Prospectus

Home Equity Loans, 2014
A Spike In Loan Production

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SUMMARY OF THE STUDY

In this annual study one year ago, we found that home equity loan production had increased marginally – the first increase since 2006.

We forecast much faster growth ahead, and even suggested that a new "golden age" for home equity lenders was no more than a few years away.

Now, we are pleased to report that this scenario is taking shape.

In 2013, home equity loan production increased by a double-digit percentage rate. In 2014, we see another round of significant growth ahead – to be followed by more in 2015.

Meanwhile, the "new credit crisis" that some people had foreseen failed to materialize in 2013.

The worry was that with a swell of old Heloc borrowers reaching their 10-year maturity dates, lots of existing borrowers would be unable to make fully amortizing monthly payments.

But in 2013, delinquency and net chargeoff rates on Helocs and closed-end home equity loans all declined. **The improvements were sharp.** Perhaps this problem will look different in 2014 and 2015. But so far, if this is a "crisis," we'd like more of it.

The new "golden age" is rapidly taking shape. There are several reasons why.

Rising home values are very helpful, but the best news is that home equity lending will increase even if home price appreciation levels off.

This year's home equity industry study includes special sections on the originations boom and new loan marketing ideas. Another special section probes the real reasons behind the recent slowdown in home sales.

SMR began publishing home equity loan research in 1987, so we've been at this a while. **It's why our industry Metrics section is the only source for more than two decades worth of annual loan data.**

We continue this year, as always, to rank the top players and show company-specific portfolio and bad-loan data.

See the Outline of Contents in this Prospectus for details on this year's study. See Highlights for more on the key events of the moment. An Order Form is enclosed or available on our web site. Thanks.

HIGHLIGHTS

The Originations Spike

SMR's crystal ball isn't perfect, but we nailed this one.

We said that in the last part of 2013, first-lien mortgage refinances would ebb, leaving home equity loans as the new product of choice.

At the same time, owner equity was rising fast – driven not only by home price increases, but also by faster retirement of mortgage principal due to the spread of 15-year and other short-term mortgages.

The net result would be a spike in home equity loan production, followed by additional annual increases. In short, we said, a new "golden age" for home equity loans was approaching.

It's happening. Looking at the credit unions, required to report their home equity originations data to regulators, we see a 16.8% increase for 2013. Selected banks were reporting even larger increases in Q1 of 2014.

SMR's industry origination estimates include loans provided to brand new customers <u>plus</u> new draws by existing Heloc borrowers. Both generate new interest income.

So if interest income is important to you, our annual origination data are the numbers you should know. We project 2014 in the Originations section of this study, and show data back to 1992 in the Metrics section.

Credit Quality: A Vast Improvement

In a perfect world, loan production increases while credit quality also improves. **That happened in 2013, and further progress seems likely.**

Looking at all banks combined, home equity loan net chargeoffs fell more than in half in 2013. Early-stage delinquency improved almost as well. Late-stage delinquency still looks bad against historical norms, but is getting better.

Regulators were worried about credit in 2013 and beyond. That was due to a swell in old Heloc borrowers approaching their 10-year maturity dates, when their loans would become fully amortizing and monthly payments would rise.

This could still be a problem, since the poorest underwriting occurred from 2004 to 2006. But most lenders are coping well with this. And there is a trump card: When homes become more valuable, people make their payments.

See the Credit Quality section for all the details, plus company-specific data on late-stage delinquency rates.

HIGHLIGHTS (continued)

The Housing Slowdown: Why?

Home sales slowed in late 2013 and have continued to show sluggishness so far in 2014. This is not good for home equity lending, although it's offset to some degree by a limited supply of homes for sale, keeping prices up.

Why is the slowdown happening? Every news story you see cites higher mortgage interest rates as the cause. Baloney. Rates were much higher in years when home sales were strong and rising, as shown in a table in this study.

So, what's the real problem? It may be weather. **But more likely, it involves insufficient growth in consumer incomes.**

In the Housing Slowdown section, we introduce a new SMR data series called the ITMI – the income-to-mortgage amount index.

We have computed per capita disposable income as a percent of the average purchase mortgage amount, and set that to 100 for year 2001 – the last year before the housing boom really took shape.

At the moment, the ITMI at the national level is still below 100 – meaning that despite the end of the housing bust, incomes are still a little below where they should be relative to prices.

We also have computed the ITMI in each U.S. county and show results for the most populous places. **Results suggest exactly where home prices have room to increase further, and where they will be under more pressure.**

Marketing: The Full-Court Press

It's embarrassing. Credit card issuers become ever more creative in finding new customers. But in many cases, the marketing strategy for home equity lenders is still to post signs in bank branches and wait to see if anyone cares.

The final section in this year's study offers a plethora of ideas on how home equity lenders could be more pro-active and creative in finding the borrower.

The ideas range from data mining to something we call the "Heloc auto loan conversion." Regarding opportunities by geography, our theory is that wherever home values are rising best, more equity will result in more customers.

Using a data series we think is the best, we rank every metro area of the U.S. by the degree of home value increase since the end of 2011.

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Finding The Home Equity Customer

Imagine this scenario for just a moment:

You have at your fingertips 90 different information items on nearly everyone who has obtained a home equity loan over the last 15 years.

And you have the same data on everyone who <u>didn't</u> get a home equity loan.

You know their LTV and CLTV ratios. You know who lives in a single-family home or a condo or duplex. You know how long they've been in the home; their current mortgage and home equity debt amounts, and when they got those loans.

You have the best AVM values. You can tell whose home equity loan occupies the senior lien position versus junior liens.

You know the term of the mortgage and who supplied it. You have the exact (or a well-estimated) interest rate on every mortgage. **You have addresses and can parse the data by metro area, county, or zip code.**

And, you have a loan history for each of 60 million home owner households: how many times each one has obtained home equity loans or mortgage refis in the past.

If you really had all this information – on people who do and people who don't get home equity loans – in any time period – don't you suppose you could come up with a good marketing formula?

<u>We know you could… because we've already done it.</u>

Working with data from the nation's largest property records vendor, SMR has been producing Home Equity Loan Propensity Scores since 2005. We provide the scores back to the vendor, but we also keep them here.

The higher the score, the more likely it is that someone will get an HE loan over the next four to five months. **It's that easy.**

Every lender who has used our scores once in direct marketing has come back again for more. They must be working.

For more information on home equity marketing scores, contact Jon Varone: 908-852-7677, or email: Jonathan.Varone@SMRresearch.com.