

Prospectus

Giants of the Mortgage Industry, 2007

How Long Will The Turmoil Last?

- **Analysis: Earnings, Credit, & Home Prices**
- **The Full 2006 Score Card by Company:**
 - **Originations by Channel**
 - **ARM, FRM, Refi, Purchase, & Govvie Breakouts**
 - **Servicing, WAC, Runoff, IO & PO Lending**
 - **Delinquency, Foreclosure, & Profits**
 - **Market Shares**

Optional Companion Study
**Dangerous Customers: High-CLTV
Concentrations By Lender & County**

Important Information about a new SMR Research Study

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SUMMARY OF THE STUDY

In just one year, we've witnessed the collapse of the subprime sector, rising overall delinquency, falling earnings, and the likely near-future disappearance of at least seven of the Top 25 U.S. mortgage originators.

In Washington, mortgage lenders (once heroes who enabled a rising home ownership rate) are now portrayed as an industry gone wild with greed or stupidity, needful of tight regulation. Class action lawyers are getting busy, too.

The questions of the hour: Why has this happened? How long will the trouble last? Will credit problems in subprime migrate upward?

Usually, we dedicate most of our March mortgage study to the recent past, creating a detailed scorecard on lenders for the prior year.

But this year, the first 37 pages of the study are different. We take a look at the current turmoil and try to answer the immediate questions.

We find that the single most important cause of the current crisis is the gap between home prices and consumer incomes, which grew far too large and had to result in a price decline. High-CLTV lending into the start of the depreciation left too many home owners unable to cure delinquency by refinancing or selling.

The good news is that the price/income gap is now shrinking. We show in tabular and chart form how much gap is left. There are, of course, other issues as well covered in Section I of the study.

Other sections continue our long series of data coverage on specific lenders for full-year 2006: loan production by channel, refi and purchase breakouts, ARM versus FRM production, FHA/VA production, servicing volumes and shares, delinquency and foreclosure rates by firm, weighted average coupons, average loan sizes, and more.

We've added an optional companion study this year, too. It's called Dangerous Customers.

This study, for the first time, ranks lenders and counties by their percentages of borrowers whose current CLTV ratios exceed 95%. Using a new SMR methodology, the results are almost scarily predictive.

Out of 270 lenders ranked this way (highest-to-lowest), literally all the recent bankruptcies, company closures, and forced company sales occur at the top of the list – and none toward the bottom. See Pages 4 and 8 of this Prospectus for more information.

An Order Form is enclosed. Thanks.

HIGHLIGHTS

Turmoil In 2007: How Long Will It Last?

We are optimists about the long-term future of the mortgage industry. Home ownership remains the great American dream, and refinancing can be very helpful. Consumer demand for mortgage loans will never go away.

But for now, we see real trouble. In the past, downcycles in mortgage profits have been caused at one time or another by reduced origination volume, tight spreads, or regional home price declines causing bad loan spikes. Today, all three are happening at once, and the price drop is a national event.

The **Profits and Credit Quality** sections of the study show earnings, delinquency, and foreclosures by lender through the end of 2006. It's not pretty.

In Section I of the study, we devote much more space to the causes of the current dilemma and scenarios for how long it will last. Our conclusion is a bit gloomy for now, but 2008 could be better.

As the gap closes between consumer incomes and home prices, defaults should decline and home sales should improve. We show the gap in tabular and graphic formats back to 1990.

Change At The Top: Many Will Fall, But Citigroup Rises

No one expects to see the industry's two biggest players, Countrywide and Wells Fargo, to disappear. But some other major players certainly will, and soon.

Looking at the Top 25 loan originators of 2006, we expect at least seven to fall off that list in 2007. Some will drop off the list of the living.

Some others, however, will benefit. **Citigroup, the largest mortgage producer in the 1980s, now appears poised to climb back to third place.** Citi becomes the prime beneficiary of the current turmoil.

Wall Street firms, once merely loan securitizers, are rapidly becoming major origination competitors. **But this might be a trend in flux.** One firm has already been burned badly and others aren't all enjoying the results of their recent subprime lender acquisitions.

Details appear in the Giants section of the study, as well as in Section 2 on industry consolidation.

HIGHLIGHTS (continued)

All The Stats On Top Players

Twenty years ago, SMR was the first to rank mortgage lenders by their loan production volumes. Today, you can get such simple rankings in trade papers.

That's why we shifted long ago to providing dozens more details on peer competitors by subject. This study brings you more data than ever by company on 2006 results.

The Giants section shows all-new data on more than 50 top companies: Originations by channel, market shares, servicing and share of servicing, comparisons of second-half to first-half 2006, plus 12 pages of analysis.

Three sections on market characteristics tell more by company and for the industry: refinance versus purchase volumes; FRM versus ARM production; interest-only, pay-option, and extended-term lending volumes; weighted average coupons in servicing portfolios; loan runoff rates, and average loan sizes.

Credit Quality and Profits sections show delinquency, foreclosure, and earnings by company. Our bad loan rates are based on [dollars](#) in trouble – arguably more important than the MBA survey on [numbers](#) of bad loans.

If you need to measure all you are doing against peer competitors, this is the only study that does it.

Dangerous Customers: High Current CLTV Ratios

This year, we offer a one-time companion study to the Giants work. It's called **Dangerous Customers**. This seemed like a good time to do it.

Two times in the recent past, SMR has looked at percentages of customers “under water” on their debts (debt exceeds home value). But we only looked at a couple segments of the mortgage market.

This time, in a study spanning 159 pages (with spreadsheet backup), we evaluated all lenders on all kinds of loans, including junior liens. **SMR used its big database of courthouse property and lien records to compute current CLTV ratios on 31 million debtors owing \$6.54 trillion.** We output results by [county](#) and by [lender](#).

Results: Mind-boggling. Ranking 270 lenders by their percentage of customers with CLTV over 95%, you basically get a “risk list” where most firms near the top are bankrupt or in trouble – and virtually no one toward the bottom of the list is having any trouble at all.

See more about this study on Page 8 of this Prospectus.

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Dangerous Customers: A Study Of High-CLTV Borrowers

Lenders always look at a borrower's combined loan-to-income (CLTV) ratio at the time they originate a loan. **But a lot can happen later.** A borrower may add to his debt with a home equity loan. Or his home's value may change.

SMR has devised a method, using county courthouse property and lien records, to estimate current CLTV ratios of individual borrowers. In this study, we estimated current CLTV ratios for 31 million owner-occupied homes, owing \$6.54 trillion in mortgage debt – a majority of all debt in existence.

We compiled the data by county and by lender. And the results seem unmistakable: **The distribution of current CLTV ratios is what predicts disaster or health at a time of flat to falling home prices.**

Looking at counties, those with the highest percentages of borrowers with current CLTV ratios above 95% typically have the highest foreclosure rates. **Among populous places, Adams County, CO, now leads the list, with an alarming 46.7% of home owners in that sinking boat.**

We ranked 270 of the largest U.S. mortgage lenders the same way. A list of them, ranked worst-to-best, is pretty amazing.

The 10 highest-ranked firms included Ownit Mortgage, Mortgage Lenders Network, and Resmae, all now bankrupt. Another in the top 10, FMF Capital, reports negative net worth. Another, GE's WMC unit, is laying off workers. Another, First NLC Financial Services, is "exploring strategic alternatives."

The 11th worst, Silver State Mortgage, has closed. The 18th worst, People's Choice Home Loans, filed bankruptcy. Others among the Top 30 include Fremont Investment, Accredited Home Lenders, New Century Financial, and Fieldstone Mortgage. Hope you didn't own the stocks.

Meanwhile, not a single company to our knowledge toward the bottom of this list has reported any trouble at all.

This study spans 159 pages in print, so that we could provide not only quick lists but also details on each major county and lender. The study also comes with **two Excel spreadsheets**, so you can re-sort the data as you see fit.

Methodologies are explained in the study. **There are a number of caveats important to consider**, such as complications caused by reverse mortgages (thereby over-stating likely actual risk for firms including IndyMac and Seattle Savings Bank). National results appear in Section I.

Clients who also order Giants of the Mortgage Industry, 2007, can have Dangerous Customers at a 50% discount.