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Servicer Evaluation: Quantum Servicing Corp.

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Servicer Evaluation: Quantum Servicing Corp.

Opinion

Standard & Poor's Ratings Services assigned Quantum Servicing Corp. (Quantum), a wholly owned subsidiary of Clayton Holdings Inc., an AVERAGE ranking as a residential special loan servicer. The ranking is based on the company's superior level of automation, industry-experienced management team, and developing internal control and risk management environment, along with strong process management, thorough policies and procedures, a satisfactory (and developing) training regimen, and successful execution of strategic business initiatives.

Senior management has established aggressive growth targets. In order to accommodate this planned, robust portfolio growth, Quantum is rapidly developing a qualified servicing staff consisting of experienced personnel and has begun to establish a second servicing site in Tampa, Fla. Quantum's plans for additional locations will provide for stronger disaster recovery and business continuity support and access to regional job markets. In addition, senior management has established a pervasive corporate governance structure within loan administration that focuses on key factors such as continuous process improvement, capacity planning, and financial planning. Moreover, management has identified certain functions of special loan servicing where it is prudent to outsource the work to qualified third-party vendors; this enables the company to leverage the vendor's staff and expertise while reducing personnel expenses in order to grow the business. Quantum continues to improve its operating efficiencies by investing in technology and by further developing management and staff.

Outlook

The outlook is stable. Management is committed to improving Quantum's performance and profits by expanding its loan servicing portfolio. Quantum's servicing strategy is to capitalize on its superior automation, experienced management team, and sound internal controls to maximize cost efficiencies while providing superior service and minimizing investor portfolio risk. By hiring experienced staff, Quantum is becoming well situated to achieve its stated goals, and we expect Quantum to be a competent special servicer in the residential loan servicing market.

Profile

Quantum was founded in 2005 and is a subsidiary of Clayton Holdings Inc. (Clayton), a publicly traded entity. Founded in 1989, Clayton is a leading information and analytics company serving capital markets firms, lenders, investors, and mortgage loan servicers. Clayton provides services including due diligence analytics, conduit support, compliance products and services, credit risk management, and surveillance and specialized loan servicing. The parent company's management and expertise have helped Quantum develop and directed its early growth. Chairman and chief executive officer Frank Philipps heads Clayton and has over 15 years of industry experience. Quantum's management and staff are developing and include highly qualified, experienced personnel hired from other servicers in the industry.

Clayton management has a history in special servicing. The Clayton Group created First Madison Services (a Quantum affiliate) in 1995 to provide special servicing of nonperforming loans for its clients, including REO management. First Madison currently performs loan servicing, including default management and loss mitigation, for assets owned by the Department of Housing and Urban Development (HUD). Quantum's special servicing is growing and totaled 3,477 loans and approximately in \$667 million in aggregate UPBs as of June 30, 2007. The

number of loans and aggregate UPBs will always be influenced by the type of business Quantum is engaged in; the company boards and special services pools of loans that are typically delinquent when boarded. Quantum and delinquent borrowers agree to a workout arrangement resulting in a cure or reinstatement, at which point the newly performing loans are pooled and securitized and servicing is released. Quantum and its affiliates continue to expand the company's footprint throughout the U.S., with immediate plans to open a second platform in Tampa, Fla.

Chart 1



Management And Organization

The ranking of AVERAGE is assigned for management and organization.

Management and staff recruitment, development, and training

Quantum has a seasoned management team, comprehensive and well-written policies and procedures, and developing internal controls, along with satisfactory and developing training programs and a sound level of automation. Quantum management, recognizing the company's size and early stage of development, has astutely decided to engage a subservicer to manage most of the nondefault management servicing functions and outsources several default management functions. Leveraging its vendors' experience with default management has allowed the company to grow while developing its own staff and immediately offering competent servicing for its clients. Internally, the company has been formed from the top down and has experienced limited turnover, which contributes to a very stable loan servicing environment.

- Senior managers average more than 18 years of industry experience and over one year with the company.
- Middle managers average over nine years of industry experience and one year with the company.

Quantum recognizes that successful operations include a well-rounded, stable staff and is developing superior training at both the corporate and departmental levels. The company offers extensive training opportunities to employees according to their discipline, experience, and tenure. Quantum also leverages its parent's training curriculum, "Clayton University." Employees receive at least 20 hours of training each year, and career-pathing and cross-training opportunities are available to all. Individual development plans are a part of the annual employee review process, which helps ensure employees' growth. Training programs use various media, including computer-based training (CBT) modules, a Web-based curriculum, and classroom instruction. Highlights of the training program include the following:

- The new-hire orientation program includes 40 hours of introductory training, while new hires for call center work in customer service and collections receive an additional 16 hours and 160 hours classroom and skills training respectively.
- Six hours of FDCPA training and FDCPA certification are required.
- Quantum line managers conduct job-specific training.
- Required and recommended courses are identified by discipline.
- The company has created "succession trees" to identify advancement opportunities and develops individual employee plans, which it updates annually.
- Quantum developed a training matrix to track employee training.

Internal controls

Quantum exhibits solid controls in the development, drafting, and dissemination of loan servicing policies and procedures. The company has effective methodologies in place for reviewing and updating policies and procedures manuals, including:

- The manuals are well-written and concise, using a combination of descriptive narrative and task-specific instructions.
- Policies and procedures are available to all employees on the company intranet.
- Electronic bulletins communicate updates to policies and procedures, ensuring consistency in the performance of servicing tasks.
- Changes to policies and procedures are approved via an authority-level matrix.
- All loan administration areas conduct annual review of policies and procedures to ensure that they are up-to-date.

Quantum is developing an effective internal audit program. Its parent company's compliance committee currently manages the audit schedule and scope. Over the past 12 years, Clayton has gained extensive experience providing the same services for its clients as Quantum, so it can provide sound direction for Quantum management while it establishes its own internal audit program and staff. The internal audit area reports directly to the parent board of director's audit committee. The current audit methodology includes:

- The audit plan is risk-based and includes financial, operational, compliance, and technology audits.
- Special servicing annual audits were scheduled for the second and third quarters of 2007.
- A contract compliance (SLA) audit is scheduled for the third quarter of 2007
- In addition to the internal audit, Quantum conducts comprehensive self-assessment reviews for various sections in its Shelton, Conn., main office and on certain aspects of its subservicer's operation, including data integrity

reviews for lien position, prepayment penalty calculations, ARM audits, and vendor operational reviews.

Quantum's corporate governance includes a risk management committee, a management committee for self-assessment, and a compliance steering committee. The purpose of these management oversight committees is to identify, prioritize, and mitigate risk. There is also an experienced director of internal controls who reports directly to the company CFO and coordinates efforts to further mitigate risk by working with Quantum's chief compliance officer. This individual also helps management evaluate internal controls. A sound methodology, including risk assessment, monitoring, control activities, and communications, is emphasized throughout the organization.

The company has established corporate performance management and analytics with the goal of translating the organization's strategy, initiatives, and tasks into a succinct performance management plan. The plan includes increased use of predictive analysis, loss forecasting modeling, and action plans for key result indicators. Quantum has designed a menu of management reports to track performance and quality.

Legal

From time to time Clayton Holdings Inc., the ultimate parent of Quantum Servicing Corp., may be party to various claims, suits and complaints. Currently, there are no such claims, suits or

complaints that, would have a material adverse effect on the business, results of operations and financial condition.

For additional information, please refer to Clayton Holdings Inc.'s U.S. Securities and Exchange Commission Form 10-Q report for the period ended Dec. 31, 2006.

Technology

Quantum developed Mortgage Asset Recovery System (MARS), a proprietary asset management system for business operations and recovery, to support its late-stage collections, loss mitigation, foreclosure, bankruptcy, REO asset management, and resolution for special servicing. The system provides all the necessary tools to manage nonperforming loans and includes the following:

- A transaction module for loan boarding and payment processing.
- A loan module for loan review and editing of loan-level customer data.
- A loss mitigation module for managing and tracking pools of nonperforming and special loans, including solicitation letters, and NPV systems.
- A letters and forms module to facilitate the use and editing of standardized communications.
- Specialized modules for monitoring and tracking bankruptcies and foreclosures.
- A collateral module to add and track property values for assets securing loans.
- A module used in managing third-party vendors.
- A task tracking module used to add and track tasks and responses to borrower requests and inquiries.

The system can also be used when creating asset plans for each loan and can produce numerous daily and monthly management reports. Moreover, the system facilitates the use of the company's Web site and, in particular, electronic communication with delinquent borrowers. Appropriate employees are provided with an extensive procedures manual and instructions on how to maximize use of its computer system.

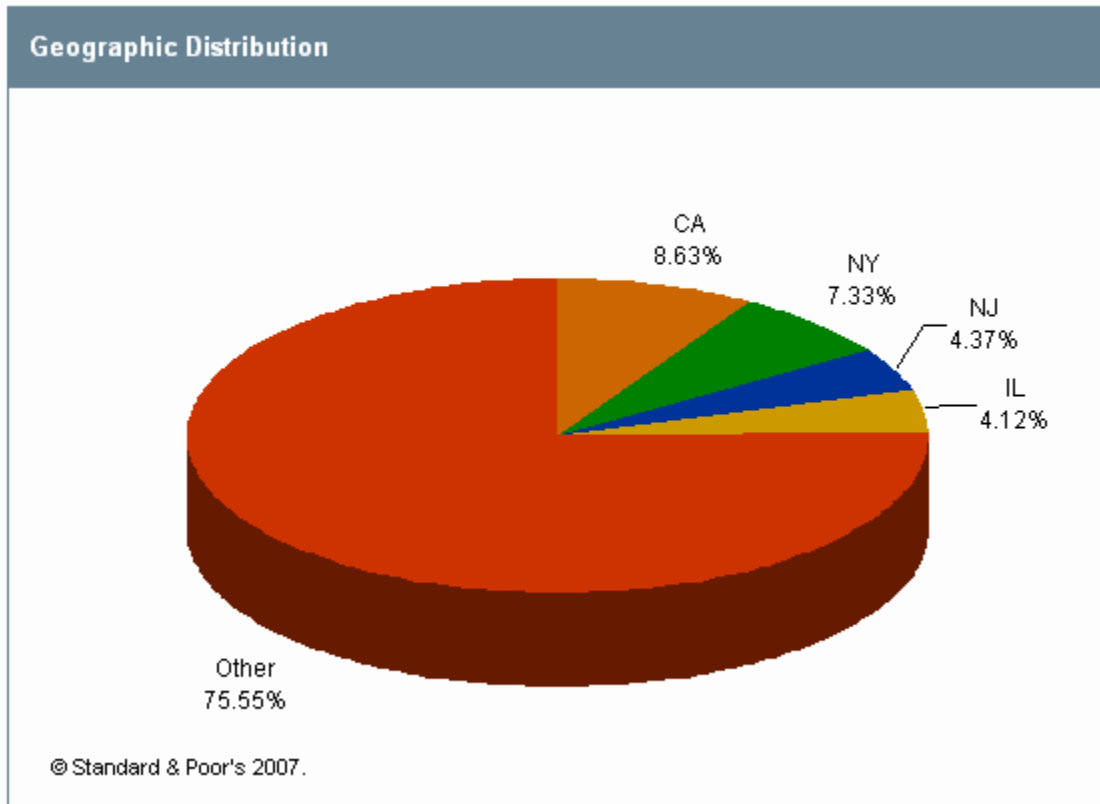
The company has a well-developed disaster recovery and business continuity plan (DR/BCP). Quantum is a part of its parent's overall DR/BCPs. The company completed a business impact assessment and updated the DR/BCP documents in 2006. The plans were successfully tested in March 2007 and will be tested annually. Quantum has

access to several alternate location sites across the country, as well as two regional sites. In addition, key employees can access the company network via VPN and Citrix connections.

Loan Administration

The ranking of AVERAGE is assigned to Quantum as a special servicer.

Chart 2



Senior Vice President John Anderson is responsible for business relations and development. The servicing staff, currently all located at the company's Shelton, Conn., headquarters, consists of 42 employees and continues to expand. Mr. Anderson is assisted by an experienced and capable management team. Ted Korzenski, another experienced and capable mortgage executive, is senior vice president responsible for day-to-day operations. Quantum's special loan servicing management includes oversight of functions assigned to a subservicer and/or third-party vendors. Quantum's special loan portfolio is geographically diverse, with the heaviest concentration of loans (based on total loan count) in California (8.6%), followed by New York (7.3%) and New Jersey (4.4%). This diversity provides a satisfactory level of insulation against additional delinquency spikes caused by regional economic downturns.

Standard & Poor's reviewed all areas of loan administration, including the loan boarding function, customer service, escrow administration, and adjustable rate loan analysis, and we also evaluated Quantum's oversight of its subservicer and third-party vendors. Overall, Standard & Poor's found these areas to be satisfactory, and we discuss key areas of risk in more detail below.

New loan boarding, cash management, and investor accounting

Robert Pazura heads nondefaulted loan administration and has over 15 years of residential mortgage loan servicing experience. Additionally, Quantum has engaged a large private-label subservicer for payment collection and processing, escrow administration, customer care, and payoffs. Loan administration's primary responsibilities include coordinating the activities necessary for accurate and timely new loan transfers, managing the activities of its subservicer, and supporting default management. A key employee is assigned to subservicer oversight, and prudent and sound service-level agreements and a responsibility matrix underlie the relationship between Quantum and the subservicer.

Quantum and the subservicer tightly coordinate new loan boarding, an important early step in the servicing of special mortgage loans. The subservicer provides basic boarding reconciliation and verifies loan balances. Quantum personnel perform robust quality assurance on new loans boarded and also do a triage-like analysis and workout strategy. Welcome calls are made and skip-tracing begins where necessary. A satisfactory oversight system ensures an efficient cash management environment, and solid internal controls are in place to minimize risk of loss from error or fraud. The subservicer uses the Fidelity MSP system to update borrower records after payments are processed. Quantum loan administration receives Passport files with updated borrower information daily, which it reviews for timeliness and accuracy. The subservicer reports that:

- Approximately 58% of all payments are processed by lockbox.
- The lockbox capture rate is 95%.

Quantum personnel and its staff handle investor accounting, including reporting, remitting, and reconciling accounts in accordance with stated investor expectations. Several layers of company- and corporate-level accounting provide oversight to ensure proper reconciliation and to certify that investor remittances are made accurately and on time. The company's chief financial officer has more than 25 years of financial services experience and oversees the investor accounting function.

Quantum's aforementioned relationship with its subservicer affects the manner with which the company manages investor remitting and reporting. The subservicer collects payments, processes them using the Fidelity MSP system, and then transmits payment information daily to Quantum's MARS system. The investor accounting area prepares reconciliations, confirms that loan and system balances agree, then submits them to Clayton's VP of finance for review. Subservicer fees and advances are checked. Quantum submits all advances it makes to clients and reconciles them with individual loan balances (principal, interest and escrow), which the company's controller reviews. Custodial accounts are updated monthly and undergo a second level of review. Overall, there is excellent segregation of duties, a high level of automation, and effective managerial control over the investor reporting, remitting, and reconciling functions, which should serve to guard against risk of loss due to errors or fraud.

Escrow administration

Quantum's subservicer is responsible for escrow administration. Quantum management represents that approximately 85% of its portfolio maintains escrow accounts for the payment of real estate taxes and/or property insurance. The subservicer's responsibilities include performing an interim escrow analysis within 60 days of loan boarding, paying all tax and insurance payments and responding to all escrow-related inquiries. Quantum administers the subservicer's management of the escrow function with frequent telephone conferences, on-site audits, and exception reporting, along with reviewing the results of a sample of completed escrow analyses, determining that escrow payments are remitted timely, and monitoring calls.

Customer relationship management

Quantum's subservicer also performs the typical customer service functions. Quantum monitors the subservicer's customer service performance as it does for the escrow function, with weekly telephone conferences, quarterly on-site meetings, and exception reporting. The subservicer must also comply with rigid performance metrics set forth in the service-level agreement. The subservicer responds to all customer service-related calls received from borrowers whose payments are less than 16 days delinquent. For borrowers with payments 16 days or more delinquent, the calls are "warm transferred" to Quantum personnel. The subservicer responds to written correspondence in accordance with RESPA guidelines. There are now 4 employees assigned to customer service duties at Quantum's main office. The subservicer also provides Quantum with monthly performance metrics. The measurements reported include:

- Abandonment rate;
- Hold times;
- Fir-call resolution rate; and
- Numbers of payoff and reinstatement requests.

Default management

Quantum is structured to focus on and emphasize default management, including collections, loss mitigation, foreclosure and bankruptcy oversight, and REO management and disposition. Vice President Joe Caravetta, who has more than 20 years of industry experience, manages collections. The company has taken advantage of the availability of experienced collectors due to the closing of a subprime servicer nearby and is building a strong staff. The collection department is driven by strict client goals and objectives. There are currently six collectors who average more than eight years of industry experience. The department maintains appropriately effective hours of operation. Collection efforts take place 8:00 a.m.–11:00 p.m. Monday-Friday and 9:00 a.m.–3:00 p.m. Saturday and Sunday. The collection department works on 1- to 59-day delinquent loans. Early-stage collectors attempt to:

- Locate and contact delinquent borrowers;
- Communicate to determine the reason for default and the borrower's interest in and willingness to pay, and to identify reinstatement opportunities; and
- Determine loss mitigation candidates and attempt early intervention to minimize loss.

Collection efforts are appropriately increased as a default worsens:

- Soft reminder calls begin on day three of default and continue through day 13.
- Soft collection calls are made on days 14-16; late-charge notices are generated on day 16, and no-contact letters are sent if necessary.
- Strong collection calls begin on day 17 and continue through day 29. During this period, the collector attempts to determine whether there are extenuating circumstances causing the default and to identify loss mitigation candidates.
- From day 30 to day 45, stronger collection calls are made, with additional attempts to determine the reason for default and whether the borrower is likely to pay and is a candidate for loss mitigation.
- • During days 46–59, collection efforts continue and the first loss mitigation letter is sent (on day 47).
- • On the 60th day of default, a notice of intent (NOI) to foreclose is sent along with a borrower financial package. The loan is also referred to the loss mitigation team.

Quantum has developed numerous collection strategies based on:

- Days delinquent;
- Broken promises to pay;
- Payment performance history;
- Product type and combined LTV;
- Updated FICO scores;
- First and early payment defaults;
- ARM resets;
- Occupancy status; and
- Other risk factors, including geography and demographics

The company utilizes predictive dialer technology to maximize overall collection efforts. Other methodologies include aggressive skip tracing, call blending, and the use of IVR technology. 100% of collection calls are recorded, and management monitors 10% of all calls per month for each collector for quality control and to identify training needs. The collection staff includes bilingual employees.

Quantum management has developed an appropriately experienced loss mitigation staff and has clearly defined and robust procedures designed to reinstate nonperforming loans, mitigate losses, turn nonperforming loans into cash flowing assets, and keep borrowers in their homes. There are 12 full-time employees assigned to loss mitigation. Asset managers average almost 10 years of related industry experience. Immediately after a loan reaches its 60th day of delinquency, asset managers attempt to contact the borrower and determine the ability and willingness to pay. Based on the initial communication, the asset manager decides upon the most appropriate loss mitigation option. Part of this process includes reviewing previous collection efforts, going over payment histories, updating FICO scores, and analyzing the present value of the collateral in light of current real estate trends. The company also conducts a net present value (NPV) analysis, which it uses along with its Key Decision Tool to establish the most desirable and profitable workout plan. The most frequent workout or resolution options include:

- Full reinstatement;
- Forbearance or repayment plans;
- Formal loan modifications;
- Refinancing/payment in full;
- Short sale;
- Deed in lieu;
- Note sale; and
- Foreclosure.

Quantum uses its proprietary technology system throughout the loss mitigation process. When a loan reaches the 60th day of delinquency it is electronically assigned to an asset manager. This triggers production of numerous management reports, and management can track the progress of individual loans as well the performance of the asset managers. Aggregate results are compared to established performance standards. Performance measurements include:

- Call attempts by asset manager each month;
- Call attempts during prime-time calling hours;
- Overall right-party contact rate;
- Average days between call attempts;

- Percentage of 60-plus-days delinquent accounts without contact;
- Percentage of calling campaigns conducted during prime time;
- Percentage of monthly mailings to borrowers not already engaged in a loss mitigation program; and
- Recidivism rates.

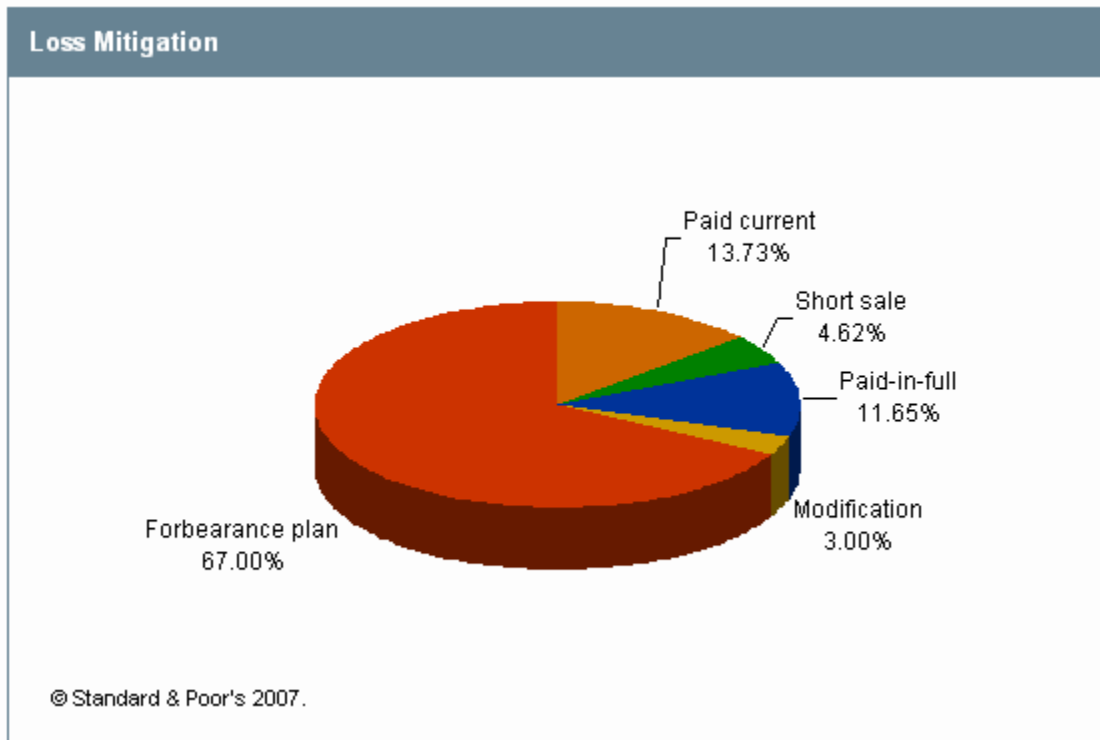
Borrower contact and loss mitigation efforts continue until the 95th day of default. At that time, if the borrower has not agreed to a formal loss mitigation plan, the loan is referred to foreclosure.

A stringent foreclosure review process is in place to ensure that all collection efforts have been exhausted prior to commencing foreclosure, and the company follows a dual path strategy wherein telephone contact will continue during the loss mitigation and foreclosure phases, where permitted. Standard & Poor's believes

that the continued collection effort is a worthwhile use of departmental resources, given the cost associated with foreclosure and real estate disposition.

April Garitta , who has over 15 years of relevant management experience, directs foreclosure and bankruptcy administration. Primary objectives are timeline adherence and legal and regulatory compliance. The foreclosure process is outsourced to a third-party vendor that has an experienced staff and foreclosure attorney network. The vendor has an employee on-site. The aforementioned foreclosure committee that must approve referrals to foreclosure includes investor representation. The committee meets weekly and maintains a thorough checklist to assure that all viable means available to cure a default have been attempted. Foreclosure attorney activity is monitored by daily step control reports which track functions due and workload volumes. There are also weekly vendor review meetings and attorney performance reporting. The vendor is responsible for establishing the foreclosure in the foreclosure module of Quantum's MARS system and for communicating with Quantum's subservicer, which creates the FIS foreclosure workstation. Quantum also uses VendorScape and iClear for tracking and to ensure the prompt payment of invoices due.

Chart 3

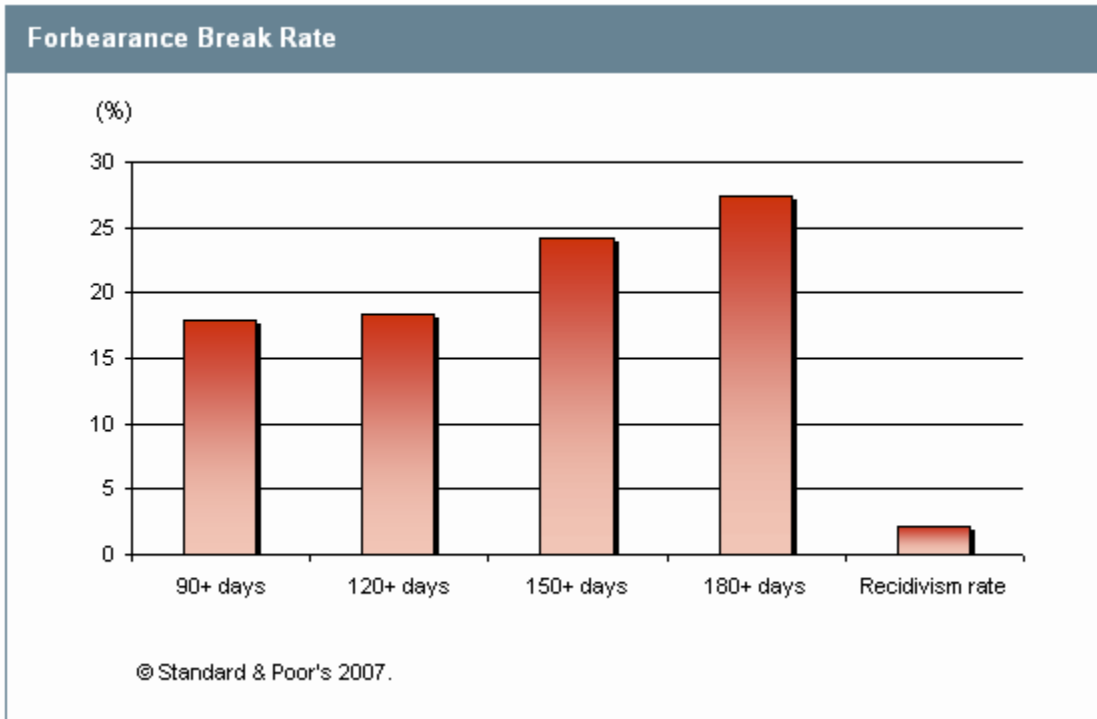


Quantum also administers loans in bankruptcy using effective timelines. All efforts are compliant with federal and state laws and regulations. Daily activities required to protect investor interests are outsourced to a well-known and reputable third-party vendor. Managers at the vendor average more than 20 years of relevant experience, and Quantum foreclosure administration management and vendor management meet weekly. The vendor uses:

- VendorScape;
- BANKO; and
- iClear.

All proofs of claim are filed within 30 days of receipt of notice. Management has created bankruptcy timeline reports and flow charts to manage the process.

Chart 4



Quantum also assigns the final disposition of real estate acquired through foreclosure to one of three third-party vendors, which allows the company to leverage the vendors' property management expertise, networks of approved realtors, established management timelines, and dedicated REO closing networks. In addition, the company benefits from its parent's prior experience with REO management. Quantum typically refers properties acquired via a foreclosure sale to the REO vendor within one business day of acquisition. The process includes premarketing activities (agent selection, valuation report updates, eviction/cash for keys, property preservation, timeline expectations); listing and marketing activities (establishment of market value, development of marketing strategy, monitoring of necessary property repairs, processing of purchase agreements); closing activities (follow-up and coordination with brokers, closing attorneys and lenders; reviewing closing documents; and receipt of funding). Quantum has developed an effective REO performance timeline and an REO marketing flow chart to better manage the turnover of owned real estate in a very timely manner. REO vendors are monitored and graded for performance.

Financial Position

The financial position is deemed to be SUFFICIENT.

The SUFFICIENT ranking is based on the debt rating and stable outlook on Clayton Holdings Inc., parent company of Quantum Servicing Corp. Additional information on this rating can be found on RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis, at www.ratingsdirect.com.

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