

Prospectus

The Mortgage Credit Crisis

- **163 Big Lenders Scored By 6 Key Credit Metrics**
 - **Lenders Still Alive But At Risk**
 - **How & Why The Crisis Developed;**
Risk Statistics Ramp-Up From 2000 To 2006
 - **Preventing Future Credit Disasters**
-

Important Information about a new SMR Research Study

Summary of the Study	Page 2
Highlights Risk Rankings Panic-Driven Company Failures How The Crisis Developed Fannie, Freddie, & The Search For Solutions	Pages 3-4
Outline of Contents	Pages 5-7
Sample Lender Risk Data Page	Page 8
ORDER FORM	INSERTED



Research Corporation

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

WWW.SMRRESEARCH.COM

SUMMARY OF THE STUDY

The mortgage credit crisis evolved into a worldwide financial panic in July and August, 2007.

Feeding the panic: A lack of information about which lenders were at most risk, how many “toxic” loans exist, and where the next surprise would emerge.

Responding to all this, SMR has created a credit risk scoring system applicable to all major mortgage lenders. It relies on six key credit metrics for which we have data on very large samplings of each lender’s loans:

- 1) The percentage of existing borrowers with a **current** combined loan-to-value (CLTV) ratio of more than 95%,
- 2) The percentage of loans recently produced to subprime borrowers,
- 3) The percentage of loans recently produced with stated-income,
- 4) Piggybacks as a percent of all loan transactions in 2005 and 2006,
- 5) The percentage of loan dollars produced with adjustable rates in 2005 and 2006, and
- 6) The percentage of loan dollars produced with teaser start-rates, such as pay-option loans.

We have scored each lender on these figures against the national averages.

Results appear to rank-order the riskiest lenders well, since nearly all with a score above 1,750 (1,000 being the national norm) are already bankrupt, closed, sold, or well-known to be in deep trouble.

The good news is: Eight of the 10 largest U.S. mortgage lenders have scores below 1,000, some far below.

Lenders scored 1,500 to 1,750 are still in jeopardy, but some are smallish and others have already been identified publicly with problems.

As the study shows, the depth of lender failures by score range will depend on near-future U.S. home prices. The **potential** good news there is that a Federal Reserve rate cut would likely have a strong positive impact on housing demand, possibly resolving the risk crisis by improving borrower CLTVs.

This Prospectus tells more about the contents of this study, a 249-page report with more detail on lender credit risk than anything SMR has published in the past. See the Order Form to get a copy. Thanks.

HIGHLIGHTS

Risk Rankings

The financial press says “subprime” loans are those at risk, defining them as loans made to “people with a shaky credit history.”

But if loans to folks with low credit scores caused the foreclosure spike, it would have started in 2004, or even earlier.

Actually, foreclosures jumped when home prices fell in late 2006, putting millions of borrowers with high CLTV ratios “under water.” When delinquent, they could no longer sell their homes or refinance to cure it.

As it turns out, the same lenders who were making the “subprime” loans also were the most egregious high-CLTV lenders in most cases. We measure both risk factors lender-by-lender: high-CLTV and subprime-credit lending. SMR’s CLTVs show borrowers’ leverage **right now**, not when they got their loans – a major improvement for default forecasting.

Our scores also look at each lender’s recent degree of stated-income lending, piggyback lending, ARM lending, and teaser-rate lending. Our sources are county courthouse property and lien records covering some 63% of all U.S. home owners with debt, plus Home Mortgage Disclosure Act (HMDA) reports filed by virtually all mortgage lenders.

In all, we assessed risk factors on [individual loans](#) held by more than 31 million borrower households holding \$6.8 trillion of mortgages. We aggregated the data by lender.

When you have the right data, conclusions become clear. Lenders like **Hudson City Savings** have virtually no underwriting-based credit risk. **Bank of America** is nearly as clean. Bankrupt lenders like **New Century** and **American Home** sunk themselves.

Other Company Failures: Panic-Driven

Our study assesses mortgage originator credit risk, not liquidity risk.

As the panic has evolved, many smaller mortgage bankers could be at risk regardless of their prior underwriting. Loan production is down, nervous warehouse lenders are calling loans, and there is no secondary market left even for prime-quality jumbo loans.

At least one mainly prime-quality lender, HomeBanc Corp., failed as a result of the panic, not due to subprime lending. Poor liquidity caused mortgage banker failures as well in 1998-1999, and 1994-1995.

HIGHLIGHTS (continued)

How The Crisis Developed: Rising Risk Stats

It's important to know who's at risk right now. **But to avoid future repeats of this dilemma, it's even more important to understand how this mess developed in the first place.**

Section II of the study devotes 45 pages to analysis and statistics on how and why the mortgage credit crisis of 2007 developed. Section IV talks about fundamental structural problems in the mortgage finance system and some ideas on how to fix them.

We go far back in time, showing key mortgage risk statistics and how greatly they changed annually from year 2000 to 2006. SMR has long been the repository of these figures, and is the most-quoted source on subjects such as piggyback mortgage lending.

On analysis, there is plenty of blame to go around. Mortgage lenders made mistakes. Slow or non-existent government regulation played a big role. So did assurances from Wall Street loan securitizers that nonprime lenders could make and sell unlimited quantities of high-risk loans for good prices. Private securitizers, in turn, got support from bond rating agencies.

Even now, hedge funds, mutual funds, banks, and thrifts are not required to disclose their holdings of mortgage securities by credit grades, so investors just wait to hear which ones declare losses. **Panic ensues; investors flee all high-risk venues because no one knows where the risks lie.**

Fannie, Freddie, And The Search For Solutions

A special tabulation in Section IV shows that Fannie Mae and Freddie Mac have steered clear of purchasing nearly all the nonprime loans behind the crisis. **This should be comforting news.**

Major changes to the entire mortgage lending system will be needed to prevent a recurrence of this collapse. Changes must address the fact that now, too much of the lender income stream depends on loan production; too little on successful management of a loan throughout its lifespan. Section IV is the shortest part of our study, but may be the most important.

Discount Coming; The Mortgage Industry Outlook

This study is a special SMR report, published very near the September date when we do our annual **Mortgage Industry Outlook**. We will provide a \$500 discount in September to companies that purchase both this study and the Outlook.

OUTLINE OF CONTENTS

I. The Mortgage Credit Crisis: Summary & Lender Rankings

A. The Mortgage Crisis: Current Status; Likely Scenarios

1. Company Failures Due To Underwriting Are Near An End
2. Attitude Extremes: Once, No One Listened To The Warnings; Now, We Have Over-Reactions
3. Countrywide & American Home
4. Mortgage Risks: Vast Misunderstandings
5. CLTV Ratios
6. Credit Scores Would Have Led To An Earlier Melt-Down
7. Good And Bad News
8. Some Mortgage Lender Risks Aren't New At All
9. Zany Underwriting: The New Twist; The Ownit Mortgage Story

B. Lender Underwriting Risk Rankings

1. 1,750...And Gone
2. **Table: 163 Major Lenders Ranked By Overall Risk Score**
3. Biggest Players: The Worst News Is Over
4. **Table: 163 Major Lenders Ranked By Size: Risk Scores, Mid-2007**

II. How And Why The Risk Crisis Developed

A. Causes Of The Crisis: A Summary

1. A Chronology Of Crisis Development
2. 21 Steps Down-Slope

B. New And Tighter Credit Does Not Mean Tight By Historic Standards

1. Subprime Max CLTV: It Once Was 70%!
2. But Consumers May Be Historically Tight On Cash
 - a. Data On Household Liquid Assets From The CEX Survey

C. Incomes & Home Prices: The Central Issue Behind The Housing Bubble

1. Table: Home Price & Income Indexed Trends: 1990-2006
2. Graph: Gap Between Home Price & Income Indexes, 1990-2006

D. Size Of The Nonprime Industry

1. Table: Nonprime Mortgage Market 1996-2006, Originations & Outstandings
2. Nonprime Counts Versus Loans At Risk

OUTLINE OF CONTENTS (continued)

3. Risk Layering: The Main Culprit
4. How Specific Risk Elements Grew From Year 2000 Onward

E. Piggybacks: The First Big Rollout

1. Enormous Growth
2. Table: Homes Purchased With Piggyback Second Loans, 2000-2007
3. Chart: Dollars Of Financing Done In Piggybacks As % Of Dollars Originated For Home Purchase, 2000-2007

F. High-CLTV Lending Skyrockets

1. Table: Homes Purchased With CLTV Ratios Over 90%, 2000-2007
2. Table: Homes Purchased With CLTV Ratios Over 95%, 2000-2007
3. Chart: Percent Of Home Purchase Loan Dollars Done At Over 95% CLTV, 2000-2007
4. High-CLTV Home Owners Today
5. About The Latest High-CLTV Figures
6. **Table: All Home Owners Sorted By Current CLTV Ranges, July, 2007**

G. Stated Income Loans: Rapid Growth, Too

1. Counting Them Up
2. Table: Stated Income/No Income Loans, From HMDA Reports, 2000-2005
3. Graph: Stated Income/No Income Loans As % Of Total Number Of Loans Originated, 2000-2005

H. ARMs: Once A Good Idea, Recently Not As Good

1. Old-Fashioned ARMs That Greenspan Liked; New Products
2. The Non-Traditional Mortgage Guidance And Its Comment Period: Fiddling While Rome Piles Tinder To Burn
3. Doubled ARM Share Of Market
4. Table & Chart: ARM Share of Dollars Originated, 1994-2006

I. Homes As Investments

1. Flipping In Earnest Began In 2004
2. Table: Loans On Non-Owner-Occupied Investment Homes, 2000-2005
3. Chart: Loans On Non-Owner-Occupied Investment Homes As Percent Of Total Number Of Loans Originated, 2000-2005

J. The Rise In Single-Borrower Financing

1. Singles And Credit Risk
2. Table: Homes Purchased Relying On A Single Person's Credit, 2000-2007

OUTLINE OF CONTENTS (continued)

3. Chart: Percent Of All Homes Bought With Financing By Singles, 2000-2007

III. Detailed Lender Risk Data As Of July 2007

A. Lender Risk Measurements: Introduction

1. Data Sources
2. Specific Risk Measures: Our Methods
3. Variances, And The Overall Lender Risk Score
4. Scores, Caveats, & Future Results
- 5. Lender Data Pages**

The lender data pages include a full page of detailed risk measures for each of 163 major mortgage lenders, occupying the bulk of this section. CLTV data segment existing borrowers into four groups. Subprime and stated-income data are expressed as a percent of all loans originated in the most recent year available.

Piggyback, ARM, and teaser start-rate data are shown for all loans produced in 2005 and 2006 from the courthouse records. Each risk category shows a lender's variance against national averages, and a resultant overall risk score.

IV. Long-Term Solutions

A. Widespread Doubts On Why This Happened

1. Incentives To Produce
2. Commissions And Loan Sales
3. Evolution Toward Mortgage Banking
4. Checks And Balances

B. Where The System Broke Down, Part 1: Non-Disclosures

C. Breakdown, Part 2: Credit Ratings Agencies

D. Breakdown, Part 3: Sluggish Mortgage Regulators

E. Breakdown, Part 4: Consumers With Low Savings

F. Fannie Mae And Freddie Mac: If It's Not Broke, Don't Fix It

1. Table: Purchasers Of High-Rate Loans In 2005, HMDA Reports

G. Conclusions: New Ideas To Consider

Sample Page: Lender Risk Details

This study is analytical, with text and commentary. It also includes lender data details, including the following sample page for now-bankrupt American Home Mortgage – clearly not the “prime” lender it was sometimes called.

AMERICAN HOME MORTGAGE CORP./MELVILLE, NY

ESTIMATED CLTV RATIOS OF EXISTING BORROWERS, MID-2007

Data Sampling:		% Of Dollars Owed By Borrowers	
# Borrowers:	263,601	In CLTV Ranges:	
\$ Millions:	65,899	0-80%	50.43
		81-90%	19.00
		91-95%	9.64
		Over 95%	20.93

SUBPRIME BORROWERS FROM 2005 HMDA REPORTS

# Of Loans Originated	207,426
# With HMDA "Rate Spread"	45,835
% With HMDA "Rate Spread"	22.10

STATED OR NO-INCOME LENDING FROM 2005 HMDA REPORTS

# Of Loans Originated	207,426
# Lacking Income Data	66,743
% Lacking Income Data	32.18

PIGGYBACK LENDING

Of Piggyback Jr. Liens As % Of Senior Liens Produced,
2006 And 2005 Combined Sampling: 25.24

ADJUSTABLE-RATE MORTGAGES (ARMs)

ARMs As % Of Dollars Of All Loans Produced,
2006 And 2005 Combined Sampling: 52.45

TEASER START-RATE LOANS

Dollars Of Loans With Rates Below 3% As % Of All Loans Produced,
2006 And 2005 Available Data: 22.63

PUTTING IT ALL TOGETHER: VARIANCES TO NATIONAL AVERAGES

(National averages set to 1.000; Greater Risk Causes Higher Variance, Lower Risk Causes Lower Variance.)

	Variance For This Lender
CLTVs Over 95% Now	1.4865
Subprime Borrowers, 2005	.8429
No-Income Lending, 2005	1.7329
Piggybacks, 2005-2006	1.0988
ARMs, 2005-2006	1.0695
Teasers, 2005-2006	4.4547

WEIGHTED OVERALL RISK SCORE: 1,547