



Two Harbors Investment Corp.
Fourth Quarter 2022 Earnings Call Transcript

February 9, 2023



TWO HARBORS
Investment Corp.

PRESENTERS

Margaret Karr, Head of Investor Relations
Bill Greenberg, President and Chief Executive Officer
Nick Letica, Chief Investment Officer
Mary Risky, Chief Financial Officer

Q&A PARTICIPANTS

Doug Harter – Credit Suisse
Trevor Cranston – JMP Securities
Kenneth Lee – RBC
Bose George – KBW
Rick Shane – J.P. Morgan
Eric Hagen – BTIG

PREPARED REMARKS

Operator Good morning, my name is Cheri and I will be your conference facilitator.

At this time, I would like to welcome everyone to Two Harbors' fourth quarter 2022 financial results conference call. All participants will be in a listen-only mode. After the speakers' remarks, there will be a question-and-answer period.

I would now like to turn over the call to Maggie Karr.

Maggie Karr Good morning everyone and welcome to our call to discuss Two Harbors' fourth quarter 2022 financial results. With me on the call this morning are Bill Greenberg, our President and Chief Executive Officer, Nick Letica, our Chief Investment Officer, and Mary Risky, our Chief Financial Officer.

The earnings press release and presentation associated with today's call have been filed with the SEC and are available on the SEC's website as well as the Investor Relations page of our website at twoharborsinvestment.com. In our earnings release and presentation, we have provided reconciliations of GAAP to non-GAAP financial measures and we urge you to review this information in conjunction with today's call.

As a reminder, our comments today will include forward-looking statements which are subject to risks and uncertainties that may cause our results to differ materially from expectations. These are described on Slide 2 of the presentation and in our Form 10-K and subsequent reports filed with the SEC. Except as may be required by law, Two Harbors does not update forward-looking statements and disclaims any obligation to do so.

I will now turn the call over to Bill.

Bill Greenberg Thank you, Maggie. Good morning, everyone, and welcome to our fourth quarter earnings call.

Before I begin, I would like to welcome back Maggie Karr as our Head of Investor Relations. Maggie worked with us from 2012 to 2020 before leaving to try something new, but she couldn't stay away, and we are delighted to have her back on the team.

This morning, I will provide color on the market environment and our performance as well as our outlook for 2023. Mary will provide information around our financial results and Nick will discuss our portfolio.

Please turn to **slide 3** for an overview of our quarterly results. Our book value at December 31st was \$17.72 per share, representing a positive 11.6% total economic quarterly return. Our earnings available for distribution, or EAD, was \$0.26 per share. As we've discussed on prior earnings calls, EAD is a complicated metric and does not necessarily reflect the earnings potential of our portfolio. To assist our investors and analysts when thinking about our earnings potential, this quarter we are introducing a new metric called Income Excluding Market-Driven Value Changes, which will provide more of a market value-based view on our quarterly portfolio returns. In the fourth quarter, this number was \$0.73 per share, representing a 16.7% annualized return on average common equity. Mary will discuss EAD and Income Excluding Market-Driven Value Changes in further detail in her remarks. Post quarter-end, we announced that our book value through the end of January was up 4% net of the preferred dividend accrual.

Please turn to **slide 4**. Too many superlatives have already been used to describe the market environment of 2022, and I will try not to add any more, except to say that inflation fears and interest rate volatility consumed investors throughout the year. Although slow to act, once in motion, the Fed increased interest rates swiftly. Last week's Fed meeting, and Chairman Powell's comments provided additional clues about the magnitude and pace of continued Fed rate hikes. While still retaining some caution, it seems to us that the Fed's actions may be working, as inflation readings have come down for several consecutive quarters. Interest rate expectations have leveled off, with the market anticipating a Fed funds rate settling in just under 5% at midyear. However, mortgage spreads have continued to be quite volatile. As seen in **Figure 1**, after widening significantly in September and October, spreads on RMBS ratcheted tighter in November and again in January, so that along with July, we have seen three of the best months on record for excess returns of the Bloomberg U.S. MBS Index in the last sixth months. Nominal and option-adjusted spreads for current coupon RMBS tightened by 30 and 37 basis points respectively during the quarter. Due to continuing high interest rate volatility, nominal spreads, at 128 basis points, are still at the 90th percentile of their 20-year history. On the other hand, option-adjusted spreads, at 30 basis points, can no longer be considered cheap, and are trading close to their long-term averages, as seen in **Figure 2**.

Finally, in **Figure 3**, you can see that the spreads on the coupon stack are displaying their typical downward sloping shape. We continue to believe that higher coupons

offer more relative value, not only because of wider nominal and option-adjusted spreads, but also because they have shorter duration sensitivities.

At our core, we are an Agency plus MSR REIT. When the mortgages underlying our MSR are near the current coupon, the MSR acts as a spread hedge relative to the mortgage basis. But, MSR does not have to have large hedging benefits with RMBS for it to be an attractive part of our strategy. Today, with the note rates on our MSR, hundreds of basis points out of the money, half of our capital is allocated to this low duration, high cash flowing asset with very attractive returns. With prepayment speeds at historically low levels, we think there is further upside to our MSR returns.

Looking ahead, we anticipate that the market volatility will follow inflation lower and provide a tailwind for RMB and MSR. While this year saw both rich and cheap extremes in mortgage spreads, we actively managed our portfolio to adjust our exposures to benefit returns when market conditions became extraordinary. There are always surprises in the mortgage market, and we stand ready to take advantage of the opportunities as they arise. With wide spreads in RMBS and slow speeds in MSR, we believe our portfolio is very well positioned for the current and expected market environment in 2023.

Now, I will turn it over to Mary to discuss our financial results in more detail.

Mary Risky

Thank you, Bill and good morning everyone.

Please turn to **slide 5**. For the fourth quarter, the company reported comprehensive income of \$160.2 million, or \$1.85 per weighted average basic common share. Our book value was \$17.72 per share at December 31st compared to \$16.42 at September 30th. Including the \$0.60 common dividend results in a quarterly economic return of positive 11.6%. Results primarily reflect the mortgage spread tightening, as well as the repurchase of 2.9 million shares of preferred stock, which contributed approximately \$0.26 to common book value and lowered our ratio of preferred stock to total equity from 34% to 30%. Before turning to slide 6, I'd like to call your attention to Appendix slide 27, where we have included the customary information on REIT taxable income and the tax characterization of our dividend distributions. For additional information regarding the distributions and the tax treatment, please refer to the dividend information found in the Investor Relations section of our website.

Moving to **slide 6**, as Bill mentioned, this quarter we are introducing a new metric: Income Excluding Market-Driven Value Changes. This new metric is defined as total comprehensive income, excluding market-driven value changes on the aggregate portfolio, income taxes associated with market-driven value changes, nonrecurring operating expenses, and the gain on the repurchase and retirement of preferred shares. This metric includes the realization of portfolio cash flows which incorporates actual prepayments, changes in portfolio accrued interest and servicing income, servicing expenses, and price changes. Price changes are measured daily based on the assumption that spreads, interest rates and volatility factored into the previous day ending fair value are unchanged. This applies to RMBS, MSR and derivatives, as

applicable, and is net of all recurring operating expenses and income taxes not associated with market-driven value changes. In essence, you can think of this new measure as being what EAD would be if we sold and re-bought our portfolio every day. As you can see in the table on this page, this quarter, our Income Excluding Market-Driven Value Changes was \$0.73 per share, representing an annualized return of 16.7%. We are introducing this metric to better help our analysts and investors understand the current quarter return contributions excluding market drive value changes, and we intend this metric to be complementary to the return potential and outlook slide later in the deck, which reflects management's prospective view on returns. It is our hope that going forward, as EAD deviates meaningfully from our earnings power, this new metric will be instructive on the return contributions of our portfolio in the current market environment.

Please turn to **slide 7**. Earnings Available for Distribution was \$0.26 per share compared to \$0.64 for the third quarter. As we communicated on our last earnings call, the decline in EAD this quarter was expected. EAD depends on the historical purchase price, the prepay speed on the purchase date, and other non-market-based measures. EAD this quarter represents an annualized return of 5.9%, whereas we are seeing market returns in the low-to-mid double digits.

In terms of the drivers of EAD this quarter, interest income increased by \$4.9 million primarily due to a higher rate on cash holdings, partially offset by a decrease in the size of our Agency portfolio.

Likewise, interest expense rose by \$32.2 million on higher financing rates and higher average borrowing balances on MSR. This was partly offset by lower borrowing balances on RMBS.

Net servicing revenue was higher as a result of increased MSR float income, however, we realized increased amortization that partially offset the higher servicing revenue due to the EAD calculation being based on original pricing yield.

TBA dollar roll income declined by almost \$22 million, as a result of lower average notional balances as well as lower price drop. Losses on U.S. Treasury futures favorably declined \$10.2 million as a result of spread compression between the cost to deliver and implied repo. Finally, we realized higher servicing expenses due to deboarding costs associated with transitioning MSR subservicing to RoundPoint, in accordance with our previously articulated plan. We anticipate that these servicing expenses will be higher than average for the next several quarters as we continue to transition our servicing portfolio. We expect to achieve considerable expense savings once the acquisition of RoundPoint has closed and our MSR portfolio has fully transferred.

Turning to **slide 8**. The portfolio yield increased 31 basis points to 4.92%, driven primarily by sales of lower coupon Agencies that had high unamortized premiums and purchases of higher coupon Agencies with lower unamortized premiums. We also experienced lower CPR on our Agency securities and had a higher proportion of our total portfolio invested in higher-yielding assets. Our net realized spread in the quarter

narrowed by 80 basis points, to 0.97% as compared to 1.77% in the prior quarter, due to higher rates on financing. A reminder that portfolio yield calculations in this table also reflect the historical purchase price, the prepay speed on the purchase date, and other non-market-based measures.

Please turn to **slide 9**. Funding in the repo market remained liquid and well-supported. Spreads on repurchase agreement financing for RMBS increased marginally from September 30th to December 31st, to SOFR plus 11 to 17 basis points, with no signs of balance sheet stress. We maintained access to diverse funding sources for MSR with a total of approximately \$700 million unused MSR financing capacity at quarter-end.

Please turn to **slide 10**. Before I hand off the call to Nick to discuss our portfolio, I'd like to note that our economic debt-to-equity declined to 6.3x at December 31st, from 7.5x at the end of the third quarter. Average in the fourth quarter was 6.5x compared to the third quarter average of 6.8x. I will now turn the call over to Nick.

Nick Letica

Thank you Mary.

As Bill noted earlier, after capturing much of the spread tightening in the fourth quarter, we moved into a more neutral position, reflected in the decline in our debt-to-equity ratio. Continuing on slide 10, our portfolio decreased to \$14.7 billion over the quarter, down about 11% predominantly from sales of specified pools. The decreased balance can also be partially attributed to the purchase of 2.9 million shares of preferred stock, which, as Mary noted, added about \$0.26 to common book value. The fair value of our MSR portfolio was stable, ending the quarter at \$3 billion.

Before turning to Slide 11, I wanted to point out that we moved our portfolio risk positioning metrics onto one page, which is slide 16 in the Appendix. The top section shows exposures across parallel and non-parallel interest rate shocks, and as has historically been the case, our exposures are quite low. By virtue of reducing our leverage over the quarter, we also brought down our current coupon spread sensitivity into a more neutral range.

Turning to **slide 11**. **Figure 2** shows the performance of RMBS by coupon, for both TBAs and specified pools. We benefitted from having concentrated positions in 4s through 5s. We continued to rotate up-in-coupon both in TBA and pool positions, increasing the portfolio's nominal yield and OAS. We added to our specified pools in 4.5s-to-6s and in TBA's from 5s-to-6s. As you can see in **figure 3**, prepayment speeds came down 35% in the quarter, to an average speed of 5.9 CPR. The anticipated slowing of prepayment speeds is why we moved the portfolio up in coupon throughout 2022. Higher coupon RMBS perform better in slow prepayment environments and provide more stable returns over a wide range of prepayment assumptions, as we showed graphically on our last quarterly call. 30-year Fannie Mae speeds slowed down by 6% in the last report, and with the slowest seasonal months ahead, we anticipate even slower speeds over this coming quarter.

The UPB of the MSR book, as captured by **slide 12**, finished at \$206 billion with flow channel purchases and recapture of \$2.7 billion mostly offsetting portfolio runoff. The price multiple of the book was unchanged at 5.x. Notably, our prepayment speeds continue to decline. The 3-month prepayment rate for the MSR book declined to 4.6 CPR. Projected speeds in January are between 3 and 3.5 CPR. These prepayment rates are at historically slow levels, which provides a strong tailwind for the strategy.

Regarding MSR supply, it's worth noting that 2022 annual transaction volume set a record at just over \$600 billion UPB, a 32% increase over the prior year. So far, 2023 volumes have already been strong with over \$120 billion in supply. A very interesting supply and demand imbalance in the MSR market has developed. As rates have risen, and origination volumes have slowed, many mortgage companies are motivated to sell MSR. At the same time, some large MSR holders have publicly announced their decision to step back from the MSR market, focusing on customers with whom they have more than a single touchpoint. Given all of this supply, we may look to opportunistically allocate some capital to bulk MSR purchases in the first half of 2023.

Please turn to **slide 13**. We introduced this slide last quarter to provide transparency around our capital allocation, estimated return and portfolio composition for the primary components of our strategy on both a portfolio and a common equity basis. We estimate that about 53% of our capital is allocated to hedged MSR with a static return projection of 14% to 16%. The remaining capital is allocated to hedged RMBS with a static return estimate of 14% to 15%. The top half of this chart is meant to show what returns are available in the market, not merely specific to our portfolio.

The lower section of this slide is specific to Two Harbors, with a focus on common equity and estimated returns per common share. With our portfolio allocations shown in the top half of the chart, and after expenses, the static return estimate for our portfolio is between 10.7% to 12.1% before applying any capital structure leverage to the portfolio.

After giving effect to the convertible notes and preferred stock, we believe that the potential static return on common equity falls in the range of 12.9% to 15.1%, or a prospective quarterly static return per share of \$0.57 to \$0.67. Please keep in mind that these estimates do not include any price changes and hence do not include any benefit due to potential spread tightening or any loss due to potential spread widening. These return estimates also do not include any benefit from our team's skilled asset management, including asset allocation, security selection, and hedging acumen. Finally, these estimates do not include any benefits arising from increased revenue or cost savings from the acquisition of RoundPoint and transfer of our MSR portfolio.

In closing, we are excited about the opportunities ahead, and we think our portfolio is very well positioned for the market environment in 2023.

Thank you very much for joining us today, and we will now be happy to take any questions you might have.

Q&A

- Operator** Our first question comes from Doug Harter with Credit Suisse.
- Doug Harter** Thanks. Hoping you could help reconcile your new disclosure, the income ex-market value changes and the return potential. This quarter, you kind of over-earned your return potential. I'm trying to understand what the difference is there and kind of how to think about that -- those two numbers going forward.
- Mary Risky** Sure. Good morning, Doug. Thanks for the question. So there are many reasons why those numbers will be different. Slide 13 is a static look forward, whereas this metric is calculated daily and includes position changes, daily spread changes, daily compounding interests and actual cash flows and prepayments.
- Doug Harter** Okay. I guess is that sort of a structural difference that could -- will kind of always lead to differences or over time, would they kind of converge towards each other? And then along that line, how does management, the board think about the importance of each of those two metrics in terms of setting a dividend level?
- Mary Risky** So the Slide 13 is a point in time estimate. So we will have differences as portfolio changes, etc. With regards to the dividend, we set the dividend with more than one quarter in mind based on book value and return expectations. We believe the current dividend is sustainable at this level, and it is supported by the range shown on Slide 13. As always, decisions on future dividends depend on many factors including the static level return estimates as well as redistribution requirements and sustainability. And ultimately, our board of directors makes that final decision.
- Bill Greenberg** If I could add just one thing -- good morning, Doug. The number -- the metrics shown earlier, the income excluding market driven value changes, is the calculation that Slide 13 would give if calculated every day, right? So take Slide 13, calculate that every day, buy and sell the portfolio every day with market changes, position changes and everything, new spread changes and then do it again every day and string those together and compound them together. And that's what ends up with being the backward looking income excluding market driven value changes as compared with the forward looking, which is Slide 13, which is a static point in time, which by the way -- so, if nothing were to happen in the portfolio or in the market for the next three months, then those two numbers would be the same and--
- Doug Harter** --Got it. But obviously, we don't live in a world where nothing changes.
- Bill Greenberg** That's right. And it would be -- and if we bought and sold our portfolio at the beginning of the quarter on the first day, then that number would also be the same as EAD.
- Doug Harter** Okay. I appreciate that. That helps. Thank you.

- Bill Greenberg** Yep.
- Operator** Our next question is from Trevor Cranston with JMP Securities. Please proceed.
- Trevor Cranston** Hey, thanks. One, follow up on the new metric, the income excluding market value changes - specifically curious about the operating expense line. I understand you were trying to exclude one-time items from that. So is the adjustment to the operating expense line there primarily due to the servicing transfer charges, or is there anything else going on in that line that's a one-time item?
- Mary Risky** No, the servicing transfers are included in recurring operating expenses. The non-recurring are certain acquisition related costs associated with RoundPoint as well as non-recurring legal fees. And I would just note that those items are the same that are excluded from EAD but the operating expense measures are consistent.
- Trevor Cranston** Sure. Okay. That makes sense. And then with respect to the recent capital offering, can you talk about sort of how you're deploying that capital, pending any potential bulk MSR purchases? And then if there are some sizable MSR portfolios that come up for sale, could you maybe discuss generally how you'd think about the potential purchase of large pools and how much -- how high you'd be willing to take your capital allocation to MSRs? Thanks.
- Bill Greenberg** Yeah, thanks very much for that question. That's a very good one. One of the main reasons for the capital raise was to be able to take advantage of what we think is a really interesting and exciting supply demand imbalance, which is currently existing in the MSR market.
- Subsequent to the comments that we made surrounding the capital raise, we actually did sign a term sheet to acquire a portfolio of \$11 billion UPB of MSR at what we think are very attractive spreads and prices. The capital is essentially already deployed through a combination of that \$11 billion, which of course we start earning the economic returns on trade date as well as we purchased some MBS as placeholders while we continue to look at MSR packages.
- There's lots of MSR available in the market today with packages -- as Nick said, there's been more than \$120 billion of UPB coming out in the market in January alone, and we're seeing more all the time. So we think there's some really interesting opportunities there. We're continuing to bid on some of those packages.
- If you look at sort of the -- Slide 13, you can sort of see how we allocate MSR with MBS. And so you can see how much additional MSR that capital raise were to support if we were to deploy it all into MSR, which would be in the \$300 million to \$400 million range of market value. And of course, we could also redeploy some of our capital out of MBS into MSR if we thought that was really attractive, too, which depending on the levels, we might actually do, also.
- Trevor Cranston** Okay. That's helpful. Thank you.

- Bill Greenberg** Thank you.
- Operator** Our next question is from Kenneth Lee with RBC Capital Markets. Please proceed.
- Ken Lee** Hi, good morning. Thanks for taking my question. Just one more question on that new metric, the income excluding market driven value changes - would it be fair to say that that, since the income x-market driven value changes is, as you mentioned backwards looking, that the static returns would still be a very good way to assess the potential dividend paying capacity or earnings power of new money yields going forward when we're trying to assess the dividend capacity there? Just wanted to get your thoughts on that. Thanks.
- Mary Risky** Yes, I think that's a fair assumption.
- Ken Lee** Got you. Great. And then in terms of the hedging strategy that you have, the lower sensitivity to spreads, are there any particular macro or market scenarios that you're looking to hedge against at this point? Thanks.
- Nick Letica** Hey, Ken, thank you for the question. This is Nick Letica. No, we really -- we're trying to stay -- as we noted in the call, we've taken our leverage to what we believe is a neutral position, and the market, while it's certainly been very supportive of the strategy, and as Bill noted in his comments, we still think mortgages look good on a nominal basis, but look a little bit less attractive on an OAS basis. We are trying to stay very balanced, and as we typically do, have hedged out a wide variety of scenarios in terms of interest rate and interest rate scenarios. So, no, there's nothing -- there's no scenario that we are looking for specifically right here.
- We think the market is still prone to some amount of volatility, as evidenced by the payroll report that came out last Friday that injected some new uncertainty into the market. But we are well hedged across a variety of scenarios.
- Ken Lee** Got you. Very helpful there. Thanks again.
- Operator** Our next question is from Bose George with KBW. Please proceed.
- Bose George** Hey, everyone, good morning. Just wanted to go back one more on this Slide 6. So if you -- I guess assume that means now, if you're hedging with swaps versus futures, it doesn't really matter in terms of the returns that it generates in that slide. Is that right?
- Mary Risky** Yes, that's correct.
- Bose George** Okay, great. And then your comment about being neutral on -- in your positioning, does that suggest -- so is most of the basis risk now being hedged through MSR and in other ways? Is that kind of what you're suggesting?

- Nick Letica** No. I mean, the -- thanks for the question, Bose. As I think you know, the current strategy that we have, the MSR and our MBS naturally hedge each other to varying degrees over time. But we manage that spread risk along with the other risk that we have. And as also noted, we have kind of -- we've taken that risk down into what we think is a more historically neutral point to us in terms of our exposure between those two broad-based asset classes.
- Bill Greenberg** I'd like to add a couple comments to that, Nick and Bose. With -- and I mentioned this in my prepared remarks -- with the mortgage rate on our MSR being 3.25, which is very far away from the current coupon, the number of mortgages, the amount of mortgages that are needed to hedge that position in current coupon terms is a low number, right? And so our portfolios in some ways now decoupled more than it has been in the past into two segments, which is why we show that Slide 13 between the hedged MSR piece and the RMBS piece by itself.
- If you look on Slide 16, right, this is where we show our sensitivity, the portfolio sensitivity, book value sensitivity to changes in current coupon mortgage spread at the bottom half of the slide, where you see up or down 6%, depending on a 25 basis point move, and you can see the components there relative to the two parts of the portfolio themselves.
- Bose George** Okay, great. Thanks.
- Operator** Our next question is from Rick Shane with JPMorgan. Please proceed.
- Rick Shane** Sure. Thank you guys for taking my questions this morning. First, Mary, is there any chance you guys would consider publishing an historical look back at the new earnings metric back perhaps at least two years by quarter, so that way, we can sort of develop a run rate? We've got the fourth quarter number, but it would be really helpful to put things in historical context, as well.
- That's a request. And then in terms of actual question, when we look at the MSR and the distribution of coupon, and you guys are out in the market making acquisitions because of the selling, I'm curious how you think about things like purchase of -- bulk purchase of legacy portfolios with lower coupons versus flow deals that might be out there today with higher coupons and potentially ultimately much higher prepayment risk.
- Mary Risky** Good morning, Rick. Thanks for the questions. With regards to publishing a couple years backward looking of this measure, we did consider but determined that it just isn't feasible, but hopefully, if we continue to produce this metric for you each quarter going forward, that will be helpful.
- Rick Shane** Okay.
- Bill Greenberg** And I can take your question about MSR, Rick. Good morning. Thanks for the question, too. We're looking -- in the market today, there are packages of different coupons. As you know, much of this servicing, which has been produced over the last two years, is

of the low coupon variety, gross WACs in the two and three quarters to three and a half range, although we are starting to see some packages with higher WACs. You suggest that maybe the higher WAC ones have more prepayment risk. I'm not sure I would agree with that. I'd say they have more prepaid sensitivity at this point in the market because they're closer to the money. But the difference between small changes in prepayment rates when the numbers are small is also meaningful.

We do think, and I think the data is showing that this view is correct, that we're in an environment with historically slow turnover speeds, historically slow prepayment speeds. As Nick said, our portfolio is experiencing between 3 and 3.5 CPR in January, and we think that February could be even slower than that.

So that phenomenon is existing all through the low coupon MSR universe. The higher coupons, by the way, aren't paying much faster. Everything is between, four, five, six, seven, eight CPR. It's all very, very slow. And of course, the thing about MSR or mortgages in general is less about the speeds and more about whether the speeds are different from what you projected them to be.

So even if you bought higher coupon MSR and you expect in an interest rate value to speed to go up, then all that's fine, as long as the speeds are within that range, right? So it's all about relative pricing, right, and which ones we think are more attractive and which ones offer most value. And we're open to purchasing any one of those. The \$11 billion pool that we bought was of the higher coupon variety, not of the low coupon variety, and we think that offered very attractive returns.

Rick Shane

Got it. And just to pull that thread a little bit more, look, I think we can imagine a scenario at some point in the next two years where there's a significant divergence in speeds for 2020, 2021, vintage loans or pools and '22 and '23. And again, we don't have the transparency on MSR pricing. What you're suggesting is that the market is appropriately pricing for that risk. How dramatic is the pricing differential, just to give us a sense, because again, from our seat, you imagine a world at some point in the future where it's sort of highly bifurcated in terms of coupon?

Bill Greenberg

Yeah. I'm not sure I understand the question exactly, but let me say a couple words. So on the one hand, the -- oh, I know what I was going to say. So the difference you were saying between 2020 and 2021 versus '22 and forward is not just coupon, although that's part of it, but also HPA is an important part of that, too, right? And so the loans which were created in 2020, 2021 have had the benefit of a significant run up in prices. And of course, I think it's well understood in the market these days that significant HPA leads to significantly faster turnover speeds, and so that is, again, understood and priced into the market, right?

In terms of the coupon distribution of the things and the relative pricing, again, that's understood. Generically, you see where our portfolio is marked for something with a 3.25 coupon. I'd say stuff with higher coupons, I always say, as a rule of thumb, just depending on everything, as I like to say, at the money servicing is oftentimes priced at around a four multiple, right, just generically, right? And it depends on the pool, depends on the characteristics, depends on, as I said, everything. But that gives you

the range of differences between where higher coupon pools are and where lower coupons are.

Rick Shane

Okay. Thank you guys very much.

Operator

Our final question is from Eric Hagen with BTIG. Please proceed.

Eric Hagen

Hey, thanks. Good morning. Maybe just going a little bit further on the MSR, can you talk about the control that you have around negotiating the recapture opportunity in the MSRs that you could acquire in this market? And then when you think about bidding on bulk MSRs, how do you think about the attractiveness relative to the cost and kind of availability of debt financing? Like, do you envision using sort of the full advance rate that's available to you with leverage whenever you acquire bulk packages, or are there scenarios where you wouldn't maybe look to lever the MSR as much? Thanks.

Bill Greenberg

Sure. Thanks, Eric, for that question. So the first question in terms of recapture and so forth, as I'm sure you're aware, and I'm sure you're alluding to, there are some portfolios out there in the market where there are restrictions on that ability for the purchaser to solicit the bars to recapture.

That ability, whether it's present or not, is of course part of the price of the asset. So we have a very good history of looking backwards and seeing how much we think that capacity is worth to be able to be able to recapture loans in our portfolio. We have had agreements with our sub-servicers to acquire recaptured loans. And so we know what that velocity is, and we know how much money that's worth, and we can include that or not include that in the market price. And I think most market participants are these days explicitly including or excluding those cash flows from the value of the surfacing. So that's just -- it's just part of the price, right? So we don't view it really positively or negatively other than just adjusting for it in the price negotiations. Your second question was about what -- I forgot--

Eric Hagen

--The attractiveness of using debt and leverage.

Bill Greenberg

Yeah. So, your question really amounts to how we manage our overall liquidity and risk to feel comfortable in the possibility of drawdowns of various kinds, either from an interest rate movement, from a spread movement and so forth. And so when we think about the amount of capital that we have allocated to our strategy, whether it's RMBS hedged with rates or MSR hedged with RMBS and with financing on both sides, we consider how much extra cash we think we need to hold in order to adequately protect ourselves against those drawdowns.

And so the question is less easy to answer in terms of do we use the full financing as much as how much extra liquidity, how much extra cash capacity do we attach in our minds to that position after it's funded and in the portfolio? And you can see some of that on Slide 13 based on how much equity we say we have allocated to each strategy. And you can see there how much assets we have, and you can look elsewhere in our

filings about what our outstanding debt is and so forth and figure out what those numbers are.

Eric Hagen All right, great. Appreciate it, you guys. Thanks.

Bill Greenberg Yep, thank you.

Operator We have reached the end of our question-and-answer session. I would like to turn the conference back over to Bill for closing comments.

Bill Greenberg I just want to thank you everyone for joining the call today and thanks everyone for your support of Two Harbors.

Operator Thank you. This will conclude today's conference. You may disconnect your lines at this time, and thank you for your participation.

CONTACT INFORMATION

Investor Relations
Two Harbors Investment Corp.
612-453-4080
investors@twoharborsinvestment.com