

# Prospectus

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## **Nonprime Mortgage Loans, 2007 Dealing With Adversity**

- **Bailing & Failing: The New Industry Consolidation**
- **Delinquency & Foreclosures Rise 50%+**
- **Wells Fargo Rockets To #1**
- **Loans Under Water: Counts By County & Lender**
- **New Alt-A & Subprime Segment Breakouts**
- **Lender Rankings, Shares, Credit Data, & Earnings**

### **Optional Volume 2: Best & Worst Metro Markets**

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# SUMMARY OF THE STUDY

**With home prices suddenly stymied, the credit risk inherent in the nonprime borrower pool has begun to surface.** Delinquencies and foreclosures have exploded; several key lenders have imploded.

As of this writing, we count five major nonprime lending firms that have already been sold. **Two more are shopping for an acquirer, five have shut down, and one is hanging onto life by a thread.** For those who remember the 1998 disaster, it's déjà vu all over again.

**Has the Apocalypse come for nonprime lenders? Not really.**

**As detailed in the Earnings section of this study, big banks in the nonprime space are doing fine.** Wells Fargo has dramatically increased its nonprime production. Wall Street firms are buying mortgage bankers, vertically integrating their business from loan production through securitization.

**Would all these big, financially savvy firms throw their money away on a doomed industry? We don't think so.**

**Nevertheless, we are forecasting more trouble for 2007.** Loan production growth fell below 4% in 2006, the slowest nonprime growth rate we've ever tallied. For many players, things will get worse before they get better.

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SMR's annual study of nonprime mortgage lending is more important this year than ever before. **There is more turmoil to sort through, and a greater need to understand the causes of the current mess.**

**The Credit Quality section helps set the parameters of the non-payment problem,** with company-by-company data and industry aggregate delinquency and foreclosure rates. **A special section on loans under water estimates, for the first time, the number of nonprime borrowers at greatest risk by county and by lender.**

**Another special section summarizes the current industry consolidation.** The **Giants** section shows big change in the top player rankings in loan production (by channel) and in servicing. **And for the first time, in our Market Characteristics sections, we break out data on the Alt-A and subprime segments of the business.**

**Our optional Volume 2 supplement delivers all-new data on the nonprime market in each of 379 U.S. metro areas.** We include a new data item on collateral value problems to help show where home price weakness has been the most severe impediment to new lending.

See the Outline Of Contents for more details. An Order Form is enclosed. Thanks.

# HIGHLIGHTS

## The Debacle Of 2006 And 2007

You know your industry is in trouble when the CEO of one major lender puts this special message on the home page of its corporate web site: Despite the rumors, we're stable and still in business, said South Star Funding.

**Other firms couldn't say the same.** Key players of the recent past have already been sold: First Franklin, Saxon, Centex Home Equity, Aames, and Champion. Erstwhile industry leader Ameriquest, smaller today, is seeking an acquirer, as is H&R Block's Option One. Five others have shut down, including Ownit Mortgage, one of the top 20 lenders of 2006.

Ownit is one example of what went wrong. The company used to publish this boastful catch-phrase: "Underwriting guidelines written in the 50's don't serve the needs of today's borrowers." **It failed to notice that reasonable underwriting is still required for corporate survival.**

Statistically, the **Market Characteristics** sections of this study tell the story better. Through September, 2006, most nonprime lenders were making loans at ever-higher CLTV ratios, to borrowers with falling credit scores, and relying heavily on ARMs, right into the teeth of a national home price depreciation.

**One result: A significant percentage of nonprime borrowers is now in the under-water position,** with mortgage debt exceeding home value. See the special section on **Loans Under Water** for counts by county and by lender.

**The Introduction to the study summarizes the mess – how it happened and how it differs from the last nonprime lender calamity in 1998.** Other sections look at the details and what they imply going forward.

## Dealing With Adversity: Some Lenders Are

**Nonprime mortgage loan originations showed the weakest growth rate in 2006 that we have ever tallied. Yet Wells Fargo nearly tripled its production.**

**Wells and other big banks in the business also reported rising profits in the earnings section of our report.**

These exceptions to the rule were a comforting reminder that nonprime lending still presents fine opportunities. The secret to success is how you manage the business. And it helps to have portfolio lending capability.

In an otherwise depressing period, make sure to see these bright spots in the Giants, Earnings, and other sections of our study.

# HIGHLIGHTS (continued)

## More Data By Far On Market Segments

**Clients have asked us repeatedly to try to break out nonprime mortgage data into its two key component parts: Alt-A loans versus subprime loans.**

**We're pleased to say we did it this year.** Most lenders responding to our annual data survey furnished separate figures on loan originations and average loan sizes in Alt-A and subprime segments.

**We continue all our traditional data breakouts, too. Lender-by-lender, we show loan production by channel: retail, broker, and correspondent. We look at ARM versus FRM loans originated; home purchase versus refinance lending, and average coupon rates on new loans and in serviced portfolios.**

We show average and ranged **credit scores** by lender and for the industry, **average loan sizes**, and average **combined loan-to-value ratios**. We've now got 30-day-plus loan **delinquency** rates and percentages of dollars of loans in **foreclosure**.

Our special section on **Loans Under Water** also estimates the percentage of nonprime borrowers whose debt exceeds home value – by county and by lender. We used data on each of more than 5 million existing nonprime borrowers in this under-water study. Note that the method is an estimation only; no one knows what homes are actually worth until the moment they get sold.

So, if you really need to know all about the nonprime mortgage business, this study is “information central.” We provide thousands of key statistics – yet well-organized for use, and with ample plain-English analysis.

## Volume 2: A New View of Best And Worst Local Markets

See Page 8 of this Prospectus for more about Volume 2. Our data on the best and worst among 379 metro area markets comes at a crucial time.

**Much of the trouble roiling the nonprime industry has to do with weakened home values – a big cause of the foreclosure spike. But values are not falling everywhere, nor is growth tepid in all locales.**

**If you focus on the good places, you win.** Volume 2 provides the data you need on each market – including estimated nonprime originations dollars – plus a scoring system that uses key data elements to compute an overall attractiveness score. A new element this year is the “Value Trouble” index, which looks at applicant denials due to weak home value as a percent of loans originated.

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## Volume 2: 379 Metro Markets; Best & Worst Places To Do Business

The optional **Volume 2** supplement covers 379 metro areas. We present numerous statistics on each, including a new item this year we call the **Value Trouble** index. Reflecting concerns over home values, this index measures applications denied by nonprime lenders due to collateral value problems as a percent of apps approved and funded.

You get a spiral-bound printed report of more than 400 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 nonprime mortgage originations market – with a 2006 percentage growth rate over 2004.**
- **Average sizes of home purchase, refinance, and home improvement loans from the 2005 HMDA data. Thanks to lien-type data in HMDA, we can now include piggyback deals as single transactions in average loan sizes.**
- **Our market segment data count B/C/D risks as a percent of the entire market, using HMDA data on loans with so-called “rate spreads” (loans with coupon rates at least 3 points over comparable Treasury securities). We also show the percent of nonprime volume in purchase vs. refi categories.**
- **On the high-rate loans, we show the average rate spread, enabling you to rank-order markets by those with most-to-least risky customers.**
- **Popularity of nonprime loans is computed by looking at the nonprime origination volume as a percentage of total U.S. mortgage volume.**
- **We show productivity of local markets through the closed loan conversion rate – the percent of applicants who became closed loan customers.**
- **We capture prepayment risk by computing the average refinancing rate for each metro area in a recent year.**
- **The new Value Trouble index (described above) lets you rank markets by their degree of collateral value problems encountered in underwriting.**
- **Credit risk: Bankruptcy filing rate per 1,000 adults through mid-2006.**
- **Most common problems of loan applicants are summarized by looking at 9 categories of reasons for loan denials, disclosed through HMDA.**
- **SMR's overall market attractiveness score.**

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