

Advantus mortgage securities strategy positioned for impact of new mortgage program

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When changes to the government's Home Affordable Refinance Program (HARP) program were announced October 24, Advantus undertook a careful review of the program to answer two questions: (1) how will it affect the mortgage market? and (2) how will it affect our strategy on mortgage securities?

We believe that HARP 2.0 is broad enough and contains new incentives that could lead to better results than the program's first incarnation. We also believe we have been managing our mortgage securities strategy for some time to address prepayment risk and the impact of a new version of HARP. We think the outline of the program announced this week verifies the soundness of our approach.

New and improved mortgage assistance

Disappointment dogged the original HARP program, launched in 2009. Projected to assist two-three million homeowners, fewer than 1 million mortgages actually came into the program, and only 70,000 of those were under water. HARP 2.0 includes a number of new provisions and extends the program until December 31, 2013 in hopes of doing better.

The new version encourages refinancing at today's very attractive mortgage rates. The program aims to help qualifying homeowners reduce their payment, shorten the term of their mortgage, or both. By providing a financially sensible alternative to walking away from a mortgage, it can hopefully cut down on defaults.

The program also includes incentives that should increase bank willingness to refinance, and borrowers' willingness to shorten the term of their mortgage.

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- The government's new mortgage refinance program has the potential to generate higher participation than the first version of the program.
- We've positioned the Advantus mortgage securities strategy to minimize the impact of additional refinancing generated by the program.

Eligibility is limited to mortgages with a loan-to-value ratio greater than 80 percent. The homeowner must have been current on payments for the last six months, and the loan must have been delivered to Freddie Mac or Fannie Mae prior to May 31, 2009. These requirements make it likely that qualifying loans will have rates between 5½ and 6½ percent, with origination dates between 2005 and 2009.

Positioning for prepayment risk

Managing the Advantus mortgage securities strategy to address prepayment risk and the impact of a new mortgage program has been at the forefront of our thinking for some time. This was prompted by the persistency of the low interest rate environment and by mortgage rates dropping into the 4 percent range.

We've attempted to address these risks through pool and coupon selection. We've bought mortgage pools with lower loan balances, as refinancing is significantly less attractive for homeowners with lower balance mortgages. We also have focused on buying coupon rates in the 3½ to 4 percent range, loans that are also less likely to refinance. We believe these actions will limit the impact of prepayment activity the revamped program may generate.

We think the program will be a positive if it succeeds in alleviating some homeowners' payment burdens. We'll be watching closely to see if the 2011 edition of HARP succeeds where its predecessor failed.

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