7.19 Mortgage-Backed Security (MBS) Instrument and Market Features.

Question 1
The pass-through rate for a mortgage pass-through security *most likely* refers to the:
A. security's coupon rate.
B. monthly prepayment rate on the underlying loans.
C. weighted average coupon rate of the underlying mortgage loans.

Question 2
An issuer constructs a mortgage pass-through security with the following underlying collateral:

Mortgage	Remaining balance ($ thousands)	Mortgage rates (%)	Months of maturity remaining
A	80	4.5	48
B	100	5.0	60
C	120	4.7	72

If the issuer charges a servicing fee of 25 basis points, then the pass-through rate is *closest* to:
A. 4.48%
B. 4.50%
C. 4.75%

Question 3
The risk to the cash flows investors receive from agency pass-through mortgage-backed securities is *most likely* related to:
A. prepayment risk.
B. reinvestment risk.
C. borrower defaults.

Question 4
A portfolio of government securities is constructed to match the cash flow stream of the interest and principal payments of a commercial mortgage and to effectively retire that mortgage. This process is *best* described as a:
A. defeasance.
B. sinking fund.
C. securitization.

Question 5
For a commercial mortgage loan, a high debt service coverage ratio coupled with a low loan-to-value ratio is *most likely* indicative of:

A. low credit risk.
B. high balloon risk.
C. low prepayment risk.

Question 6
For commercial mortgage–backed securities, which of the following mechanisms is *least likely* to provide call protection at the loan level?
A. Prepayment lockout
B. Sequential-pay tranches
C. Yield maintenance charge

Question 7
A homeowner borrowed $850,000 in a 30-year fully amortizing recourse mortgage loan to purchase a house that secures the loan. The borrower defaults on the loan at the end of Year 3, when the loan has been amortized by $25,000. Interest rates have increased so that the present value of the loan is $800,000. If the lender forecloses on the loan and receives $750,000 from the sale of the house, the amount that the lender can recover from the borrower is *closest* to:
A. $50,000
B. $75,000
C. $100,000

Question 8
Which of the following *best* describes a consequence of a nonrecourse mortgage loan in the event of default?
A. The borrower cannot be forced into foreclosure.
B. The borrower can be held liable for the entire loan balance.
C. The lender receives only the proceeds from the sale of the property.

Question 9
An issuer creates a sequential-pay collateralized mortgage obligation that consists of Tranches A, B, C, and D. The face value of each tranche is paid in order of seniority, with Tranche A the most senior and Tranche D the least senior. The collateral consists of 30-year residential mortgages. An investor in Tranche D *most likely* assumes a greater exposure to:
A. balloon risk.
B. extension risk.
C. contraction risk.

Question 10
Which of the following types of residential mortgage loan is *least likely* to result in a balloon payment at maturity?
A. Interest-only
B. Fully amortizing
C. Partially amortizing

Question 11
A local bank advertises the availability of 30-year home mortgages that carry a 4% annual interest rate for the first 10 years. After that, the interest rate becomes variable until maturity. This type of mortgage is *most likely* a:
A. hybrid mortgage.
B. variable mortgage.
C. convertible mortgage.

Question 12
Which of the following is *most likely* a credit enhancement for commercial mortgage-backed securities (CMBS)?
A. Subordination
B. Call protection
C. Limits on loan-to-value ratio (LTV)

Question 13
Which of the following is *most likely* a difference between mortgage pass-through securities and collateralized mortgage obligations (CMOs)?
A. CMOs contain multiple tranches.
B. CMOs eliminate prepayment risk.
C. Pass-throughs reallocate prepayment risk.

Question 14
Of the following investments, the one that *most likely* offers the greatest protection against contraction risk is a:
A. commercial mortgage–backed security.
B. residential mortgage pass-through security.
C. support tranche of a planned amortization class security.

Question 15
An analyst finds that a mortgage pass-through security issued three years ago has a prepayment rate of 200 PSA. The analyst's *most appropriate* conclusion is that the:
A. prepayment assumption is 2% annually.
B. prepayment assumption is half the PSA benchmark.
C. collateral had many mortgages at above-market rates.

Question 16
A corporate bond with a 6% annual coupon rate, paid monthly, is quoted at a 5.5% YTM. If the YTM is restated as a bond with semiannual payments, the restated YTM is *closest* to:
A. 5.56%
B. 5.58%
C. 5.64%

Question 17
In a nonagency residential mortgage-backed security (RMBS) where a significant portion of the securitized mortgages are nonrecourse and underwater, bondholders are *most likely* exposed to:
A. contraction risk.
B. interest rate risk.
C. strategic default risk.

Question 18
When interest rates are rising, investors in residential mortgage–backed securities are *most likely* to be exposed to higher-than-expected:
A. default risk.
B. extension risk.
C. contraction risk.

Question 19
A convertible mortgage is a loan that is *best* described as one that the borrower can convert from a(n):
A. nonrecourse to a recourse loan.
B. interest-only to an amortizing loan.
C. fixed-rate to an adjustable-rate loan.