Prospectus

Giants of the Mortgage Industry, 2014

New Issues, New Strategies

- **Falling Loan Production; Forward Projections**
- **Fannie & Freddie: Replaced By What?**
- **Population Shifts To The Big Cities**
- **Beyond Ability-To-Pay**
- **Finding The Purchase Loan Customer**
- **Home Prices In 2014 & 2015**
- **2013 Data By Company**
  - **Top Originators & Servicers**
  - **Industry & Company Foreclosure Rates**
  - **Implications Of Mass Sales Of Servicing**

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SUMMARY OF THE STUDY

In September of 2012, SMR's report on the mortgage industry included a special section: The Coming Crash In Mortgage Production.

Now, the crash is underway. We also had forecast that this reduction would last a very long time, and we're sticking with that view now.

Quarterly loan production data in this year's study show the timing of the crash. A new count of people who already have super-low-rate loans suggests that another refinancing boom is unlikely for several years.

And, hard to believe as it might seem, the production crash may be a lesser issue than some others that have since arisen.

● **Will Fannie Mae and Freddie Mac really be terminated?** How? When? With what impact on mortgage rates?

● **Suddenly, loan servicing rights are being bought and sold in unheard of quantities.** Will there be consequences for the sellers? For the buyers?

● **In 2013, home prices rose by a double-digit percentage.** How long can this continue?

● **How about the new ability-to-pay rules?** They are intended to reduce foreclosures – yet they fail to provide a forward-looking view. What will John Doe's income be three years from now?

● **If the purchase loan market is what's left, how do you get a larger piece of it?**

This year's annual SMR study of the mortgage business provides data and analytics on these issues. And there are other issues as well that have so far passed under the radar.

For instance, in the last decade, population shifted to the "exurbs" outside major cities. That's now finished. The center cities are back. **Better re-examine office locations and advertising venues.**

As always, our annual study also ranks the players in loan production and servicing – and shows foreclosure statistics on dozens of named companies. Banks made huge progress in 2013 on credit quality. We are now within striking distance of "normalcy."

Seldom has change come so rapidly as now, or on so many fronts at once. This Prospectus has all the details. An Order Form is enclosed or available on our web site. Thanks.

HIGHLIGHTS

Strategic Issues On Multiple Fronts

It's a good thing the credit crisis is finally coming under control. Lenders suddenly have other things to worry about. Lots of them.

Is the Senate Banking Committee serious about killing Fannie Mae and Freddie Mac? Are the politicians going to do this just when the GSEs have turned around and begun to yield positive income for the Treasury?

We analyze the new proposal in Section II. **We have serious doubts about it.** The government is closing the barn door after the horse is out – and also after it has come back in again. Taxpayers would still be at risk, and mortgage interest rates would rise.

Section II also forecasts home price trends for 2014 and 2015, using our historical data on the relationship between incomes and home values. In **Section VIII,** we use the same methodology to look at local markets, showing where prices could still rise more and where they are likely to be crimped.

The full list of new strategic issues is a long one.

Externally, we have **climate change** beginning to hit home and we have trouble in Ukraine.

The U.S. population is shifting locations, too, with all that implies about where to find the home buyer. We also cover the new trend toward marijuana legalization, which (oddly enough) could have a positive effect on home values.

The Production Crash: It Will Continue

The crash began when refinances tailed down in the third quarter of 2013, followed by a harder fall in Q4.

We strongly believe volume will continue to drop for refis. A new count of mortgages originated since 2009 shows well over half of all home owners now locked into super-low-rate loans, unlikely to refinance again for many long years.

See the data in Section III. Purchase lending did well in 2013, but falling refis cut total loan production by 21% from 2012. In 2014, things will <u>not</u> get better.

Home purchase lending is what's left. **If you want to explore new ideas to capture more of these customers, be sure to see Section I of the study, and more information on Page 8 of this Prospectus.**

HIGHLIGHTS (continued)

Change At The Top

With the disappearance of Ally Bank (formerly GMAC) from mortgage lending in 2013, we reach the end of an era.

Once, all sorts of non-bank outfits became big in mortgage lending and servicing: Sears Roebuck, the two biggest automakers, the two biggest life insurers, and even the two biggest container manufacturers (Owens Illinois and American Can). **After nearly 30 years of this experimentation, it's all over.**

There's change among the banks, too. Massive, unprecedented sales of servicing rights by several banks have changed the ranks of top loan servicers.

Section IV ranks originators, and Section V ranks depository institution servicers. We suspect these giant sales of servicing rights are going to pose a challenge to some sellers – and to some buyers as well.

Among the biggest mortgage firms, we also now see an abrupt reversal of fortunes in loan production.

In recent years, the big story at the top of the industry was Wells Fargo's huge growth and Bank of America's retreat. But in 2013, Wells' loan production declined far faster than the industry norm; BofA chalked up a slight increase!

Nothing is as it was.

Credit Quality: Much Better, Not Fixed

Commercial banks are required to report loans in foreclosure to federal regulators quarterly, covering both owned and serviced mortgages. SMR gets these reports and adds them all up.

Since the sum total is a large majority of all loans that exist, we can safely report great progress in trimming the foreclosure rate in 2013. See the numbers in Section VI of the study.

But there is still some distance to go before we are back to the foreclosure rates that were common historically. We may be two to three years away.

In the meantime, we have the new ability-to-pay rules, designed to safeguard credit. Will they really? If you know John Public's income today, do you also know what it will be in three or four years?

We think you could, with models predictive of how borrower incomes are most likely to change. It's worth thinking about – and we suggest the method in Section VII.

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Finding The First-Time Home Buyer

There are at least some methods available to find existing home owners getting ready to move. For instance, you can buy data on which of your existing customers have their homes on the market for sale.

But there hasn't been much available to spot first-time home buyers, who represent 30% to 45% of the total purchase market each year.

And you need to spot them first if you want to increase your share of the purchase loan market – the business that's left when refis are down.

SMR began working on the first-time home buyer question in mid-2013. What causes some renters to buy a home, while others remain renters year after year?

We think we know the answer – and we think we have the right <u>names and addresses</u> of the most likely first-time home buyers.

The key is: <u>rising incomes</u>. Renters who abruptly find themselves making a lot more money are the ones who can make the jump from the apartment to an owned home.

We've had a full-time crew working for months on building a database of renters whose incomes are almost certainly rising, and sharply.

For example, consider the struggling medical student, slogging through years of post-graduate education, followed by in-hospital training.

Finally, the day arrives: The student becomes a licensed physician. **What's the likelihood this person is about to start earning serious money?**

In the database we've compiled – looking at young people in 32 professions – **we've been able to test the results.** And we've found that these folks will indeed buy first-time homes <u>three to six times</u> faster than the national norm – in each of three consecutive years!

In some groups, 10% or more will buy a first-time home <u>per year</u>.

Marketing to these prospects should get strong returns – without spending a fortune on Internet leads, and without courting the realty brokers. The brokers tend to recommend any lender who closes fast with easy credit, and that is not necessarily a good thing.

SMR now has compiled more than 500,000 of these first-time home buyer leads. **We are announcing the availability of this list right now.**

For more information on obtaining some or all of these names, contact Dr. Richard Veith of our staff, heading up the project: Call 908-852-7677, or email: <u>Richard.Veith@SMRresearch.com</u>.