

Prospectus

Home Equity Loans: 2007 Outlook

- **Growth: Good Despite Adverse Conditions**
- **Bank Of America Retakes Industry Leadership**
- **Under-Water Borrowers: By Location & Lender**
- **Delinquency & Default: Rising Now, Worse in '07**
- **Lender Rankings, Shares, & Credit Performance**

**Optional Volume 2:
379 Metro Markets; New Price Depreciation Score**

Important Information about a new SMR Research Study

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Research Corporation

SUMMARY OF THE STUDY

The next year looks like one of the most challenging in the history of the home equity lending business.

The so-called housing bubble has burst, loudly. It now appears we may have the first national-level home price depreciation in decades. Even house price optimists such as the National Association of Realtors (which forecast sharply increased prices for 2006 in December of 2005) are eating their words.

Making matters worse, lending at very high combined loan-to-value (CLTV) ratios was occurring right until the moment prices started coming down.

Result: Nearly 10% of home equity borrowers by our count are already under water (their total mortgage debt exceeds home value). This means delinquency and foreclosure rates – already spiking – are likely to get a lot worse before they get better.

As if this weren't enough, the prime rate is now more than double where it stood two years ago. **Borrowers who want or have home equity lines of credit with interest-only features now face doubled monthly payments.**

Amazingly, however, total home equity loan receivables continued to grow at a double-digit rate from June, 2005, through June, 2006. Originations rose, too. Lenders are having good success at marketing closed-end junior-lien loans instead of Helocs.

The recent growth rate may soon taper down, but it remains a testament to the popularity of home equity products in the face of seriously adverse conditions.

The grim outlook hasn't stopped everyone. Bank of America has been increasingly successful in home equity loan production and has retaken first place in receivables among all competitors. Citigroup, too, made huge progress in loan volume over the last year.

The study includes all our customary features: **Market size and growth projections and time series data, with Heloc and closed-end loan breakouts; lender rankings and market shares, credit data by lender, and earnings analysis through SMR's copyrighted combined income statement of "home equity banks."**

A special section of more than 30 pages reports the results of our study of home equity borrowers now "under water." We rank counties and states by their under-water percentages, and we show the data for named lenders as well. Some look markedly better than others.

This is the home equity industry's one complete and comprehensive annual research study. An Order Form is enclosed. Thanks.

HIGHLIGHTS

Implications Of A Home Price Depreciation

Home price declines, which began in cities like Detroit, are now spreading to many locales. **In 2006, and possibly 2007, we may see the first national average decline in prices in a long time.** Some analysts cite 1995 as the last year this happened; most say it hasn't happened since the Great Depression.

There will be multiple impacts. We analyze the problem and present new data about it throughout this research study. The most obvious impact is that lower home values reduce available owner equity against which to lend.

A special section reports – for the first time, we believe – the number of home equity borrowers already under water. Given the popularity of high-CLTV lending, with piggyback junior-liens attached to many recent home sales, you only need a slight price decline to put borrowers in the under-water position. **Historically, such borrowers have defaulted on their loans frequently.**

Our special section **ranks counties and states** by their percentages of home equity borrowers under water. **We also rank the major lenders**, but it's important to read the Methodologies section on how we made these rankings.

Industry Growth Continues Against The Odds

With home prices falling and the prime rate doubled from 2004 levels, you would expect to see shrinkage in home equity loan receivables and originations.

The news is: Shrinkage isn't happening, or at least not yet. From June of 2005 through June of 2006, industry receivables continued to grow at a double-digit rate, and originations were up.

This is not a guess. SMR makes a hard count of Heloc and closed-end junior-lien numbers from the regulatory financial reports of more than 12,000 institutions. Production of closed-end loans exploded.

Still, the growth rate is down from even higher levels of the last few years, and our outlook for 2007 calls for sluggish results. **See all the numbers and specific 2007 projections in Section I of the study.**

BofA, Citi, HSBC, & Others Did Very Well

Even under current conditions, some lenders have found a way to spike outstandings dramatically. **Citigroup, HSBC, and E*Trade saw receivables climb more than 50% in the year ended June 30, 2006. A few others came close. Bank of America recaptured the #1 position from Wells Fargo.**

See the full story, company by company, in the Giants section of the study.

HIGHLIGHTS (continued)

Credit Quality: The Bad News Is Here

Home equity loans have a long history of low delinquency and chargeoffs. But that is beginning to change.

As of June, 2006, the rate of 90-day-plus delinquency on Helocs nearly doubled from one year earlier for all U.S. bank holding companies. Net chargeoffs rose, too. Credit looked OK on closed-end loans, but probably only because so many of them are brand new and unseasoned.

Our Credit Quality section has the details for the industry and by company. This story, already getting a little ugly, is going to get worse in 2007, we suspect, due to home price depreciation and loans under water. The section includes our forward projections.

Volume 2: Best And Worst Metro Markets

The optional Volume 2 supplement to this year's study presents the latest home equity loan statistics on 379 metro areas – along with economic data and our overall attractiveness ratings.

See Page 8 of this Prospectus for a list of the specific data items we present. Clients get Volume 2 in printed form, and also in Excel spreadsheet format to make it easier to re-sort by any item that grabs your attention.

There's an important new statistic in Volume 2 this year: a newly designed SMR Home Price Depreciation Score, calculated for each city. The higher the score, the higher the chance of depreciation in 2007, we think.

Back in the main home equity study volume, we tell more about how we created this score, and we show the retroactive results if we had used it in 2005 to predict a 2006 outcome. In Volume 2, we show the score for each city.

CLTV Monitoring Service

At a time like this, we think it becomes prudent for all mortgage lenders to begin monitoring the current estimated CLTV ratios of all existing customers. If you agree, call SMR President Stu Feldstein at 908-852-7677, because we are now offering to do it, one borrower at a time.

SMR uses AVMs (automated valuation model estimates) for current home value, the denominator of the CLTV fraction. AVMs usually sell for high prices, but by merely including them in a CLTV ratio, we needn't charge so much.

Once you know where you stand on CLTV risk, there are all sorts of actions you can take, like buying credit risk derivatives, pool insurance, and prioritizing collections.

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Volume 2: The Metro Markets Best & Worst Places To Do Business

The optional **Volume 2** supplement to our annual study covers 379 metro areas, as newly defined by the federal Office of Management and Budget.

With so much concern this year about falling home prices, **we've added a newly designed Depreciation Risk Score for each metro area. We've also changed our overall attractiveness scoring system to more heavily weight the first-lien refinancing rate in each city.** Refis are becoming endemic and badly hurt home equity loan lifespans.

You get a spiral-bound printed report of more than 430 pages. But don't fret over the size of it; **all clients also get the metro area data in an Excel spreadsheet**, making it easy to use and re-sort. **Clients who buy the main study get this one at a discount.**

For each metro market, we show:

- **3 years of data on the size and growth of the home equity market – with breakouts for loans versus lines;**
- **Average sizes of originated free-standing home equity loans, home improvement loans, and piggyback home purchase junior liens;**
- **Popularity of home equity loans, measured by receivables per household (better than the per capita figure we used to show);**
- **Recent growth, numbers of owner-occupied homes with mortgage debt;**
- **Average home prices through mid-2006;**
- **Average incomes of recent home buyers and refinancers;**
- **Value of the local housing stock – debt – remaining equity – and potential home equity market size at 85% LTV;**
- **Attrition Indicator: The recent local rate of refinancings;**
- **Credit risk: Bankruptcy filing rate per 1,000 adults through mid-2006;**
- **The new Depreciation Risk Score for 2007, plus its two components:**
 - Home purchase demand as a percent of supply
 - Local borrower disposable incomes as a percent of home purchase mortgage amounts
- **SMR's overall market attractiveness score.**

**Where else do you find these data about 379 local markets?
Nowhere.**