backed bonds	1,980,000	1,580,000	1,175,000	775,000	375,000	-	
Equity	90,000	109,000	120,525	124,625	125,450	121,775	
Total Liabilities & Equity	2,070,000	1,689,000	1,295,525	899,625	500,450	121,775	
REIT Income Statement (\$ in 000's)	3/1/XX	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Interest income	-	144,000	111,600	79,000	46,600	15,200	396,400
Premium amortization expense	-	9,000	9,225	9,113	9,113	8,550	45,000
Interest expense	-	89,000	68,875	48,750	28,750	9,375	244,750
Net interest income	-	46,000	33,500	21,138	8,738	(2,725)	106,650
							-
Provision for credit losses	10,000	25,000	22,000	15,600	5,000	-	77,600
Fee Income	-	7,000	7,000	3,500	-	-	17,500
Servicing Expense	-	9,000	6,975	4,938	2,913	950	24,775
Net Income	(10,000)	19,000	11,525	4,100	825	(3,675)	21,775
Gross cash flow (before losses)	(65,000)	53,000	42,750	28,813	14,938	4,875	79,375
Net cash flow (after losses)	(65,000)	43,000	22,750	11,813	4,338	4,875	21,775
Realized Losses		10,000	25,000	22,000	15,600	5,000	77,600
OC Coverage			5,000	5,000	5,000	5,000	20,000

Mortgage loans held in portfolio falls \$400 million by the end of year 1. This decline is caused by prepayments and losses. In this example, \$390 million of the pay down is due to prepayments while \$10 million is due to loan losses. In future years, the amount of loss included in the change of balance can be determined by the previous year provision for loan losses, found in the income statement. Remember, we are assuming we have perfect knowledge of future losses, and correctly reserve for 12-month forward loan losses.

The **mortgage loan premium** is simply the excess over par value paid by the REIT for the mortgage assets. As discussed in figure 4, the REIT paid \$2.045 million for \$2 billion in mortgage assets. The difference, or \$45 million, is booked as an asset on the REIT's balance

sheet and amortized through the life of the transaction. The amortization expense can be found in the income statement.

The **loan loss reserve** is a contra-asset against mortgage loans held in portfolio. It is equal to the ending loan loss reserve in the prior period, plus the current period loan loss provision less current period realized loan losses. As previously discussed, the loan loss reserve is equal to next period realized losses.

Asset-backed bonds represent outstanding debt issued against the mortgage collateral securitized. This debt is repaid as a result of scheduled principal repayment, principal pre-payments and realized losses (to the extent excess cash flow is sufficient). Note that starting in year 2, the difference between mortgage loans held in portfolio and asset-backed bonds begins to narrow. This represents the utilization of OC. Year 2 is the first period in which OC is used to cover losses.

Interest income is the assumed coupon (8.00%) multiplied by the average loan balance outstanding.

The **premium amortization expense** was touched on above. In this example, the premium is amortized at approximately the same rate as principal payments

To calculate **interest expense**, we have multiplied the average balance of loans outstanding by the financing cost, or 5.00%

The **provision for loan losses** was covered above. Again, we are assuming our 1-year forward provision is realized.

Fee income is realized from pre-payment penalties.

Servicing expense equates to 0.50% of the average balance of mortgage loans held in portfolio.

Given the explanation above, it is easy enough to find the values for the remainder of the example. Note, at the conclusion, \$21.775 million in income and additional cash (which is net of the \$65 million initial investment) was recognized in the REIT. This computes to a return on investment of 17.3%. In addition, \$10 million in income/cash gain was recognized in the TRS. On a separate company basis (including both the REIT and TRS), \$31.775 million in cash and income was earned. We have now concluded our example of an origination/securitization cycle when the transaction is treated as a financing for financial reporting purposes. Please keep in mind that this example was presented on a separate company basis. Consolidating the entities throws a wrinkle into the financial reporting. However, the consolidated income and cash flows remain unchanged. We will touch on this subject again after we run through our next example – an identical transaction using sale accounting treatment.

Securitization treated as a sale for accounting purposes

On 3/1/XX \$2 billion in mortgage loans are securitized. Using a sale structure, a substantial majority of the economic interest is sold to third-party bond investors while a residual interest is sold to the REIT. Keep in mind that the value of assets sold is the same, only the number of

counterparties has changed. The TRS records a gain-on-sale, identical to the gain computed in figure 2. On a stand-alone basis, the balance sheet and income statement of the TRS is the same as that in figure 3.

As mentioned previously, the majority of the economic value of the \$2 billion in loans was sold to third-party bond investors. However, the residual asset (excess spread, first-loss piece and prepayment penalties), was sold to the REIT. For this example, the computation used to find the value of the residual asset is simple and intuitive. In figure 2, we assumed that a similar pool of loans were valued at 102.25% of par, or \$2.045 billion, in the secondary market. Also, we have assumed that this transaction was over-collateralized by 1.00% of par, or \$20 million. Alternatively, the TRS sold 99.00% of par, or \$1.98 billion, of the economic value to third-party investors while the remainder of the value was sold to the REIT. The difference, or \$65 million, is the value of the residual asset sold to the REIT.

	% of Par
Net whole-loan price	102.25
Less proceeds of securities sold	<u>(99.00)</u>
Residual Value	3.25

As in our example, detailed in figure 6, the REIT has beginning cash, assets and equity of \$100 million. On 3/1/XX, the residual security is purchased from the TRS for \$65 million. Cash declines by \$65 million while assets and equity remain unchanged.

Figure 6		
REIT Parent		
Balance Sheet (\$ in 000's)	2/28/XX	3/1/XX
Cash	100,000	35,000
Mortgage securities	-	65,000
Total Assets	100,000	100,000
Total Liabilities	-	-
Equity	100,000	100,000
Total Liabilities & Equity	100,000	100,000

At this point, the REIT has \$65 million, or 3.25% of par, invested in a \$2 billion pool of mortgage loans. Now that the TRS has completed its part in this origination/securitization cycle, let's take a look at the financial statement impact in the REIT as the transaction winds down.

First, we will take a look at how income is recognized when using this structure. In figure 7, we have all the information necessary to describe the method used to compute the value presented on the REIT's balance sheet and the income that flows through the income statement. On 3/1/XX, the time of securitization, the REIT has a \$65 million residual asset on its balance sheet. Again, this value reflects the price paid to the TRS for the asset. If we look back to figure 5, we

see that the REIT had an identical investment, or outflow of cash, when the transaction was structured as a financing for accounting purposes. We can also see that the cash flow stream throughout the life of the transaction is the same, only the timing of income has changed.

Figure 7

REIT Securitization (\$ in 000's)	3/1/XX	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Market value	65,000	33,243	16,244	7,241	4,156	-	
Book value	65,000	33,243	16,244	7,241	4,156	-	
Cashflow	(65,000)	43,000	22,750	11,813	4,338	4,875	21,775
Accrual rate		17.3%	17.3%	17.3%	17.3%	17.3%	
Net Income	-	11,243	5,750	2,810	1,253	719	21,775

When a securitization is structured as a sale for accounting purposes, income is accrued over the life of the transaction. The rate at which income is recognized, or accrual rate, is found by finding the yield given a set of cash flows and a beginning basis, or book value. In this example, our beginning basis is \$65 million and future cash flows are projected given our assumptions such as the implied forward yield curve, prepayment rates, delinquencies and losses. The initial yield and discount rate for this transaction is 17.3%. Remember, for this exercise we have assumed perfect knowledge of the future. Therefore, the yield (accrual rate) found at the time of securitization remains constant. However, these assumptions typically change as the transaction seasons and the accrual rate is adjusted to reflect them.

As we just discussed, the initial income accrual rate was found to be 17.3% given our beginning basis and expected cash flows. We compute year 1 income by multiplying our beginning basis (\$65 million) by our accrual rate (17.3%). This calculation yields \$11.243 million and can be found in the income line item above. To find the year 1 ending basis, we add the income accrued (\$11.243 million) to the beginning basis (\$65 million) and subtract the cash received (\$43 million). This calculation yields \$33.243 million, which is our year 1 ending basis. This process continues as the transaction winds down over time. Notice that the market value and book value are equal in all periods. Why? Because our initial accrual rate and discount rate are set at the same rate, and our initial cash flow expectations turned out to be reality. In other words, because our expectations turned out to be reality, we accrued the proper amount of income in every period. Note that calculations in figure 7 are off slightly due to rounding.

The effect on the REIT's balance sheet and income statement can be found below, in figure 8.

Figure 8

REIT Parent Balance Sheet (\$ in 000's)	3/1/XX	Year 1	Year 2	Year 3	Year 4	Year 5	
Cash	35,000	78,000	100,750	112,563	116,900	121,775	
Mortgage securities held for sale	65,000	33,725	21,021	8,853	4,241	-	
Total Assets	100,000	111,725	121,771	121,416	121,141	121,775	
Total Liabilities	-	-	-	-	-	-	
Equity	100,000	111,725	121,771	121,416	121,141	121,775	
Total Liabilities & Equity	100,000	111,725	121,771	121,416	121,141	121,775	
REIT Parent Income Statement (\$ in 000's)	3/1/XX	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Interest income	-	11,243	5,750	2,810	1,253	719	21,775
Residual Cash Flow	(65,000)	43,000	22,750	11,813	4,338	4,875	21,775

Note that residual cash flow is the same cash flow that was computed in figure 5, or \$21.775 million. This is true because the cash flows are equal regardless of the accounting treatment. The residual cash flows are simply the net effect of the activity we saw when the securitization was treated as a financing for accounting purposes

Again, we can look back to figure 5 and see that the REIT's initial investment, future cash flows and income recognized are identical under both the financing and sale structure. We have also looked at the gain-on-sale calculation for the TRS and concluded that the gain is equal for both accounting treatments. This will always be true when looked at on a separate company basis. Remember, the underlying economics are the same using both structures, confusion surrounds the accounting around elimination activity when the separate entities are consolidated for financial reporting purposes. Hopefully, we can provide some clarity by walking through the example below.

Understanding intercompany eliminations

FASB 140 requires gains and losses that occur because of intercompany transactions be eliminated for financial reporting purposes. This makes sense! On a consolidated basis, no cash changes hands when intercompany transactions occur.

On a separate company basis, the TRS reported a gain-on-sale of \$25 million under both the financing structure and sale structure. When the financing structure was used, the loans were sold to the REIT and securitized. Therefore, the entire \$25 million gain-on-sale booked by the TRS was related to an intercompany sale. When the sale structure was utilized, the TRS

securitized the mortgage assets and sold 99% of the value to third-party bond investors and 3.25% of the value to the REIT. In this case, only a small proportion of the \$25 million gain-on-sale was due to an intercompany transaction.

The gain-on-sale booked by the TRS is entirely eliminated upon consolidation when the securitization is treated as a financing for GAAP. In addition, the loan premium booked on the REIT's balance sheet is reduced by the amount of the elimination. Although both the premium eliminated and the gain-on-sale eliminated is added back to the separate company financials over the securitization's life, they are offsetting and have no impact to the consolidated financial statements.

When the securitization is treated as a sale for GAAP, the elimination is roughly equal to the percentage of pool value sold to the REIT. Referring to our example, approximately 3.25% of the gain-on-sale in the TRS would be eliminated and the initial book value of the residual asset would be reduced by the same amount. Again, the elimination activity is recovered over the life of the transaction in a manner similar to that described above. Given that this elimination activity is not meaningful for explanatory purposes, we have ignored it in the following consolidation example for sale accounting treatment.

In figure 9 (financing accounting treatment) and figure 10 (sale accounting treatment), we have summarized this exercise by presenting the consolidated balance sheet and consolidated income statement for both accounting treatments, given our work up to this point. We should be able to compare these results with prior financials, presented on a separate company basis, and bring some clarity surrounding the economics of our business model, and the accounting treatment specified by GAAP.

In figure 9, the consolidated balance sheet reflects the REIT's balance sheet in figure 5, except for the following items:

- **Cash:** We started this example with \$200 million in cash, on a consolidated basis. Both the TRS and REIT had \$100 million in cash at 12/31/XX. The COP was 2% in this example. Thus, it cost \$40 million to originate \$2 billion in mortgage loans. The TRS also made \$5 million in net interest income. Finally, OC was equal to 1%, or \$20 million. After securitizing the loans, our cash balance is \$145 million. Consolidated cash in future periods reflects net cash receipts from the securitization.
- **Mortgage loan premium:** \$25 million of premium was eliminated due to the intercompany gain-on-sale elimination at the TRS. Although the beginning loan premium is \$25 million lower than in figure 5, notice that premium amortization expense is equal. We will touch on this subject again, shortly.

In figure 9, the consolidated income statement reflects the REIT's income statement in figure 5, except for the following items:

- **Interest income:** This line item is higher due to interest income earned at the TRS during the origination phase (figure 3) and the reversal of the gain-on-sale elimination taken at the TRS when loans were sold to the REIT. This reversal is completely offset by higher amortization expense, which serves to reverse the loan premium elimination. Notice that the premium amortization expense did not change from that expensed in figure 5. This is despite the \$25 million reduction of mortgage loan premium on the balance sheet. These steps are taken to restore the financial statements of the REIT and

TRS, on a separate company basis, to what they would have been if no elimination activity had taken place. Again, these reversals completely offset each other and have no effect on net income.

- **Interest expense:** Expense is higher due to interest expense at the TRS during the origination phase (figure 3). Interest expense in year 1 through year 5 is the same as discussed in figure 5.
- **General & admin. expenses:** During the origination phase, the TRS had operating expenses of \$20 million (figure 3).

Figure 9

**Financing Accounting Treatment
Consolidated**

Balance Sheet (\$ in 000's)	3/1/XX	Year 1	Year 2	Year 3	Year 4	Year 5
Cash	145,000	188,000	210,750	222,563	226,900	231,775
Mortgage loans held in portfolio	2,000,000	1,600,000	1,190,000	785,000	380,000	-
Mortgage loan premium	20,000	16,000	11,900	7,850	3,800	-
Loan loss reserve	(10,000)	(25,000)	(22,000)	(15,600)	(5,000)	-
Total Assets	2,155,000	1,779,000	1,390,650	999,813	605,700	231,775
Asset-backed bonds	1,980,000	1,580,000	1,175,000	775,000	375,000	-
Equity	175,000	199,000	215,650	224,813	230,700	231,775
Total Liabilities & Equity	2,155,000	1,779,000	1,390,650	999,813	605,700	231,775

**Financing Accounting Treatment
Consolidated**

Income Statement (\$ in 000's)	3/1/XX	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Interest income	13,333	149,000	116,725	84,063	51,663	19,950	434,733
Premium amortization expense	-	9,000	9,225	9,113	9,113	8,550	45,000
Interest expense	8,333	89,000	68,875	48,750	28,750	9,375	253,083
Net interest income	5,000	51,000	38,625	26,200	13,800	2,025	136,650
Provision for credit losses	10,000	25,000	22,000	15,600	5,000	-	77,600
Gain on sale of loans	-	-	-	-	-	-	-
Fee Income	-	7,000	7,000	3,500	-	-	17,500
Servicing Expense	-	9,000	6,975	4,938	2,913	950	24,775
General & admin. expenses	20,000	-	-	-	-	-	20,000
Net Income	(25,000)	24,000	16,650	9,163	5,888	1,075	31,775
Cash Flow	(55,000)	43,000	22,750	11,813	4,338	4,875	31,775
Realized Losses	-	10,000	25,000	22,000	15,600	5,000	77,600
OC Coverage	-	-	5,000	5,000	5,000	5,000	20,000

In figure 10, the consolidated balance sheet reflects the REIT's balance sheet in figure 8, except for the following items:

- **Cash:** Again, we used \$55 million in cash through the origination/securitization process.

In figure 10, the consolidated income statement reflects the REIT's income statement in figure 8, except for the following items:

- The origination/securitization phase (1/1/XX – 3/1/XX) reflects the income statement of the TRS (figure 3).

Figure 10							
Sale Accounting Treatment							
Consolidated							
Balance Sheet (\$ in 000's)	3/1/XX	Year 1	Year 2	Year 3	Year 4	Year 5	
Cash	145,000	188,000	210,750	222,563	226,900	231,775	
Mortgage securities held for sale	65,000	33,725	21,021	8,853	4,241	-	
Total Assets	210,000	221,725	231,771	231,416	231,141	231,775	
Total Liabilities	-	-	-	-	-	-	
Equity	210,000	221,725	231,771	231,416	231,141	231,775	
Total Liabilities & Equity	210,000	221,725	231,771	231,416	231,141	231,775	
Sale Accounting Treatment							
Consolidated							
Income Statement (\$ in 000's)	1/1/XX- 3/1/XX	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Interest income	13,333	11,243	5,750	2,810	1,253	719	35,108
Interest expense	8,333	-	-	-	-	-	8,333
Gain on sale of loans	25,000	-	-	-	-	-	25,000
General & admin. expenses	20,000	-	-	-	-	-	20,000
Net income	10,000	11,243	5,750	2,810	1,253	719	31,775
Cash Flow	(55,000)	43,000	22,750	11,813	4,338	4,875	31,775