

Net Interest Margin (NIMs)

Overview

Net Interest Margin (NIMs) deals are most commonly backed by either Home Equity (HEL) or Manufactured Housing (MH) deals. These structures are collateralized by the pooled excess spreads of different HEL and MH deals. Excess spread is the difference between the gross weighted average coupon (WAC) less servicing fees and the net coupon paid within the deal. This spread number usually ranges between 3.5% and 4.5%. In most deals, the excess spread is used as the first line of subordination in the case of defaults. Excess spread off of six different HEL or MH deals is pooled together to create NIMs.

AAA-rated Senior Bonds
Subordinated Bonds AA-B
Residual
Excess Spread

NIM Structure

In order to create NIMs dealers take the entire pool of excess spread cash flow and separate it into both a senior and a subordinated tranche. At present the levels of subordination are 25%-35%. The subordinated tranche is commonly retained by the issuer. The senior tranche is then artificially separated into scheduled principal and interest. The senior tranche is 1 – 3 years in average life, 0.8-2.5 years in duration and is currently trading at spread of 200-250. It is important to realize that even though NIMs have assigned principal, they are based on interest only cash flow (i.e. excess spread). The senior NIM tranche is usually rated BBB. Each month's exceed spread is used to first pay down the NIM's coupon and then to pay down the principal.

Risks

In order to understand the risks of NIMs one must first understand the underlying cash flow. Excess spread, as a stream of future cash flow, can be negatively impacted by two different factors. First, prepayments lower the amount of outstanding balance I the

underlying HEL or MH deals, therefore eliminating the future cash flow expected to be derived from the spread differential between the net WAC and the net coupon. Defaults also negatively impact the cash flows by both lowering the outstanding balance and using part of the actual excess spread cash flow as subordination to pay down the senior bonds in the underlying HEL/MH deals.

Vanderbilt Research Team

Emad A. Zikry
Chief Executive Officer
Vanderbilt Avenue Asset Management

Emad is the Managing Partner and Chief Executive Officer of Vanderbilt Avenue Asset Management LLC. Vanderbilt's client base includes Multi-national Corporations, Public Funds, Foundations/Endowments, and Taft Hartley accounts.

Previously, Emad was Chairman of Institutional Business at Pioneer Investments. Pioneer investments has more than \$300 Billion in assets under management. The parent of Pioneer, UniCredit S.p.A., is the largest bank in Italy and the second largest bank in Europe. Pioneer had purchased Vanderbilt Capital Advisors, of which Emad was the founder and Chief Executive Officer.

Emad has had numerous articles published in professional and academic journals such as The Journal of Forecasting, The American Economist and The Journal of Fixed Income. He is a Board member of The National Investment Company. Emad was a member of the Board of Advisors of the Pacific Institute, The Advisory Committee of Fulcrum Global Partners, The Chief Executive Officers Club and formerly a board member of The Foreign Policy Association. He also served on the Board of Directors of the University of Albany Foundation, NextGen Healthcare Inc., The Park Avenue Bank, AA Bank and The New Providence Fund and Associates LP.

Emad is an FINRA Arbitrator. He is also a member of the National Association for Business Economists and The Economic Club of New York. Emad served as an adjunct professor at the University of Kansas and St. John's University.

Emad holds a Bachelor of Science from the University of Albany, and a M.A. and Ph.D. in Economics from the University of Kansas.