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## **Mortgage Lender Insolvencies Due To Bad Credit Are Nearing An End, Study Finds**

Mortgage lender insolvencies due to poor underwriting are probably nearing an end, according to a study of credit risk published today by SMR Research Corp. of Hackettstown, NJ.

Ironically, however, investors have abandoned all private mortgage-backed securities, causing new mortgage market turmoil, even though most lenders who started the crisis have disappeared, the study noted.

**“The Mortgage Credit Crisis,”** a 250-page study, reviewed six measures of credit risk for each of 163 of the largest U.S. mortgage lenders. It scored each lender based on the results against a national average score of 1,000.

Nearly all lenders with risk scores above 1,750 are already bankrupt, closed, sold, or partially closed, the study found. Those scored 1,300 to 1,750 have had mixed results. Companies scored 1,000 to 1,300 may have trouble ahead, but due more to the financial panic than because of their own mistakes, SMR said.

“The companies whose underwriting errors caused their own demise are largely gone or are well-known to be among the ‘walking wounded,’” said SMR President Stuart A. Feldstein. “But the industry crisis won’t end until investors regain confidence and home prices stabilize.”

Eight of the nation’s 10 largest mortgage lenders earned low risk scores, suggesting they maintained fairly high credit standards from 2004 to 2006, when most of the underwriting excesses occurred, SMR said.

Bank of America had the lowest risk score (465) among the 10 biggest lenders. HSBC Bank had the highest score (1,444) among the top 10 lenders. Countrywide Financial had the second highest score among industry giants, at 1,016, indicating slightly above-average risk, SMR said.

The lender with the highest risk score was South Star Funding LLC of Atlanta, which scored 2,704. It is now closed.

The study relied on county courthouse lien records covering most U.S. home owners with debt, plus annual Home Mortgage Disclosure Act (HMDA) reports. The six credit risk criteria studied were:

1. Estimated combined loan-to-value (CLTV) ratios of each lender's pool of borrowers as of July, 2007. (CLTV is mortgage debt – on combined loans if the borrower has two home-secured loans – as a percent of estimated current market value of the home.)

2. The percentage of total loans that were provided to subprime-credit borrowers in a recent year.

3. The percentage of total loans recently made to borrowers without verified incomes (“stated-income,” or “Alt-A” loans).

4. The lender's reliance on piggyback loans in 2005 and 2006 (two-loan packages typically used by high-CLTV borrowers who do not want private mortgage insurance).

5. The percentage of loans originated with adjustable rates, and

6. The percentage of loans with low “teaser” startup interest rates, such as pay-option loans.

SMR computed each item for each lender as a variance against national averages. The overall risk score combined the six variances on a weighted basis, giving more weight to the CLTV ratio than the other items.

“High-CLTV lending just prior to the national home price decline caused the sharp rise in foreclosures, even more than lending to borrowers with low credit scores,” Feldstein said. When home prices decline, borrowers with high CLTV ratios no longer can sell their homes or refinance to cure a delinquency.

The study found that most of the time, the high-CLTV lenders were the same firms that catered to borrowers with credit history problems. SMR said “risk layering” – the practice of making loans to people with multiple types of risks – was a central cause of the credit crisis.

Aside from lender risk rankings, the study included 45 pages of analysis and data on the causes of the mortgage credit crisis, plus a section on future solutions.

Stabilization of home prices would likely cause foreclosures to ebb, SMR noted. In turn, SMR said, that would require the Federal Reserve Board to cut short-term interest rates, or else would require the passage of a lot more time.

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Founded in 1984, SMR Research Corp. is the nation's largest provider of industry research studies on mortgage and home equity loan subjects. The firm first warned of a pending "perfect storm" of mortgage defaults in a 2004 research study. More details about the new study can be found under the "mortgage" subject button at [www.SMRresearch.com](http://www.SMRresearch.com).