

Prospectus

Home Equity Loans, 2008: Hard Times

- The Credit Disaster; Earnings Go Negative
- Why The Downturn Should Be Short
- Surprise: Receivables Keep Rising
- Special Section: Current CLTV Ratios By Lender
- Top Players: BofA On Top; JPM Closes On Wells
- Tracking Home Values: Problems & Solution

Optional Volume 2
**Best & Worst Metro Markets:
New Data For Hard Times**

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Research Corporation

300 Valentine St. • Hackettstown, NJ 07840 • Phone 908-852-7677 • Fax 908-852-6884

WWW.SMRRESEARCH.COM

SUMMARY OF THE STUDY

A year ago, our annual home equity study said that the rest of 2007 could be "bleak." **It was. But 2007 was a cakewalk compared to now.**

First-quarter 2008 home equity credit losses appear to be up nearly 1,000% from the same quarter of 2007. Profitability is gone. Indeed, you now may question the basic premise of the modern home equity loan:

Is it safe, really, to offer people junior-lien loans on top of their first-lien mortgage debts? Was the modern home equity loan an ill-conceived idea?

We think the product will be vindicated. The safety and earning power of home equity loans will return, but not until national home values rise.

This year's study reports and analyzes all aspects of the current downturn – and the prospects and timing for recovery.

- **A special section shows the distribution of all existing home equity customers grouped by their current combined loan-to-value (CLTV) ratios. Results are unsettling.** The same section ranks top lenders by their high-CLTV concentrations.
 - **Better news:** We update readers on the "housing bubble." **Using new data current through March 2008, we find the bubble fully deflated, setting the stage for recovery.**
 - **The Credit Quality section details a more than 10-fold spike in loan losses – the biggest in history.** But it also shows no change at all for lenders focused on markets with stable home values! The lessons we are learning are all about CLTV.
 - **Confounding predictions, home equity loan receivables continue to rise.** They were up 7.7% in 2007, crossing the \$1 trillion mark for the first time. As a group, the Top 25 lenders had a 14% receivables increase.
 - **As always, SMR ranks all the leading players in the business, in multiple ways:** total portfolios, leaders in Heloc and closed-end segments, market shares, line-of-credit draw-down rates, delinquency and net chargeoff rates, etc.
 - **The optional Volume 2 supplement on metro markets has new data points and scores, focused strongly on measures of risk.**
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The subtitle for this year's annual study, **Hard Times**, says it all. But the passage of time will change this, and maybe not much more time.

This Prospectus details our most comprehensive study to date on home equity lending. An Order Form is enclosed. Thanks.

HIGHLIGHTS

Measuring The Default Disaster

Over the last 20 years, there have been four regional home price depreciations. Each time, foreclosures in the region spiked by 10-fold to 15-fold from trough to peak.

Now, we are seeing this play out on a national stage. It has turned home equity lending into a net loss business – at least temporarily.

First-quarter 2008 earnings reports from the largest home equity lenders showed a near-1,000% increase in home equity net chargeoffs from one year earlier. Looking at full-year 2007, the loss rate roughly tripled over 2006. Details by company appear in the **Credit Quality** section of the study.

A different special section adds a forward spin. Using our database of U.S. owner-occupied homes, we have calculated current combined loan-to-value (CLTV) ratios on 11.6 million existing home equity borrowers. **The percentage of these borrowers now "under water" is shocking.**

The same special section calculates the CLTV distribution by company, covering more than 100 of the largest home equity lenders.

Any good news? Some: Many high-risk borrowers were customers of lenders already bankrupt or closed, so surviving lenders will be less impacted.

When Does This End?

We've been saying it for years: Credit scores will rank-order risks, but only CLTV ratios will forecast aggregate losses. Check the tables in the important Introduction section of the study.

Looking at all mortgage debtors in CLTV ratio groups at the end of 2006, we calculated the rate of completed foreclosures during all of 2007. **The highest-CLTV group had a foreclosure rate more than 20 times that of the lowest.**

So, the current disaster won't end until home prices firm up. When? **No one knows for sure, but we have included another special section, more than 20 pages, on the housing price bubble.**

Parts of this section appeared in our last study of the first-lien mortgage business, but now we have updated all the figures through March, 2008. **We find the bubble now fully deflated.** Incomes have caught up with monthly housing costs.

Based on our findings, we believe prices could begin to turn back up before the end of 2008 – certainly the best news in this study.

HIGHLIGHTS (continued)

Receivables Up; Originations Down. New Market Share Opportunities

As we forecasted one year ago, home equity loan originations declined in 2007. But we didn't expect the flip-side: **Home equity loan receivables increased by a significant 7.7%.**

In fact, for the Top 25 lenders, ranked in the Giants section, receivables were up by an aggregate 14.1%. How come? First-lien mortgage refinancings declined and home sales declined, causing existing home equity loans to stay on the books longer.

Normally, a longer lifespan means better home equity earnings. **But not now.** Rising loss rates have pushed Citigroup into a retreat from home equity lending. Wells Fargo has set up a big "liquidating" portfolio of home equity loans. Some of the biggest names in the business are scaling back.

See the Giants section for details and rankings. This is the only study that ranks home equity lenders biggest to smallest, by Heloc and closed-end segments, by dollar gains over the prior year, by Heloc draw-down rates, delinquency rates, and net chargeoff rates.

What's shaping up? This could be a once-in-a-lifetime opportunity for medium-sized and smaller players to regain market share lost to industry giants.

Volume 2: Best & Worst Metro Markets In The Credit Storm

We all know credit looks terrible. But take a look in the main study at loss rates for outfits like Zions Bancorp, Cullen/Frost, and the Boeing Employees Credit Union. **You'd never know there was a credit problem.**

What do these lenders have in common? Most of their customers are in geographies where home values are holding up very well. It's never been more important than now to know what's going on in local home equity markets.

See Page 8 of this Prospectus for more about the Volume 2, Metro Markets. **We have scored 284 metro areas, each a city and its suburbs, for overall attractiveness based on many data points, including home valuations and other measures of risk.**

Volume 2 is more than 300 pages and comes with a free Excel spreadsheet version. **It's optional.** You can get the main study without Volume 2 if you prefer.

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

The **optional** Volume 2 supplement to our annual study has been completely revised to reflect the harsh realities of the 2008 lending environment. We cover 284 metro areas, including all the largest in the nation.

This study spans more than 340 pages in print. But don't despair. All clients who order it also get an Excel spreadsheet version which allows you to view or re-sort the data easily.

Clients who also order the main home equity study get Volume 2 at a special, discounted price. See the Order Form.

Using many sources, including our national home owners database, we provide the following information on each metro area:

- **Current estimated Heloc and closed-end receivables**, with more breakouts for piggyback versus free-standing home equity loans.
- **Average outstanding loan sizes**, as of March 2008, for piggybacks, free-standing loans, and total home equity loans – against USA averages.
- **Popularity and penetration:** The percentage of mortgage borrowers in the city who also have home equity loans.
- **Median home value** (based on automated valuation model data) as of March, 2008 – **plus the percent change in value from one year earlier.**
- **Loss forecaster:** The percentage of home equity borrowers who have current CLTV ratios greater than 95% -- the chief predictor of loss.
- The percentage of mortgage borrowers in the city with credit problems (**subprime**).
- **Prepayment risk:** The 2006 first-lien mortgage refinancing rate.
- **The personal bankruptcy filing rate** for 12 months ended 9/30/2007.
- **Future opportunity measures:** Incomes of recent borrowers, plus the percentage of home owners with debt who could still borrow \$30,000 or more without exceeding a 90% CLTV ratio.
- **Overall Market Attractiveness Score:** Our model that takes all the key items and renders them into a score based on 100 being the norm. (Hint: Seattle got the highest score – a whopping 425).

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