

P I M C O

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via Federal Express

March 3, 2009

Mr. Richard L. Mayfield, CFA
Capital Markets Specialist
Office of Corporate Credit Unions
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-6113

Dear Rick:

You will find enclosed the hard copy of the Consultancy Report for NCUA.
The report consists of four binders.

Please contact me if you need copies of specific sections and/or copies of the entire report.

Best regards,

(b)(4)

Senior Vice President – Product Manager

PCT:cdm

Enclosures

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Individual CDO Analyses

Individual RMBS Analyses

February 26, 2009

National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Attention: **Scott Hunt and Rick Mayfield**

Re: Portfolio Analysis - Investment Advisory Service

Scott and Rick,

Attached please find our completed assessment of expected loss for the portfolios you have presented to us, based on our engagement letter from January 29, 2009. As agreed, we have analyzed and provided loss assessments for all 2,007 bonds. For approximately 250 of these bonds (mostly 2nd Liens and Home Equity Lines of Credit), loan level data was not available, so we provided summary data in a spreadsheet instead of the two page summary.

These materials are delivered to you in accordance with and subject to the provisions of the Investment Advisory Services Agreement. We have delivered electronic copies by email and hard copies via mail. Please let us know if you would like additional printed copies.

Attached you will find the following parts of our consultancy report:

1. Introduction and Executive Portfolio Summary
2. Analysis of Market Conditions
3. Evaluation of Government Policy Developments
4. Assessment of Possible Courses of Action
5. Description of Modeling Methodology
6. Analysis of Servicers

File Attachment 1 – Presentation of Results of NCUA Portfolio Analysis

File Attachment 2 – Assessment of Fair Value

File Attachment 3 – Bond Specific Summaries

File Attachment 4 – *Investment Outlook* by Bill Gross

Thank you again for choosing PIMCO Advisory Services. We are truly honored.

Best wishes,

(b)(4)

Senior Vice President
PIMCO

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PIMCO Advisory



Consultancy Report National Credit Union Administration

February 26, 2009

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File Attachment 1 – Summary Presentation

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1. Introduction – Executive Portfolio Summary

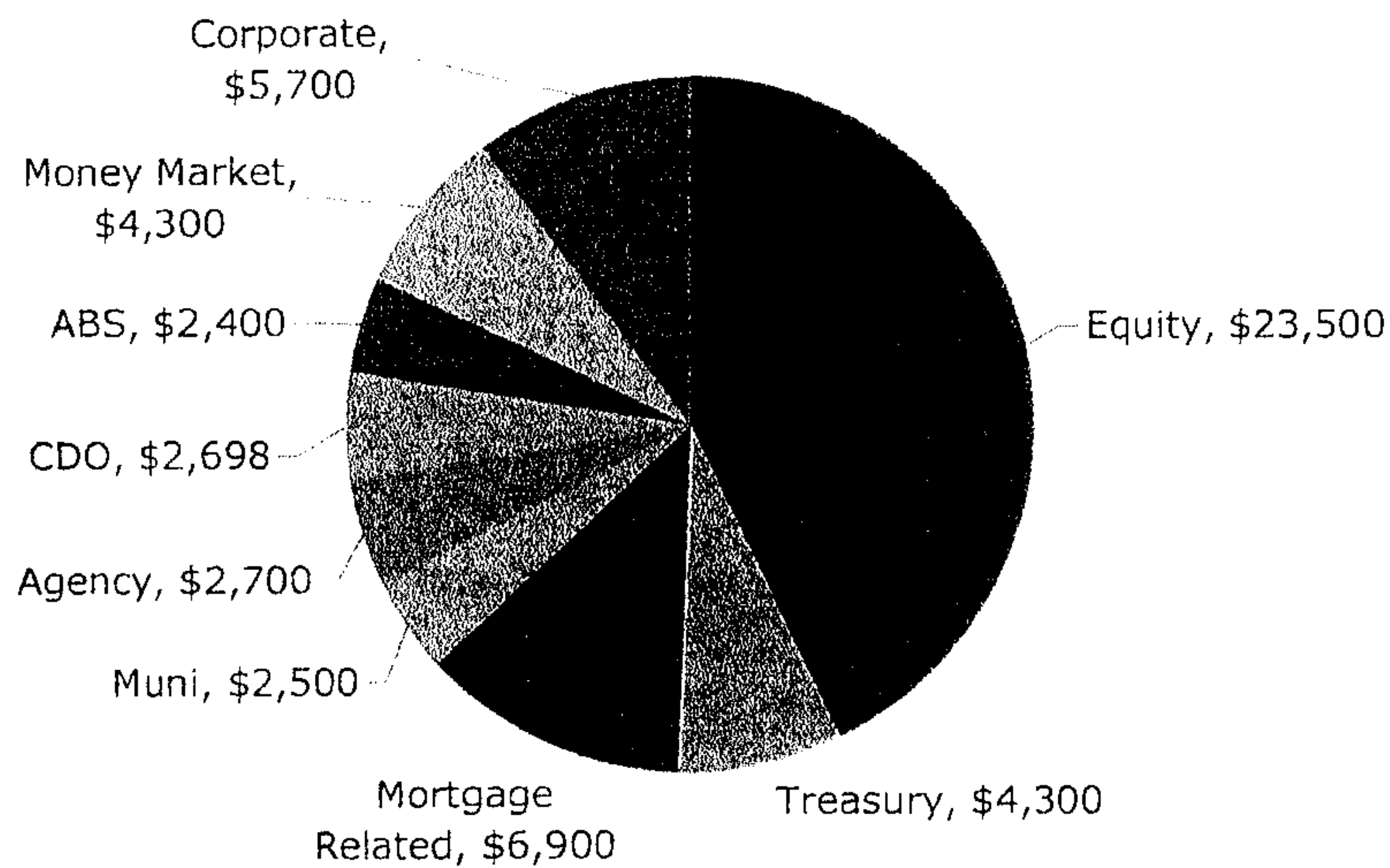
We are pleased to provide NCUA with your completed report and accompanying valuation analyses, at the aggregate portfolio, sub-portfolio and individual asset levels. At your request, we are focused on valuing the assets and ultimately providing an assessment of the timing of losses under pessimistic, base and optimistic scenarios.

PIMCO's process incorporates both top-down macroeconomic views and granular analysis of each asset. To provide context for your analysis, we have included a discussion of the qualitative market forces that are impacting your portfolio, e.g., home prices, public policy and servicer performance. Importantly, we discuss various strategies for reducing risk based on the specifics of your portfolio. Finally, we attach a summary of the analytical framework that we employed for this analysis.

We are witnessing a massive deleveraging of the global economy driven initially by poorly underwritten mortgages, which led ultimately to failures of some of the world's largest financial institutions. We are seeing banks, corporations and consumers forced to sell nearly every type of asset. This has resulted in a sharp decline in the value and liquidity of risk assets and a concurrent increase in volatility.

Until recently, few understood how integral to the global financial infrastructure structured products truly were. For decades, they were considered an esoteric part of the fixed income markets. It is now painfully obvious that they touched nearly every aspect of the global economy. For example: leveraged buyouts were financed via collateralized loan obligations (CLOs); home mortgages via residential mortgage-backed securities (RMBS); consumer credit such as credit cards, student loans and auto loans through asset-backed securities (ABS); and commercial real estate through commercial mortgage-backed securities (CMBS). These esoteric assets were held directly and indirectly by nearly everyone, including "risk-free" money market funds that invested heavily in commercial paper (CP) issued by structured vehicles. Issuance of structured credit peaked around June 2007. At that point in time there was approximately \$5.1 trillion of dollar-denominated funded structured credit outstanding. To put this in context, this is nearly as big as the corporate debt market at that time.

US Capital Markets Outstanding
As of June 2007 (Billions of USD)



SOURCE: SIFMA

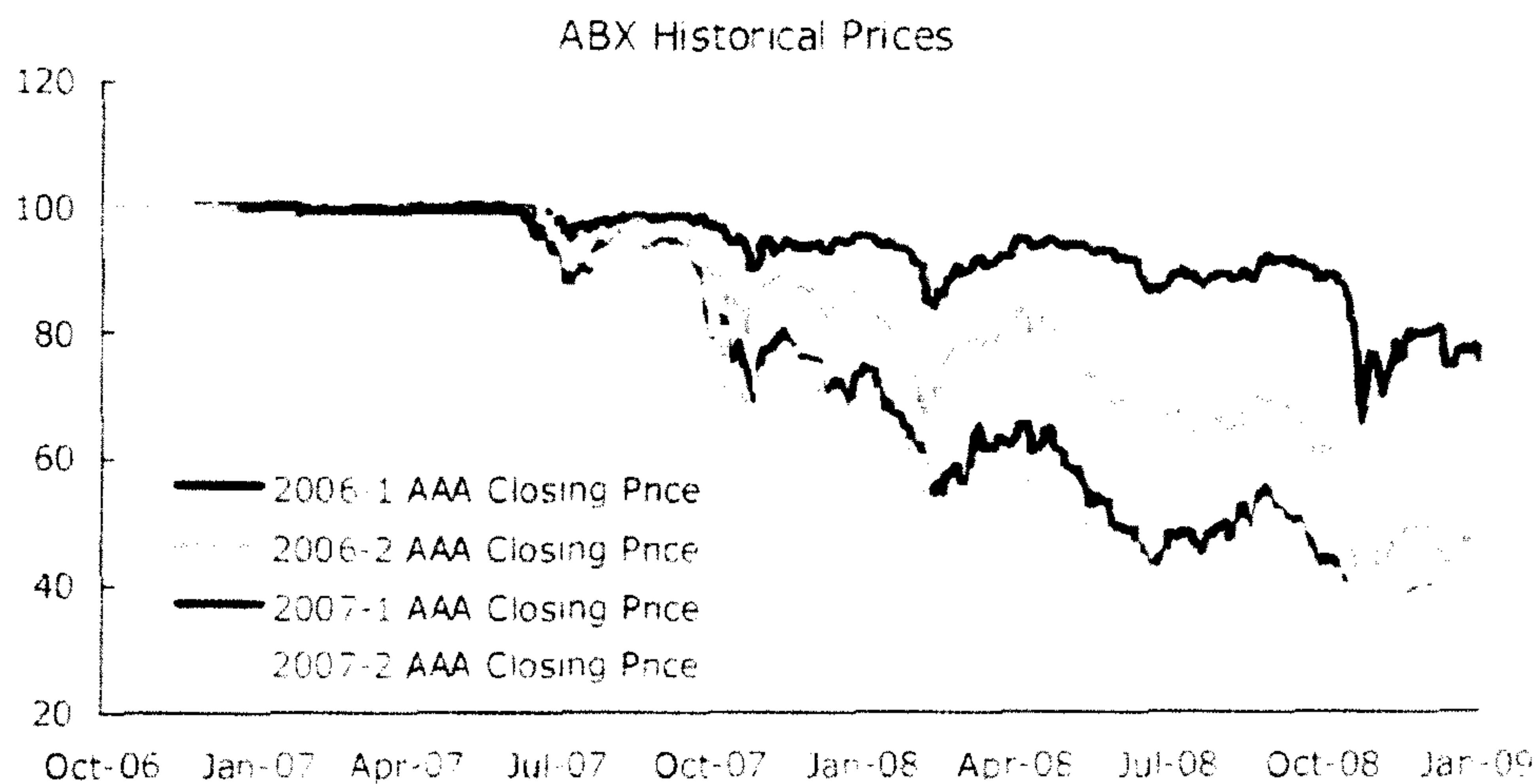
The portfolio you asked PIMCO to analyze is composed of residential mortgage-backed securities (RMBS) and collateralized debt obligations (CDOs). As such, its performance is driven by several important factors, e.g., real estate prices, public policy and servicer impacts, bankruptcy carve-outs, loan modifications and cram-downs. The impact of these factors can change dramatically based on policy decisions and market conditions.

- Policy changes could have either a positive or negative impact on mortgages; however, the impact on your portfolio is largely dependent upon the specifics of each tranche.
- Contingent on the enactment of bankruptcy reform, a feature of the pending H.R. 1106, carve-outs, if applicable, increase the probability that senior bonds that would not otherwise take a loss could suffer a small loss, e.g., 0%–2%. Consequently, the impact on loss forecasts is small, but could result in a material risk of downgrade of senior tranches. Note that based on developments this week, we believe the probability of this applying is materially reduced.
- Servicer Safe Harbor and incentive payments to servicers for performing modifications are each features of the pending H.R. 1106; they will combine to increase the frequency and loan-level impact of modifications in non-Agency RMBS.
- The mezzanine tranches of Alt-A, Prime & Prime Option adjustable-rate mortgages (ARMs) are highly levered to the negative outcomes associated with aggressive streamlined loan modifications that are performed under the auspices of servicer-harbor legislation and bankruptcy court-imposed principal-balance reduction modifications (i.e., cram-downs). This composes approximately 25% of your portfolio.

It is important to note that our base case incorporates not just a weakening of the housing market, but also the potential benefits to the housing market from positive policy responses.

2. Analysis of Market Conditions

Residential Mortgage Backed Securities (RMBS) continue to deteriorate from a fundamental credit and pricing perspective, as illustrated by the following chart of historical ABX pricing. This is a reflection of continuing increases in delinquency rates, declines in home prices and regulatory changes such as mortgage cram-downs and streamlined loan modifications. The loss estimates have not recently increased as much as in other fixed-income sectors over the last quarter because the poor credit performance in RMBS has persisted over the last 1-2 years and is experiencing some burnout especially for the 2004-2005 vintages.



Home Prices, Non-Agency Concentration, and Unemployment

Nationally and across the major regions, house prices have continued their decline, with further year-on-year price declines registered in all the major cities in the S&P/Case-Shiller Home Price Index. In the composite of 20 major U.S. cities (metropolitan statistical areas (MSA)), home prices have fallen over 18% since November 2007, and have fallen over 27% from their peak. The specific city breakouts are listed below:

| MSA | 1-Year Home Price Change | MSA | Peak to Trough Price Change (Change/Peak) |
|------------------------------|--------------------------|------------------------------|---|
| Phoenix | -34.0% | Phoenix | -45.5% Jun-06 |
| Las Vegas | -33.0% | Las Vegas | -44.0% Aug-06 |
| San Francisco | -31.2% | Miami | -41.3% Dec-06 |
| Miami | -28.8% | San Francisco | -40.4% May-06 |
| Los Angeles | -26.4% | San Diego | -39.2% Nov-05 |
| San Diego | -24.8% | Los Angeles | -37.4% Sep-06 |
| Tampa | -22.0% | Detroit | -36.3% Dec-05 |
| Detroit | -21.7% | Tampa | -34.5% Jul-06 |
| Washington | -19.2% | Washington | -29.8% May-06 |
| Minneapolis | -18.5% | Minneapolis | -25.8% Sep-06 |
| Chicago | -14.3% | Chicago | -18.6% Sep-06 |
| Seattle | -13.4% | Seattle | -16.7% Jul-07 |
| Portland | -13.1% | Atlanta | -16.6% Jul-07 |
| Atlanta | -12.2% | Boston | -16.1% Sep-05 |
| New York | -9.4% | Portland | -15.0% Jul-07 |
| Charlotte | -7.2% | New York | -15.0% Jun-06 |
| Boston | -7.0% | Cleveland | -14.8% Jul-09 |
| Cleveland | -6.1% | Denver | -10.4% Aug-06 |
| Dallas | -4.3% | Charlotte | -9.9% Aug-07 |
| Denver | -4.0% | Dallas | -8.6% Jun-06 |
| Composite of 20 MSAs: -18.6% | | Composite of 20 MSAs: -27.1% | |

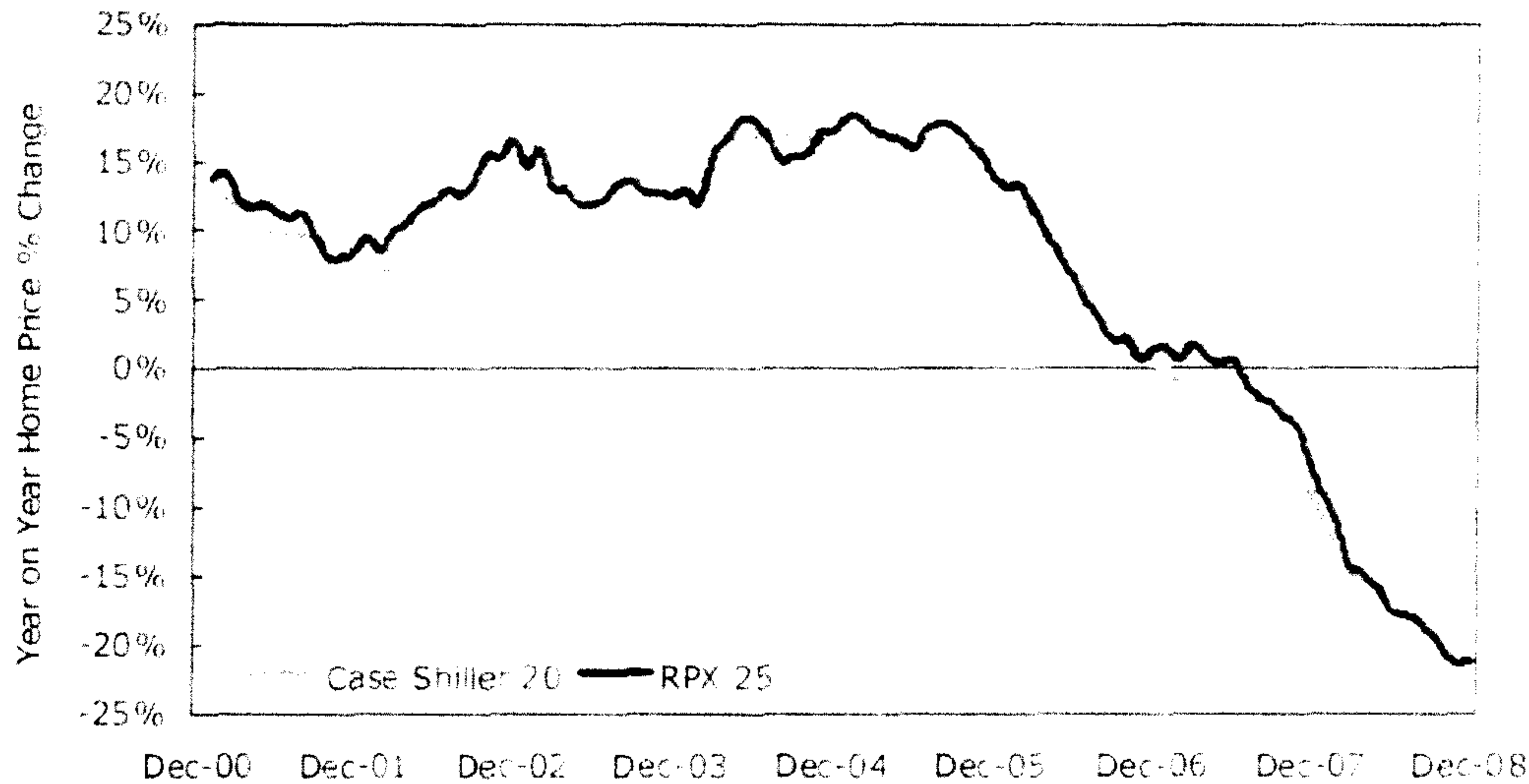
As the crises in the housing and financial markets continue, regional differentiation with respect to house price depreciation is increasing markedly. In December 2007, the range between the most severe peak-to-trough depreciation area (San Diego) and the least severe area (Portland) was 17%. Currently, the spread between best and worst performing regions has more than doubled to 37% (Dallas and Phoenix.)

The growing dispersion between regions in home price depreciation can largely be attributed to the concentration of non-Agency mortgages in a given area, with the notable exception of the housing market in Detroit and its previously unique unemployment issues. Areas with the highest concentrations of non-Agency mortgages (AZ, CA, FL, NV) have been hardest hit by falling home prices as affordability products like Pick-A-Pay mortgages and no-doc loans created the earliest and largest run up in home prices. With the non-Agency loan origination market closed and increasing numbers of borrowers unable to refinance into higher credit quality and larger down-payment Agency mortgages, these houses are being foreclosed on and sold back into the market at severe discounts, driving down all house prices.

In addition, the effect of rising unemployment will further weigh on home prices as demand for housing decreases further.

The path of home prices over the last decade can be seen in the graph below. While the S&P/Case-Shiller Composite is an index tracking home prices across 20 major metropolitan areas, the RPX 25 Index is a tradable composite based on housing prices per square foot across 25 major metropolitan areas. As the graph shows, the housing market crossed into year-over-year declines in mid-2007 and continued its fall uninterrupted throughout all of 2008 and during the first quarter of 2009.

RPX 25 Index vs Case Shiller 20 Composite Index



The RPX property price index is implying significant further declines in home prices.

RPX Peak To Trough Home Prices

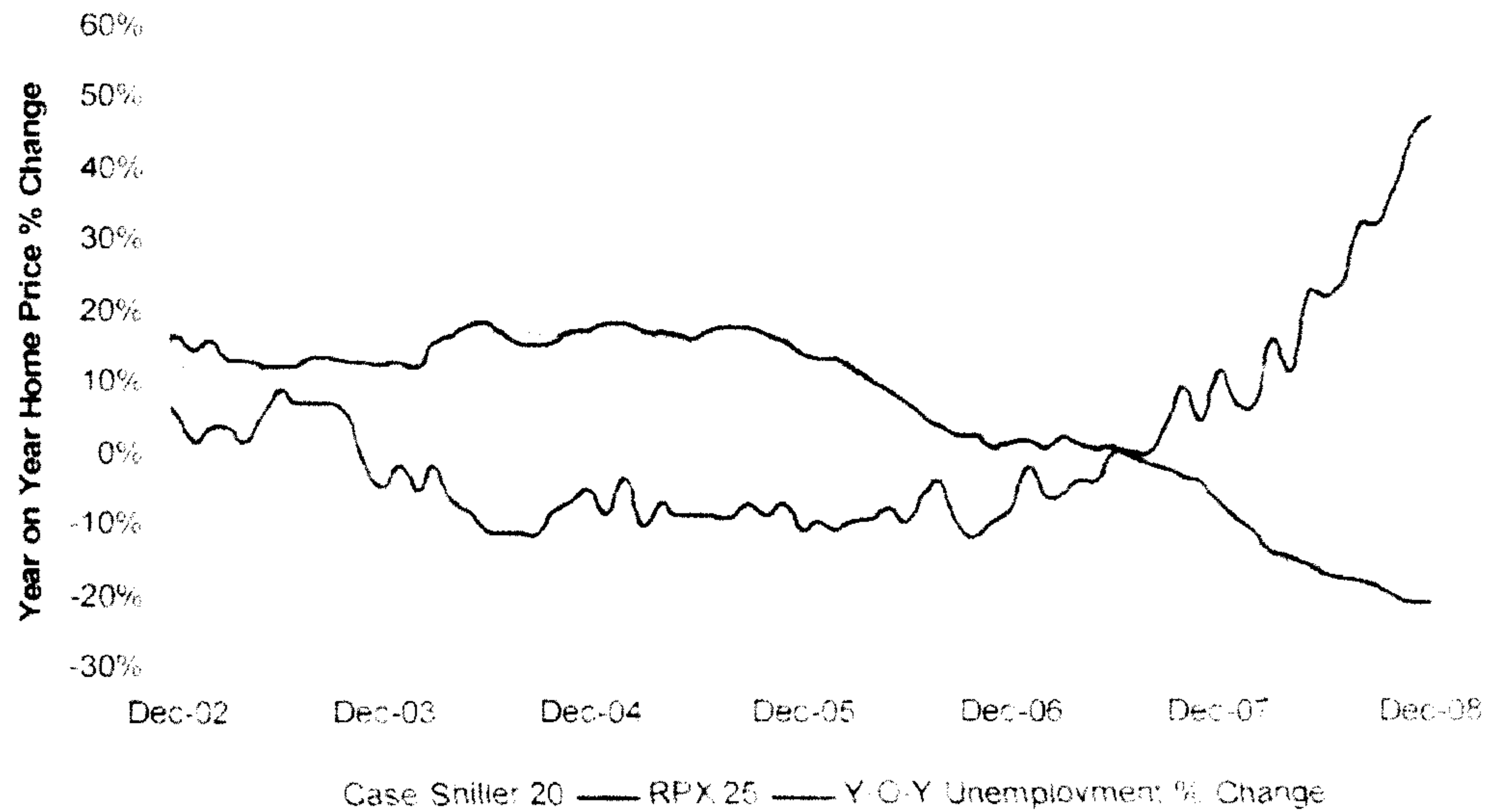


RPX is a home price index based on actual transactions across 25 MSAs. This index is published daily with a 63-day lag. An over-the-counter (OTC) market based on forwards on the RPX provides insight into the forward home price path implied by the market. We use implied home price appreciation from this OTC market as one of the inputs for our forward projections.

Currently, RPX is implying a bottom in 2010 with a peak-to-trough decline of 42% (19% lower than current prices).

The systemic de-leveraging catalyzed by the steep and persistent decline in national house prices has, as displayed in the following chart, resulted in credit contraction sufficient to cause substantial increases in unemployment. This has resulted in a flurry of public policies intended to break the vicious cycle of deleveraging, asset-price deflation, credit contraction and unemployment.

RPX 25 Index vs Case Shiller 20 Composite Index vs Unemployment Rate



3. Evaluation of Government Policy Developments

| Program | \$ Allocated | Specific Program Goal | PIMCO Views |
|--|---------------------------|--|--------------------|
| Fannie/Freddie Conservatorship | \$200 Billion | Prevent collapse of Government-Sponsored Entities (GSE) and ensure mortgage capital flow | (b)(4) |
| Troubled Assets Relief Program (TARP) I | \$350 Billion | Stabilize financial markets | |
| Federal Reserve & U.S. Treasury MBS Purchase Programs | \$500+ Billion | Stimulate home purchases through lowering conforming mortgage rates | |
| Term Asset-Backed Securities (ABS) Loan Facility (TALF) | \$200 Billion | Increase availability of consumer credit by replacing structured investment vehicle (SIV) / collateralized debt obligation (CDO) demand for consumer ABS | |
| Financial Stability Plan (Obama Plan) | \$350 Billion | Continue to recapitalize the banking system, directly address foreclosure prevention, with a probable extension to troubled asset purchases | |
| <i>Public-Private Investment Fund (PPIF)</i> | <i>Up to \$1 Trillion</i> | Cleanse financial institution balance sheets of legacy assets | |
| <i>TALF Expansion</i> | <i>\$100 Billion</i> | Increase availability of all ABS credit by replacing SIV/CDO demand | |
| <i>Homeowner Affordability and Stability Plan (HASP):</i> | | | |
| <i>Hope for Homeowners</i> | <i>up to \$75 Billion</i> | Keeping homes off the market by providing expanded refinancing options and restoring equity | |
| <i>Bankruptcy Reform</i> | <i>n/a</i> | Keeping homes off the market by eliminating negative equity | |
| <i>Loan Modifications & Servicer Safe Harbor</i> | <i>up to \$75 Billion</i> | Keeping homes off the market by eliminating negative equity | |
| <i>Fannie/Freddie</i> | <i>\$200 Billion</i> | Stabilize the balance sheets of Fannie and Freddie and support the guarantee on Agency MBS | |

Appendix A: Description of Modeling Methodology

Overview

In the combined portfolio, there are a total of approximately \$44.5 billion of residential mortgage-backed securities (RMBS). The loss expectations for these securities were derived primarily from scenario analyses using PIMCO's proprietary loan loss model, assuming the base, stress, and optimistic cases derived from PIMCO's economic outlook.

Once a market-based loss indication and the base, stress and optimistic scenarios are compiled, we review each security individually to ascertain whether the output is reasonable and in line with our expectations. We are mindful that there are limitations to any model, particularly with respect to Alt-A and pay-option securities. For example, even if we agree with the ultimate cumulative loss the model predicts on an individual pool, the timing of the cash flow can shift expected losses throughout the capital structure, treating some securities too harshly or not harshly enough. Thus, the analyst will override the model's output if they believe it is inconsistent with our expectations.

The following are important market indicators we review:

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PIMCO Fundamental Analysis

PIMCO's residential mortgage model allows the entire RMBS portfolio to be reviewed in the same consistent format. This appendix provides a detailed summary of our mortgage model.

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It is important to note that our base case incorporates not just a weakening of the housing market, but also the potential benefits to the housing market from positive policy responses. The table below outlines our expectations for ultimate cumulative losses (on average) on various RMBS sectors.

Loss Estimates (As a % of Original Balance)

| Pay Option | | | Subprime | | |
|---------------|---------------|---------------|---------------|---------------|---------------|
| 05 Vintage | 06 Vintage | 07 Vintage | 05 Vintage | 06 Vintage | 07 Vintage |
| (b)(4) | | | | | |
| Alt-A | | | Prime | | |
| 05 Vintage | 06 Vintage | 07 Vintage | 05 Vintage | 06 Vintage | 07 Vintage |
| (b)(4) | | | | | |

Each RMBS security is reviewed by a PIMCO analyst to assess the validity of the market indicators and the mortgage model's output, based on the idiosyncratic characteristics of the security. These characteristics include originator and issuer effects as well as the structural aspects of each individual security. In the event an analyst identifies an idiosyncratic or structural dynamic not incorporated in the model, the analyst adjusts the output accordingly.

Pricing for most of the RMBS was derived primarily from third-party vendor marks and PIMCO analysts.

Our general conclusion is that risk premiums are high in the RMBS sector, particularly when based on the loss estimates in the above table, given the various policy-based uncertainties specific to the sector, including: (1) proposed bankruptcy reforms (e.g., principal cram-downs) and (2) streamlined bulk modifications based on policy preferences as opposed to maximizing investor outcomes. The uncertainty created by these policy issues leads to a material divergence between our estimates of base-case losses and losses implied in the current market prices of these securities. Accordingly, our general conclusion is that current market pricing is overly pessimistic.

PIMCO Mortgage Credit Model

The PIMCO residential mortgage credit model – henceforth referred to as the credit model – is an internally developed proprietary tool used to predict principal and interest payments, or cash flow, associated with (i) a residential mortgage loan, (ii) any pool of loans, and (iii) by extension, any security whose cash flow is derived from the cash flows of the underlying pool(s) of mortgages.

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Residential Mortgages

A residential home mortgage is a contract under which a borrower pledges his house as collateral for a loan issued by a mortgage originator. The mortgage contract typically gives the borrower the explicit right to prepay or refinance his mortgage. This occurs often at the borrower's expense of paying specific prepayment penalties. The borrower may exercise the prepayment option if prevailing market interest rates sufficiently decline so that this action becomes financially optimal. The option may also be exercised in order to "cash out" home equity that has accumulated over time through principal payment and home price appreciation.

Implicitly, the borrower also receives a default option which, when exercised, gives up the collateral of the home for failing to adhere to the terms of the mortgage contract. Thus, the mortgage contract gives the lender the right to foreclose on the loan and take possession of the collateral in the event that the mortgagor fails to make the scheduled principal and interest payments. This event is referred to as a default. When a borrower defaults on a loan of, for example, a \$100k principal balance, the entire \$100k balance is not lost. The lender, having taken possession of the home collateralizing the loan, may sell the property and thus mitigate the net loss. The proportion of the remaining loan balance, which is lost in the event of default, is referred to as the loss severity ratio or loss given default.

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Market Sectors

The conventional U.S. residential mortgage market (non-FHAVA) is generally classified by different sectors, depending on the creditworthiness of the borrower and the degree of underwriting of the mortgage. Major segments recognized by market participants include:

1. *Conforming Prime*: borrowers with good credit history.
2. *Jumbo Prime*: borrowers with good credit history *and* a loan balance exceeding the conforming loan limit.
3. *Alt-A*: borrowers with fair credit history, but with loans that for some reason do not meet the standards for Agency prime securitization programs (e.g., limited income verification and documentation)
4. *Subprime*: borrowers with blemished credit history.

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Model Specification

Input into the credit model includes, but is not limited to, the following information:

1. Static loan level attributes

- a.
- b.
- c.
- d.
- e.
- f.
- g.
- h.

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2. Dynamic loan level attributes

- a.
- b.
- c.
- d.

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3. Historical borrower payment history

a.

b.

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4. Economic drivers

a.

b.

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Based on the above factor inputs, the credit model projects loan level monthly estimates for the following measures:

- 1) The conditional prepayment probability
- 2) The conditional default probability
- 3) The conditional 60+ day OTS (Office of Thrift Supervision) delinquency rate
- 4) Loss severity ratio

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Model Estimation Data

The model is estimated using a sample of data from the (b)(4) historical database, a third-party vendor of mortgage performance data on a large fraction of the securitized universe (b)(4). The population used to derive the estimation sample consists of loans originated since 1997. The data set used in calibrating the credit model parameters covers 10%–50% of all mortgages that are in the (b)(4) database.

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Model Specification

As described, the credit model yields monthly loan level forecasts

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The credit model therefore includes eight transitions that govern the evolution of each loan over time.

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Monthly Transition Probabilities

To estimate the eight monthly transitions, logistic regression is applied to obtain coefficients associated with the credit model covariates. Maximum likelihood estimation using the SAS statistical application is the method of choice to recover information on model coefficients.

Estimated coefficients are subsequently used in the following equation to yield model transition probabilities using the following equation:

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Separate parameter sets and equations exist for the eight transitions, and Monte Carlo simulation is applied to determine the expected evolution of loan states for each loan over time.

Severity Model

The loss severity ratio is defined as net credit loss divided by current loan balance. For example, for a loan with a current balance of \$100k and predicted loss of \$40k at default, the predicted severity ratio would be 40%. Severity is defined as loss given default. Mortgage default is defined for purposes of the severity model estimation to be consistent with the definition used in the default model.

The net loss number used for modeling severity is reported by the respective servicers contributing to the estimation database and will for almost all servicers be calculated as the sum of multiple loss components. These components include

- 1) Collateral deficiency (unpaid loan balance – REO [real estate owned] sales price)
- 2) Lost interest (accrued as servicer advances interest on non-performing loans to the security)
- 3) Expenses (including legal expenses, selling expenses, taxes and insurance)

Historical loss severity numbers (b)(4) are net of Primary Mortgage Insurance (PMI) proceeds. PMI coverage is one of the explanatory variables used to predict net loss severity.

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Model Estimation

The model coefficients can be estimated jointly as a multinomial logistic system of equations. Alternatively the coefficient vectors can be estimated separately as pairs of uncoupled binary logistic regression equations. In both approaches, maximum likelihood estimation forms the basis of information recovery on the unobservable set of parameters. SAS is the statistical software tool used to accomplish this task. The loss given default component as described

above consists of a linear specification for which parameter coefficients can be readily estimated using the least-squares regression method.

Appendix B: Analysis of Servicers

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Servicing Advances

According to PSAs, servicers are obligated to advance principal and interest for delinquent loans until it is deemed that future advances would no longer be recoverable. The servicer's main obligation is to maximize the net present value of the loan to the trust. Prior to 2007, the cost of financing advances was not a significant obstacle for servicers. Previously, a servicer would have to fund 5% of the advances from their own capital and the remaining 95% of the advances would be financed at a cost of approximately LIBOR+50bps (London interbank

offered rate). As delinquencies have increased at a tremendous pace and access to wholesale financing has been significantly curtailed, servicers who have the benefit of a strong and stable parent have found themselves under far less financial duress, as they are able to access funding through their parent company. Servicers (b)(4) have been able to rely on (b)(4) during these tumultuous times, whereas servicers such as (b)(4) have been financially hindered due to this dramatic increase in cost. Servicers are now forced to pay 20%–25% of the advances of principal and interest on delinquent loans from their own capital, and the cost to fund the remaining advances has increased to LIBOR+500–700bps and above.

This increase in cost is attributable to the bursting of the housing bubble and the exponential increase in delinquencies. It has forced servicers to increase the amount of money borrowed at higher market rates.

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PSAs give servicers a great deal of latitude in deciding when to stop paying advances. The trustee and investors are therefore relying on the good faith of the servicer to make such decisions. In the past, servicers were not inclined to stop advances, as home prices were increasing and both delinquencies and advance costs were low. As we approached the end of 2008, servicers sharply changed their practices and increasingly limited the payments of advances. Low balance loans along with loans in particular parts of the country (e.g., Michigan, Ohio, parts of Florida, Nevada and California) are all facing steeper haircuts in their values, ultimately leading to the decision to stop paying advances. As a result, the trust is faced with a curtailment of income and particularly subordinate tranches, which are currently valued as IOs (interest only), are seeing sharper declines in even the IO value.

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Overview of Possible Modification Programs and Actions

Streamlined Loan Modification Guaranty Programs (SMP)

- Objective: Foreclosure prevention by restoring borrowers' performance through concessions to rate, term and/or principal to lower borrowers' payments, but not so much as to generate a lower net present value to the securitization trust than is available through foreclosure
- Rationale: reduced documentation re-underwriting of borrowers, intended to maximize efficiencies and adoption of modification
- Consequences: moral hazard – inducement to default; it is clear that house price depreciation weakens a borrower's attachment to their house
 - Large near term re-default rates in a falling house price cycle can cause losses to exceed what would have been realized through foreclosure
 - Guaranteed payments will defray losses to bondholders (depending upon the attachment point of the guaranty and its size)
 - Bondholder losses will still likely be higher than what would occur given adequate servicing
 - Unlikely to fundamentally resolve the core issue

Servicer Safe Harbor

- Purpose: absolves the servicer from any liability from actions taken when pursuing loan modifications that may be contrary to specific provisions in individual PSAs
- Objective: foreclosure prevention by shielding servicers from investor lawsuits which are ostensibly inhibiting modifications