RMBS/Spain
Presale Report

Fondo De Titulización De Activos Santander Hipotecario 3

Expected Ratings*

Class	Size (EURm)	Final Maturity	Rating	CE (%)
A	2,573.3	Jan 2050	AAA	8.90
B	79.2	Jan 2050	AA	6.07
C	47.5	Jan 2050	A	4.37
D	72.0	Jan 2050	BBB	1.80
E	28.0	Jan 2050	BB	0.80
F	22.4	Jan 2050	CCC	NA

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* Expected ratings do not reflect final ratings and are based on information provided by the issuer as of 12 March 2007. Final ratings are contingent on final documents conforming to information already received, as well as on satisfactory legal opinion. Ratings are not a recommendation to buy, sell or hold any security. The prospectus and other offering material should be reviewed prior to any purchase.

Special Reports
The following special reports provide additional detail on Fitch Ratings' rating approach to, and the performance of, the RMBS market; all are available at www.fitchratings.com:

- "*Banco Santander Central Hispano*", dated 16 May 2006;
- "*Spanish Residential Mortgage Default Model III*", dated 15 September 2005;
- "*Commingling Risk in Structured Finance Transactions*", dated 9 June 2004;
- "*Counterparty Risk in Structure Finance Criteria: Swap Criteria*", dated 13 September 2004;
- "*Fitch Issuer Report Grades May 2006 Update*", dated 5 June 2006.

■ Summary
This transaction is a cash flow securitisation of a EUR2,800m static pool of first-ranking residential mortgage loans (the collateral) granted by Banco Santander Central Hispano (Santander or the seller, rated 'AA/F1+') to individuals in Spain. Fitch Ratings has assigned expected ratings to the class A (i.e. A1, A2, A3), B, C, D, E and F notes (the notes) to be issued by Fondo de Titulización de Activos Santander Hipotecario 3 (FTA Santander Hipotecario 3 or the fund) as indicated at left.

This is the third residential mortgage-backed securities (RMBS) transaction brought to the market by Santander, and the first one rated by Fitch. The seller is an active player in the Spanish securitisation market. A new issue report on the previous structured finance transaction from the same originator rated by Fitch, entitled "*Fondo de Titulizacion de Activos Santander Empresas 2*" and dated 29 December 2006, is available at www.fitchratings.com.

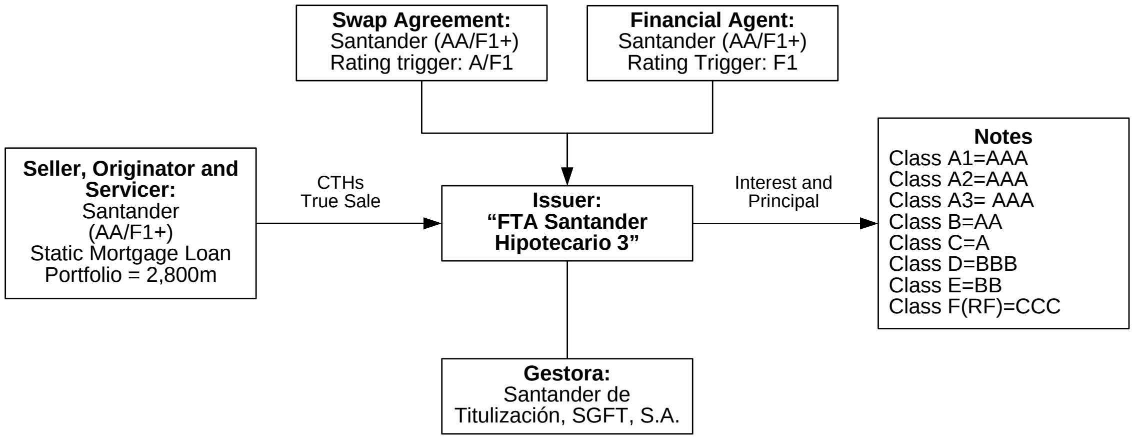
Santander is the parent of Spain's largest banking group, the result of a 1999 merger of Banco Santander and Banco Central Hispano. As of end-June 2005, Santander was the 13th largest banking group in Europe by total assets. The bulk of the group's activities are focused on retail banking, including Latin America, where operations are centred in Brazil, Mexico and Chile. Fitch's last credit analysis of Santander, dated 16 May 2006, is also available at www.fitchratings.com.

The fund will be regulated by Spanish Securitisation Law 19/1992 and Royal Decree 926/1998. Its sole purpose is to convert the mortgage transfer certificates (Certificados de Transmisión de Hipoteca (CTH)) acquired from Santander into RMBS. The CTHs will be subscribed on behalf of the fund by Santander de Titulización, S.G.F.T., S.A. (the sociedad gestora), whose sole function is to manage asset-backed funds.

The expected ratings of the notes are based on the quality of the collateral, the underwriting and servicing of the mortgage loans, available credit enhancement (CE), the integrity of the transaction's legal and financial structure and the sociedad gestora's administrative capabilities. The expected ratings address payment of interest on the notes according to the terms and conditions of the documentation, subject to a deferral trigger on the class B to E notes, as well as the repayment of principal by legal final maturity for each note.

To verify that the CE available for each class of notes is in line with its respective rating, Fitch analysed the collateral using a loan-by-loan mortgage default model specific to Spain (see "*Spanish Residential Mortgage Default Model III*", dated 15 September 2005). The agency also modelled the cash flow contribution from excess spreads using stress scenarios determined by its default model. This showed that each class of rated notes could withstand loan losses at a level corresponding to the related stress scenario without incurring any principal loss.

Structure Diagram



Source: Transaction documents

Credit Committee Highlights

- **Low or No Equity Borrowers:** The securitised pool comprises loans granted to individuals with little or no equity. The original loan-to-value (OLTV) is above 80% for 100% of the loans included in the pool. The weighted-average (WA) OLTV and the current loan-to-value (CLTV) stand at 92.4% and 90.2%, respectively. *Comparison:* Even though these ratios are among the highest seen in Spanish RMBS transactions rated by Fitch, they are slightly lower than what has been observed for recent Spanish high LTV deals. *Mitigated by:* All mortgage loans are first-ranking and approximately 37% of the pool by value benefits from a mortgage insurance guarantee (MIG) provided by American International Group Inc. (AIG, rated 'AA') and another 1.2% benefits from a MIG provided by Genworth Financial Mortgage Insurance Limited (Genworth, rated 'AA'). Fitch has given credit to AIG insurance in accordance with its MIG criteria (see Fitch's "*European Criteria for Mortgage Insurance in RMBS Transactions*" criteria report, dated 18 April 2006 and available at www.fitchratings.com). Moreover, some of the loans included in the portfolio might also benefit from co-guarantors required on a case-by-case basis by Santander. Fitch calculated base case default probabilities using these LTVs as the primary drivers and then adjusted them on a loan-by-loan basis to account for non-standard loan or borrower characteristics.

- **Scenario Multipliers:** Similar to the most recent Spanish RMBS high LTV transactions rated by Fitch, an exception to the published rating criteria for Spanish RMBS has been agreed by the credit committee. Multipliers scaling between rating scenarios have been revised to reflect the inherently higher base default probability for this high-OLTV pool and the additional information provided on the performance of these types of loans. In this regard, Santander was able to provide historical data on its mortgage book on arrears greater than 90 days from Q101 to Q305. Note that data filters used by Santander to generate vintages mirror the main features of the collateral to be securitised in terms of LTV and rank, among others. The method employed was to extrapolate the base case to higher rating scenarios using the formula known from Basel II and standard assumptions on correlations for prime residential mortgages. Due to the limited discrepancy, scenarios up to 'A' were kept conservatively at the levels implied by the standard scenario multipliers. The resulting differences in the upper rating scenarios, however, warranted a reduction in default probabilities of around 15% at the 'AAA' and 12% at the 'AA' level compared to the standard approach. This approach will also be used for similar high LTV transactions where specific data is available to warrant the adjustments.

- **Debt-to-Income Information:** Santander did not provide loan-by-loan debt-to-income (DTI) information for the pool. *Mitigated by*: In accordance with Santander's general underwriting criteria, maximum DTI (computed as all debt instalments over net income) should not be above 40%. Exceptionally, for loans with higher DTIs, Santander will always ask for additional guarantees such as co-obligors or MIG. In this regard, the maximum DTI for application to a mortgage insurance policy is 40%. Therefore, insured borrowers have been

Key Information

Portfolio Characteristics

Total Amount at Closing: EUR2,956m, as of 20 February 2007 (of which EUR2,800m will be selected at closing)

WA Original LTV: 92.4%

WA Current LTV: 90.2%

WA Indexed Current LTV: 87.4%

WA Remaining Maturity: 32 years

WA Seasoning: 18 months

Structure

Originator and Seller: Banco Santander Central Hispano (Santander)

Servicer: Santander

Fund: FTA Santander Hipotecario 3

Sociedad Gestora: Santander de Titulización, S.G.F.T., S.A.

Swap Counterparty: Santander

Final Expected Maturity: 9 November 2046

Final Legal Maturity: 18 January 2050

assumed Class 3 DTI, which encompasses loans with DTI of between 30% and 40%. For the rest of the pool, the agency has randomly distributed loans among Class 3 and Class 4 DTI, which encompasses loans with DTI of between 30% and 40%, and between 40% and 50%, respectively.

- **Bank Employee's Loans:** The collateral to be securitised includes 1.28% of loans granted to Santander employees. The agency increased the default probability on these loans (1.28% of portfolio) by 50% in a 'AAA' stress scenario. *Mitigated by*: Loans extended to employees follow the same origination policies as external borrowers and historical delinquency series provided by Santander also incorporate exposures on employees.

- **Employment Information:** Santander was not able to provide employment information on a loan-by -loan basis. Although, according to its sources, no self-employed borrowers were included in the pool, Santander could not provide a representation and guarantee to this effect. *Mitigated by:* The agency assumed that 15% of the pool had been granted to such borrowers and adjusted the default probability on these accordingly, applying a 15% hit.

- **Second Homes:** Santander was not able to provide information on the proportion of second homes in the pool. *Mitigated by:* Given the high LTV profile of this transaction as well as the geographical diversification of the portfolio, the agency assumed a percentage of second homes similar to that observed in previous Spanish RMBS deals. Although information concerning mortgage performance for second homes in Spain is limited, Fitch believes that second homes and investment properties are more susceptible to default. A financially distressed borrower is more likely to default on a second home or an investment property than on a primary residence. Therefore, the agency increased the base default probability for such loans by 20% to mitigate risk.

- **Regional Concentration:** The pool to be securitised does not present local concentration risk as the collateral is fairly well distributed among different Spanish regions. Catalonia (17.2%), Andalucía (17%) and Madrid (15.8%) constitute the highest concentrations in single regions.

■ Financial Structure

The issuer will be a limited-liability special-purpose vehicle incorporated under the laws of Spain, whose sole purpose is to acquire credit rights from Santander as collateral for the issuance of floating-rate and quarterly-paying securities, based on three-month Euribor plus a margin.

In the structure, Santander acts, among other functions, as the servicer of the collateral, account bank and swap counterparty. However, for the protection of investors, if Santander is unable to continue to service the collateral, the sociedad gestora must appoint a replacement administration company in accordance with the Spanish securitisation law (RD 685/1982).

Interest and principal collections will be handled jointly through a combined priority of payments as described below. A treasury account, held in the name of the fund at Santander, will receive all the incoming cash flows from the mortgage pool on a daily basis. Amounts standing to the credit of this account will receive a guaranteed interest rate equal to three-month Euribor.

Concerning this treasury account, if Santander's Short-term rating is lowered below 'F1', the sociedad gestora will be required to take one of the following steps within 30 days: (i) obtain from an entity rated at least 'F1' a first demand guarantee as security for the amounts deposited in the treasury accounts; (ii) transfer the treasury accounts to an entity rated at least 'F1'.

The cash/bond administration function for this transaction will be carried out by the sociedad gestora, a special-purpose company with limited liability, supervised by the Comisión Nacional del Mercado de Valores. Santander de Titulización, S.G.F.T., S.A was incorporated under the laws of Spain in 1992. The sociedad gestora, whose activities are limited to the management of securitisation funds, was involved in the pre-closing phase of the deal. After closing, it will carry out cash reconciliation and waterfall calculation functions, as well as the related reporting, including the verification of applicable triggers. It will also be responsible for taking any action in the interest of the noteholders, such as the replacement of the servicers, account bank or swap counterparty. The transaction envisages that a subordinated loan from Santander will be granted to the fund to cover initial cost and expenses at closing.

Priority of Payments (Waterfall)

On each payment date, commencing on 18 July 2007, the combined ordinary priority of payments will be as follows:

1. expenses, taxes and servicing fees;
2. net swap payment;
3. interest due on the class A1, A2 and A3 notes;
4. interest due on the class B notes (if not deferred);
5. interest due on the class C notes (if not deferred);
6. interest due on the class D notes (if not deferred);
7. interest due on the class E notes (if not deferred);
8. principal in order of seniority excluding the class F notes (see *Principal Redemption*);
9. interest on the class B notes if deferred, which occurs if the cumulative level of defaults exceeds 14.0% of the original balance of the collateral;
10. interest on the class C notes if deferred, which occurs if the cumulative level of defaults exceeds 11.0% of the original balance of the collateral;
11. interest on the class D notes if deferred, which occurs if the cumulative level of defaults exceeds 7.0% of the original balance of the collateral;
12. interest on the class E notes if deferred, which occurs if the cumulative level of defaults exceeds 6.0% of the original balance of the collateral;
13. replenishment of the reserve fund (see *Reserve Fund*);
14. class F note interest and principal amounts (see *Class E Notes*); and
15. subordinated amounts, such as net swap payments (under default of the swap counterparty), or remuneration and reimbursement of the loan to cover start-up expenses, including interest and principal due.

Cumulative defaults are defined as the aggregate balance of loans more than 18 months past due. The transaction also benefits from a provisioning mechanism whereby these defaulted loans will be written off using available excess spread.

Principal Redemption

Principal due for the amortisation of the class A to E notes on any payment date will be capped at the difference between the outstanding balance on the A to E notes and the balance of non-defaulted collateral. It will be paid subject to the availability of funds, according to the priority of payments.

The first principal payment date on the notes is expected to be 18 July 2007 and payments will be quarterly thereafter. All classes of notes will amortise sequentially on a pass-through basis. The funds available for amortisation will initially be allocated to the redemption of the class A1 notes until fully amortised, and will subsequently be allocated to the class A2 notes and thereafter to the other classes in order of seniority. Once the A1, A2 and A3 notes have been fully redeemed, all amounts available will be used to redeem the class B notes and so on. No pro-rata amortisation is envisaged with the exception of the pro-rata amortisation of classes A1, A2 and A3 subject to outstanding delinquent loans being greater than 1.5% of outstanding performing loans.

The amortisation profile for the class F notes has been structured to mirror the amortisation profile of the reserve fund. Principal funds available for the amortisation of the class F notes will be limited to the cash released from the reserve fund. Note that the reserve fund is subject to a floor (i.e., 0.4% of the initial class A to E notes balance) and will be released to the class F noteholders at legal final maturity (or before, if the 10% clean-up call is exercised). See *Reserve Fund*.

The legal final maturity date for the notes will be January 2050, which is three years after the final scheduled maturity date for all loans in the collateral pool. This delay has been deemed adequate to ensure that collections from the mortgages will be sufficient to redeem the obligations of the fund in respect of any defaulted loans.

Call Option

All notes are subject to a clean-up call option in favour of the sociedad gestora, when less than 10% of the initial collateral balance remains outstanding.

Swap Agreement

The fund will enter into a swap agreement with Santander (the swap counterparty), which will hedge the risks arising from the mismatch between the reference indices for the collateral and the three-month Euribor payable on the notes. In addition, the swap as described below will guarantee a 0.75% excess margin.

Under the swap agreement, the fund will pay the swap counterparty all the interest received from the mortgages up to 90 days in arrears. In return, it will receive three-month Euribor, plus the WA margin on the class A to E notes plus a spread of 75bp, over a notional defined as the greater of:

a. the balance of loans up to 90 days in arrears; and

the lesser of:

b. the outstanding balance of the collateral; and
c. interest collections from the collateral during the last liquidation period divided by the interest rate paid by the swap counterparty and adjusted for the number of days of the liquidation period.

Note that the issuer will also receive the servicing fees of the collateral in case of a replacement of the servicer (see *Cash Flow Analysis*).

If the swap counterparty is downgraded below 'A/F1', it will, within 30 calendar days, take one of the following steps:

- find a replacement counterparty with a Short–term rating of at least 'A/F1';
- find an entity rated at least 'A/F1' to guarantee its obligations under the swap agreement; or
- cash or security-collateralise its obligations in an amount sufficient to satisfy existing Fitch criteria.

Fitch's cash flow analysis modelled for servicing fees to be paid by the swap in all stress scenarios, considering the rating downgrade language incorporated (see *Cash Flow Analysis*). Indeed, if Santander is downgraded below 'A/F1' and when posting of collateral is the action of choice, it will, within 15 calendar days, report to Fitch the formula to calculate the mark-to-market of the swap and therefore the amount to be posted as collateral. If the formula was not in line with Fitch's criteria, the mark-to-market formula would have to account for an additional amount equivalent to 100bp times the WA life of the collateral at zero prepayments with regards to this servicing replacement cost feature.

For details on the method used to calculate the collateral amount see *"Counterparty Risk in Structured Finance Transactions: Swap Criteria"*, dated 13 September 2004 and available at www.fitchratings.com.

Credit Enhancement

In addition to the guaranteed excess spread of 0.75% payable on the swap notional, the transaction will benefit from initial CE provided by subordination and a reserve fund. This will total 8.90% for the class A1, A2 and A3 notes, 6.07% for the class B notes, 4.37% for the class C notes, 1.80% for the class D notes and 0.8% for the class E notes.

Reserve Fund

A reserve fund in an amount equivalent to 0.8% of the original note balance will be created at closing using the proceeds of the class F notes and will be held in the treasury account at Santander.

Subject to the following conditions, the reserve fund may amortise to the greater of 1.6% of the outstanding collateral balance and 0.4% of the initial collateral balance:

- the balance of loans more than 90 days in arrears remains below 1% of the outstanding performing collateral;
- on the previous payment date, the reserve fund was replenished to its required amount; and
- the issuance of the notes took place more than three years ago.

■ Legal Structure

At closing, the seller will transfer the mortgages to the fund. However, under Spanish law, mortgage loans are not actually transferred as this would entail a lengthy process of re-registering the mortgages at the property registry. Instead, mortgage originators are permitted to issue mortgage participations (PHs) and mortgage certificates (CTH). Mortgages transferred in the form of PHs are subject to certain restrictions with which CTHs do not have to comply. In particular, PHs must be first-ranking mortgages with a CLTV below 80%, and the properties underlying the mortgage must be properly insured. In this transaction, the entire portfolio will be transferred to the fund through the issuance of CTHs.

Representations and Warranties

The seller will provide representations and warranties in relation to the collateral, including the following:

Portfolio Summary

Pool characteristics	
Current principal balance (EURm)	2,956.4
Average current loan per borrower (EUR)	166.258
Average original loan per borrower (EUR)	170,390
Oldest loan in portfolio	September 1993
Most recent loan in portfolio	October 2006
Floating-rate loans (%)	100.0
WA interest rate (%)	4.01
Interest index	90.58% Euribor
Payment method	Direct debit
Loans <30 days in arrears (%)	96.84
Regional concentration (%)	
Catalonia	17.2
Madrid	15.7
Andalucia	17.0
First-ranking mortgages (%)	100.0
WAOLTV (%)	92.4
WACLTV (%)	90.2
CLTV>80%	97.9
WA seasoning (months)	18

Source: Santander

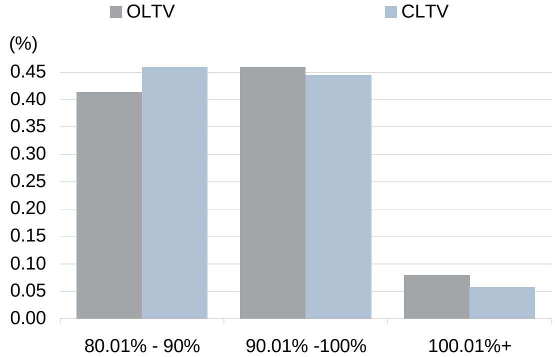
- Each mortgage loan is registered in the relevant property registry and represents a first-ranking claim on the corresponding property.
- Each mortgage loan finances the purchase, refurbishment or construction of a residential property; however, for those loans granted for construction, the property must be fully built.
- None of the loans in the pool is a RED (real estate developer) loan or is granted for commercial purposes or the acquisition of land.
- All loans have been fully disbursed and granted to individuals.
- All loans are euro-denominated and instalments are paid via direct debit.
- All properties have undergone a valuation process, as required by law.
- Each property under the underlying mortgage loan is insured as required by law. Santander has further contracted a global insurance policy that covers any insufficiency or lack of insurance.
- LTV at closing stands below 120%.
- The seller has full right and title to, and the power to sell and transfer the mortgages.
- At closing, all selected loans have paid at least four instalments.
- The seller is unaware that any of the underlying properties have been subject to a reduction in value of more than 20% since acquisition.
- All properties are located in Spain.
- None of the mortgage loans will be more than 30 days delinquent at closing.

Neither the fund nor any other transaction parties will conduct a search of title; instead, they will rely on the abovementioned representations and warranties provided by Santander in relation to the collateral, and on the external audit on a sample of the collateral. Following an irremediable breach of any of the representations or warranties, Santander will replace or repurchase the loan(s) in question.

Set-Off Risk

In the event that Santander defaults, the fund could be affected by the set-off rights of borrowers with deposits in an account held with Santander. According to Spanish law, the set-off risk should cease to be valid following the notification of assignment of the receivable to the other party (i.e. borrowers), or the bankruptcy of one of the parties. The documents include a provision to inform debtors within three days in case Santander is replaced as servicer of the collateral.

FTA SANTANDER HIPOTECARIO 3
Loan to value distribution



Source: Fitch

In addition, in the event of any set-off amounts being crystallised while Santander is not in insolvency state, the risk is fully mitigated as the seller commits in the documentation to pay such amounts plus accrued interest to the issuer.

Provisional Collateral

At closing, the sociedad gestora will randomly select the loans to be securitised from the current provisional pool. The final portfolio will have an outstanding balance of EUR2,800m, selected from a provisional portfolio of 17,782 mortgage loans. Furthermore, all the loans are first-ranking mortgages secured by residential properties in Spain. Security for the loans takes the form of mortgages registered in the “Registro de la Propiedad” (the official register).

As of 20 February 2007, the provisional portfolio’s main characteristics, in volume terms, included:

- WAOLTV and WACLTV ratios of 92.4% and 90.2%, respectively;
- WA indexed current LTV of 87.4%;

- some 49.2% of the loans had CLTVs greater than 90%; and
- WA seasoning of 18 months.

At closing, none of the mortgage loans will be more than 30 days in arrears.

Mortgage Insurance

Some 37% of the pool by value benefits from a MIG provided by AIG Europe, the European subsidiary of American International Group, Inc. (rated 'AA').

Primary mortgage insurance (MI) protects lenders and investors from principal and interest losses in the event of a borrower defaulting, by serving as a first layer of loss coverage. Fitch has given credit to this feature in line with its criteria report entitled "*European Criteria for Mortgage Insurance in RMBS Transactions*", dated 18 April 2006 and available at www.fitchratings.com. Accordingly, the agency has based its analysis on the specifics of the policy, the rating scenario, the Insurer Financial Strength Rating (IFSR) of the MIG provider, and the quality of the relationship between the insurer and insured (i.e. Santander on behalf of the fund).

The insured balance represents 4.25% of the global portfolio since the MIG covers the tranche of the first-ranking loan above an 80% LTV and up to 97% LTV. According to the master insurance policy between AIG and Santander, coverage excludes certain losses, in particular losses due to fraud or *force majeure* events, and loans must comply with a set of eligibility criteria. These criteria and Santander's representations and warranties under the terms of the policy are consistent with those included in typical securitisation transactions. Some of these requirements would be: first-ranking mortgage loan on first homes; DTI lower than 40%; outstanding balance of the loan lower than EUR350,000; and maximum tenor lower than 30 years. On a monthly basis, Santander will send AIG all the files in electronic format and AIG will run an initial audit to ensure that the loans comply with the abovementioned eligibility criteria. Besides, AIG will carry out periodic audits of the original documentation of the mortgage loans on a representative sample of the insured pool.

Under the terms of the policy, the maximum claimable amount will be capped at a maximum value resulting from the positive difference between the original LTV and 80% up to 97%, multiplied by the original appraised property value.

Origination and Servicing

In addition to the pool analysis, Fitch has reviewed and analysed Santander's origination and servicing guidelines. In this regard, the agency held a conference call with the originator and servicer manager responsible for the mortgage loan department in March 2007. The results of this conference call together with some additional information provided by the arranger are summarised below.

Origination

Like most Spanish originators, Santander originates loans through:

- branches; around 3,000 branches and 11 regional offices represent approximately 82% of total originated loans;
- real estate agents (APIs); these represent 6% of the total originated and are specially underwritten and supervised through their own specific channel; and
- real estate developers; Santander finances the construction and then subrogates the mortgage loan: these represent around 12% of originated loans.

Branches and real estate developers follow the same underwriting procedures, whereas API's are managed via a specialised process.

Underwriting

The underwriting process always combines the results of both a credit and commercial analysis. The credit analysis is supported by a scoring tool that has been in place and binding for the past three years as well as complementary checks and a hierarchical system of authorisation levels. The scoring tool, implemented to automate the credit approval process, is currently under validation from the Bank of Spain in the scope of Basel II.

At first, the application form and documentation related to the mortgage loan are channelled through the branches, which input data into the scoring system. Depending on the outcome, the transaction could either be approved at the branch or escalated to a higher level where it is studied by a specifically trained analyst belonging to the UDO (Unidad de Decisión de Operaciones).

In addition to the result of the scoring system, other parameters might result in the transaction being reviewed by an analyst. These include, among others, transactions with LTV above 80%, mortgage loans greater than EUR500,000, second homes, loans granted to bank employees or non-residents and DTI higher than 40%. Note that as the securitised pool is nearly 100% above 80% LTV, the loans must have been underwritten mainly at the UDO level.

Information requirements also include credit checks with external systems such as CIRBE (Central de Información de Riesgos del Banco de España) or RAI (Registro de Aceptaciones Impagadas) as well as the bank's internal systems and property valuation undertaken by homologated agencies and is always validated by Santander's own valuation entity (SIVASA). DTI is computed internally factoring all debt instalments over net income.

According to Santander's underwriting guidelines, transactions with an LTV greater than 80% and/or DTI greater than 40% need further guarantees such as co-obligors, additional properties backing the loan or mortgage insurance granted by AIG and Genworth (see *Mortgage Insurance*).

Santander estimates that around 25-30% of the approved mortgage applications are underwritten by the branch with the rest escalated to a higher level.

Arrears Management

Santander's mortgage portfolio is monitored at a global level through automated checks depending on the origination channel, geographical location, scoring system and so on.

Early arrears management is handled by an outsourcing company called TRAMSCOM that has been working with Santander for the past 10 years. More than 70 people work for Santander on loans between 10 and 132 days delinquent:

- For loans up to 80 days in arrears, phone calls are made to the debtors and letters might be sent by a specific team of 55-60 people.
- For loans more than 80 days in arrears, a manual and tailor-made approach is adopted by the seven person team in charge.
- In parallel to the actions taken by the call centre and the outsourcing company, the branch might also take additional measures to clear the arrears.
- For loans more that 132 days in arrears, the pre-legal procedure (precontencioso) starts and the recovery process is managed directly by a specific department within Santander that exceeds 100 people (including central and local offices). Santander's recovery team is increasingly supported by a group of external lawyers.
- Santander estimates that, as of January 2007, 1.1% of the total mortgage book enters into pre-legal procedures. Also, according to Santander, the recovery process from day one is estimated to last around 800 days.

■ Credit Analysis

Fitch analysed the collateral by subjecting the mortgage loans to stresses resulting from its assessment of historical house price movements and defaults in Spain. The agency's analysis is based on the probability of default and expected recoveries for the portfolio's individual loans (see *Appendix 1)*.

The following section details the agency's particular areas of focus and concerns regarding FTA Santander Hipotecario 3, as well as the factors it has incorporated into its analysis to deal with these concerns.

Default Probability

Generally, the two key determinants of default probability (DP) are the borrower's willingness and ability to make their mortgage payments. The willingness of a borrower to pay is usually measured by LTV. Fitch assumed higher DPs for high-LTV loans and lower DPs for low-LTV loans. The main reason for this is that, in a severe negative equity situation, borrowers in financial distress but with equity in their homes (low LTV loans) have an incentive to sell and maintain/protect their equity, thereby eliminating the need for the lender to repossess the property.

The ability to pay is usually measured by the mortgage payment in relation to the borrower's net income. Santander did not provide DTI information on a loan-by -loan basis. In line with the originator's general underwriting criteria where maximum DTI should not be above 40% and taking into account that maximum DTI for application to a mortgage insurance is also 40%, the agency distributed loans among Class 3 and Class 4 DTI, which encompasses loans with a DTI of between 30% and 40%, and between 40% and 50%, respectively. (see *Credit Committee Highlights*).

Once the base case default probabilities had been calculated using these LTVs and DTIs as parameters, Fitch adjusted them on a loan-by-loan basis to account for the following individual loan and borrower characteristics in the portfolio:

- An underwriting hit of 5% has been applied to the DP of the loans included in the pool.
- There is no local concentration risk as the collateral is fairly well distributed among different Spanish regions. The highest concentration in one single region is in Catalonia (17.2%), followed by Andalucia (17%) and Madrid (15.8%).
- The DPs for loans to bank employees have been increased by 50% in a 'AAA' stress scenario.

- The DPs of loans granted for the purchase of second homes, which have been assumed to account for 10% of the outstanding balance, have been adjusted upwards by 20%.
- The DPs of loans under a grace period (23% of the collateral balance) have been adjusted upwards by 5%.
- The DPs for loans currently 1-30 days in arrears have been increased by 25%. Loans more than 30 days in arrears were not hit since they will not be included in the final pool.

Note that, exceptionally for this transaction, Fitch adjusted the base case multipliers escalating to the higher rating scenarios in light of historical data provided by Santander and taking into account the specificities of the collateral's high LTV (see *Credit Committee Highlights*).

Recovery Proceeds

To estimate recoveries on mortgage loans in Spain, Fitch examined house price movements on a regional basis from 1987 to 2005. The agency found significant differences, most notably between Madrid, Catalonia and the Basque Country, and the other regions of Spain. Cities in these three regions have experienced higher price increases than regions elsewhere in Spain. Based on its analysis of the real estate market, Fitch assumed slightly higher market value declines (MVDs) for certain regions, as well as for some large urban areas.

To derive MVDs for the respective stress scenarios, Fitch then compared the characteristics of the Spanish real estate market with those of markets in other European countries. As with its other European mortgage default models, the agency has increased MVDs for higher-value properties. These are generally subject to higher declines in a deteriorating market than houses with average or below-average market values, owing to limited demand.

When calculating recovery value, the agency's model reduces each property's worth by the MVD, external foreclosure expenses and the cost to the servicer of carrying the loan from delinquency through to default. This cost depends on the time to foreclosure as well as the applied interest rate, which Fitch assumes to be 10%. Fitch assumes a time to foreclosure of 36 months.

Fitch Default Model Outputs

(%) Rating Level	WAFF	WARR
AAA	22.8	58.5
AA	18.1	64.9
A	13.6	70.5
BBB	9.1	74.7
BB	4.5	82.1

Source: Fitch

Mortgage Insurance Treatment

Fitch gave partial credit for the MIG backed by AIG in its recovery rate calculation for all rating scenarios.

Fitch gave credit to the MIG based on the specific characteristics of the policy, the rating scenario and the IFS rating of AIG (rated 'AA'). The shortfall in MIG payments also depends heavily on the overall relationship between the insurer and the insured party. Fitch assesses the quality of the relationship via its operational risk and quality adjustment (ORQ), which aims to capture the risk arising from denied and reduced claims and rescissions. ORQ assessments range from very good quality (ORQ1) to low quality (ORQ5). In this transaction, given the short record of the relationship between Santander and the MIG provider and the lack of comprehensive information that will support a better ORQ, the MIG was attributed an ORQ4 adjustment.

As a result, recoveries from the MIG were calculated by applying the product of the following two haircuts to the maximum insured amount underwritten by AIG on a loan-by-loan basis:

Mortgage Insurance Adjustments

	AAA	AA	A	BBB	BB
Operational Risk and Quality Adjustment ORQ4	75.0	78.0	80.5	83.0	84.5
Insurer Financial Strength Rating 'AA'	75	100	100	100	100

Source: Fitch

Cash Flow Analysis

To evaluate the contribution of structural elements such as excess spread, the reserve fund and other factors, Fitch modelled the cash flows from the mortgages based on the WA recovery rate (WARR) and WA frequency of foreclosure (WAFF) provided by the loan-by-loan collateral analysis. Recoveries included both interest and principal.

The cash flow model assumes that defaults are spread over the first five years of origination, starting straight after closing. The analysis calculated the cost of carrying defaulted loans as being the difference between the performing balance of the collateral and the notional note balance until all the recovery proceeds are collected. Excess spread, the reserve fund and principal collections must be sufficient to cover the carrying cost until all recoveries are received after 36 months.

CE analysis accounted for the interest deferral mechanism in place on the class B to D notes; this will redirect funds away from junior notes and towards the more senior ones. Should the triggers be hit, while interest on the class B to D notes may be deferred for a period, it will ultimately be paid prior to the legal maturity date.

Interest rates are stressed upwards over time, although the effect of this factor is limited because the swap covers the basis and reset risks, with the interest on the notes based on three-month Euribor.

Fitch ran various stress tests on the key variables affecting the cash flows generated by each mortgage portfolio, including prepayment speed, interest rates, default and recovery rates, the timing of recession, WA margin compression and delinquencies. The agency also modelled prepayments, which can affect certain components of a transaction (primarily, they lower the absolute amount of excess spread, which is vital to the total CE in this structure). However, since the principal repayment is directed towards the senior series, these notes benefit from higher CE as a result of the increase in subordination. Prepayments may also cause adverse selection as the strongest obligors are likely to be most inclined to prepay, which would leave the pool dominated by weaker obligors as the collateral ages. The high level of prepayments peaks at 25%, 20% and 18% under ‘AAA’, ‘A’ and ‘BBB’ scenarios, respectively. The low level of prepayments is modelled at 5% per year in all rating scenarios.

Fitch’s cash flow analysis also took into account the fact that servicing fees are to be paid by the swap. Nevertheless, the agency made the conservative assumption that the fund would still have to cover some senior expenses.

Finally, the analysis showed that the CE levels provided for each of the tranches would be sufficient to withstand the default hurdles and losses determined by the agency for the individual ratings.

Class F Notes

The performance of the class F notes requires very favourable conditions for the collateral backing the series A to E notes. Fitch calculated an expected recovery rate after testing several cash flow scenarios commensurate with speculative-grade rating levels. The sensitivity analysis performed consisted of testing several variables that affect the release of the reserve fund and, consequently, the availability of interest and principal payments on the class F notes. Fitch ran multiple stress scenario assumptions, including:

- alternative timing of default assumptions – back-loaded, front-loaded and evenly spread defaults;
- alternative interest rates – increasing, low and constant interest rate scenarios;
- prepayment speeds – high, low and average historical prepayment rates;
- different WA margin compression rates on the mortgage loans – the agency modelled high- and low-margin compression rates assuming the percentage of prepayments are allocated to the higher margin loans in the portfolio; and
- exercise of the clean-up call by the originator.

The ‘CCC’ expected rating on the class F notes is supported by the expected recovery rates. As default on the class F notes appears probable, a distribution of possible recovery rates was obtained. The recovery rate has been calculated as the present value of the class F notes’ expected interest and principal payouts using a discount factor of 8.0%. Based on Fitch’s calculation, the expected recovery rate was in the range of 50%-100% of the initial note balance.

Performance Analytics

Fitch will monitor the transaction regularly and as warranted by events. Its structured finance surveillance team ensures that the assigned ratings remain, in the agency’s view, an appropriate reflection of the issued notes’ credit risk. Details of the transaction’s performance are available to subscribers at www.fitchresearch.com.

Please call the Fitch analyst listed in the first page of this report with any queries regarding the initial analysis or the ongoing performance.

Issuer Report Grade

Fitch has recently introduced Issuer Report Scores as part of an ongoing effort to improve the transparency of transaction performance to investors. Transactions are scored on a system ranging from one star (meets basic requirements) to five stars (outstanding). For further information on the agency’s Issuer Report Scores, please see the “*Fitch Issuer Report Grades May 2006 Update*”, dated 5 June 2006.

Appendix 1

Rating Methodology

To determine appropriate levels of credit enhancement, Fitch analyses the collateral for Spanish residential transactions using a loan-by-loan mortgage default model. The model subjects the mortgage loans to stresses resulting from its assessments of historical house price movements and defaults. Fitch's study showed that the LTV, reflecting the size of the borrower's down payment, and the borrower's debt-to-income ratio (total monthly debt payments over monthly net income) are the primary indicators of default risk in Spain. Fitch also modelled the cash flow contribution from excess interest using stress scenarios determined by its default model. The cash flow test showed that each class of rated notes, taking available credit enhancement into account, can withstand loan losses at a level corresponding to the related stress scenario, without incurring any principal loss or interest shortfall.

Default Probability

Generally, the two key determinants of default probability are the borrower's willingness and ability to make the mortgage payments. The willingness of a borrower to pay is usually measured by the LTV. Fitch's model assumes higher default probabilities for high LTV loans and lower default probabilities for low LTV loans. The main reason is that in a severe negative equity situation, borrowers in financial distress but with equity in their homes (low LTV loans) have an incentive to sell and maintain/protect their equity, eliminating the need for the lender to repossess the property.

The ability to pay is usually measured by the borrower's net income in relation to the mortgage payment. Historical data available for Spain shows low levels of default. Base default probabilities are determined using a matrix which considers each loan's affordability factor and LTV. The matrix classifies affordability into five classes: the lowest (class 1) encompasses loans with DTIs of less than 20%, while the highest (class 5) encompasses all loans with DTIs exceeding 50%. The average DTI for the mortgage market in Spain is between 27%–33%.

Adjustments

Fitch adjusts the base default rates on a loan-by-loan basis to account for the individual loan characteristics of the collateral across all rating levels. In the absence of case-by-case specific mitigants, Fitch conducts the following adjustments:

- **Product type:** Fitch may increase default probability assumptions by 0%–20% for loans that have riskier profile (i.e. flexible products) vis-à-vis standard variable rate amortising loans.

- **Repayment type:** Mortgage payments by Spanish borrowers are generally made monthly by direct debit. Fitch will increase base default rates by 5% for quarterly payments and 10% for biannual or annual payment frequencies. Interest-only mortgages may be included in Spanish transactions at some point in the future. Fitch increases the default assumptions for these loans by up to 25% to take into account the balloon risk to the borrower and the strong reliance on the borrower's equity in the property.

- **Loan purpose:** Fitch believes that a financially distressed borrower is more likely to default on a second home or investment property than on a primary residence. Accordingly, Fitch will increase the default probability by 15% to 50%. If the purpose of the loan is not the acquisition of a property in Spain, Fitch will increase the default probability by 50%–100%.

- **Borrower profile:** Fitch increases the default probability on loans to self-employed borrowers by 20%-50% to account for their lack of a fixed annual salary and for non-Spanish residents, as presumably such borrowers may have less incentive to repay a mortgage loan in periods of stress.

- **Arrears status:** When rating portfolios combining current and arrears mortgages, Fitch increases base default rates for mortgages in arrears by 1–30, 31–60, and 61–90 days by 25%, 50% and 70% respectively. Fitch assumes that mortgages over 91 days in arrears (non-performing status) will have a 100% probability of default.

Underwriting Quality: Fitch's review and analysis of the origination process determines whether the agency decreases default rates by up to 25% or increases them by 0%-200%.

The adjusted default probability is scaled across rating scenario via scenario multipliers. Standard multipliers common to all European jurisdictions and independent of the type of collateral have generally been applied in the past. However, in some cases where concentrations in higher risk segments (such as high LTV), multipliers warrant adjustment according to the nature of the underlying collateral. Multipliers may be adjusted according to outcomes from benchmarking exercises using portfolio model approaches, taking into account default correlations among borrowers.

Recoveries

To estimate the recovery rates on the mortgage loans in Spain, Fitch examined house price movements in Spain on a regional basis from 1987-2005. Fitch found significant differences in price development among the regions, mainly between Madrid, Catalonia and the Basque region, and the rest of the country. The cities in these regions have experienced higher price increases than cities in other regions in Spain. As in most other countries, rural areas tend to develop on a more stable basis. Based on its analysis of the real estate market, Fitch assumed slightly higher MVDs for certain regions and for some large urban areas.

To derive MVDs for the respective stress scenarios, Fitch then compared the characteristics of the Spanish real estate market with markets in other European countries. As with its other European mortgage default models, Fitch has increased MVDs for higher value properties. These properties are generally subject to larger MVDs in a deteriorating market than homes with average or below-average market values, due to limited demand for such properties.

When calculating recovery value, Fitch’s model reduces each property value by the MVD, external foreclosure expenses and the cost to the servicer of carrying the loan from delinquency through default. For Spain, Fitch assumes that external foreclosure costs represent 10% of the loan’s balance at the time of default. Loss severity also incorporates the fact that the length of the foreclosure process might be longer than the actual one in a recession period. To calculate carrying costs, Fitch uses a worst-case scenario analysis, one that assumes the borrower does not pay any interest and the collateral is not realised for a period of three years.

Excess Spread

Excess spread represents the monetary difference between the income received by the issuer from the borrowers and the interest on the notes and other expenses paid by the issuer. Any reserve fund will be replenished from available excess spread, if it is drawn. The actual value of excess spread depends on levels of delinquencies, defaults and prepayments, as well as the WA interest rate of the reference mortgage portfolio throughout the life of a transaction.

Appendix 2: Summary

Fondo de Titulización de Activos Santander Hipotecario 3 RMBS/Spain

Capital Structure

Class	Expected Rating	Size[a] (%)	Size (EURm)	CE (%)	I/P PMT freq	Legal maturity	Coupon
A1	AAA	21.9	613.3	8.90	Quarterly	Jan 2050	3M Euribor plus a spread
A2	AAA	55.0	1,540.0	8.90	Quarterly	Jan 2050	3M Euribor plus a spread
A3	AAA	15.0	420.0	8.90	Quarterly	Jan 2050	3M Euribor plus a spread
B	AA	2.83	79.2	6.07	Quarterly	Jan 2050	3M Euribor plus a spread
C	A	1.70	47.5	4.37	Quarterly	Jan 2050	3M Euribor plus a spread
D	BBB	2.57	72.0	1.80	Quarterly	Jan 2050	3M Euribor plus a spread
E	BB	1.00	28.0	0.8	Quarterly	Jan 2050	3M Euribor plus a spread
F=RF	CCC	0.8	22.4	NA			

[a] These percentages are expressed as a proportion of the initial collateral balance.
Source: Fitch

Key Information

Closing date	29 March 2007 (expected)	**Role**	**Party**
Country of assets	Spain	**Seller/originator**	Santander
Structure	Pass-through	**Issuer**	FTA Santander Hipotecario 3
Type of assets	Residential mortgages	**Trustee**	Santander de Titulización S.G.F.T., S.A.
Currency of assets	EUR	**Swap provider**	Santander
Currency of notes	EUR	**Financial agent**	Santander
Primary analyst	marta.aisa@fitchratings.com		
Secondary analyst	josepablo.zuniga@fitchratings.com		
Performance analyst	charlotte.eady@fitchratings.com		

Source: Fitch

Fitch Default Model Outputs

(%) Rating Level	WAFF	WARR
AAA	22.8	58.5
AA	18.1	64.9
A	13.6	70.5
BBB	9.1	74.7
BB	4.5	82.1

Source: Fitch

Collateral as of 20 February 2007

Pool characteristics (percentages are expressed in volume terms)

Current principal balance (EURm)	2,956.4	**Regional concentration (%)**	
Average current loan per borrower (EUR)	166,258	Catalonia	17.2
Average original loan per borrower (EUR)	170,390	Madrid	15.8
Number of loans	17,782	Andalucía	17
WA seasoning (months)	18	**Mortgage characteristics (%)**	
Oldest loan in portfolio	September 1993	First-ranking	100
Most recent loan in portfolio	October 2006	**Loan to value (LTV) (%)**	
Interest rate type (%)		WAOLTV	92.4
Variable	100	WA indexed CLTV	87.4
Fixed	0	WACLTV	90.2
WA interest	4.01	OLTV > 80%	99.2
Interest index	Euribor (90.6%)	CLTV > 80%	97.9

Source: Santander