Prospectus

Home Equity Loans, 2010

Loss Mitigation

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SUMMARY OF THE STUDY

Loss mitigation now drives most activity within home equity lending operations. We have dedicated this year's annual industry study to this subject.

A large special section inside the study is called: Home Equity Loan Foreclosures: Risk Variables And Their Correlation.

In it, we look at 16.8 million home equity borrowers who existed at the end of 2008 – count the completed foreclosures that occurred among them in 2009 – and then look at what predicted those results.

The correlations are sharp, and none of the variables we review were items you could have obtained from credit bureau data.

If you've already noticed that CLTV ratios are one key to trouble ahead, you are right (obviously). But CLTVs are not the only predictors. **And, our study shows that the real problem with high-CLTV borrowers is not just debt-to-value, but the fact that so many have other credit problems.**

We have other bad loan statistics – for the industry and by lender – throughout the study. **This year, we have included early-stage plus late-stage delinquency rates by lender, by loan type, and with quarterly trends.**

The study also updates clients on the housing recovery. A year ago, it looked good. Then, in later 2009, housing turned back down. **Now, things seem to be headed in the right direction again. But will it last?**

Loan marketing, meanwhile, nearly stopped in 2009 at many firms. **Too bad. By our count, many millions of nearly risk-free potential customers are still out there.**

Some have zero home-secured debt. The optional Volume 2 supplement to this year's study makes a hard count of low-risk customers by county and state.

We start with total home owners, then eliminate those with a subprime borrowing history. Next, we move through CLTV ranges down to zero. Finally, we add more criteria to isolate and count "extreme" low-risk prospects in each of 344 of the largest U.S. counties.

As always, this study also ranks the players by their 2009 home equity portfolios, with Heloc and closed-end loan breakouts, market shares, and other data. All our historic time series data are updated as well.

This Prospectus has all the details. An Order Form is enclosed or available on our web site. Thanks.

HIGHLIGHTS

Variables That Predict Foreclosure

SMR's U.S. property database, as large as any in existence, includes records of completed foreclosures. We used them in this study.

We identified 16.8 million home equity borrowers who had loans as of 12/31/2008 and marked those foreclosed during all of 2009. **Then, we looked at the variables that would have forecast those defaults.** Results are revealed in a 27-page special section of this year's study.

None of the variables were credit scores. You already get those, and everyone knows they failed to forecast the credit disaster.

There were surprises. High CLTV ratios do correlate, of course, but the difference is enormous between borrowers with CLTVs of 100% to 120% versus those over 120%.

Even more enlightening is our report on why this correlation exists. It's not just "walk-aways" with bad attitudes. The highest-CLTV borrowers turn out to be those with myriad other credit problems.

The study looks at percentage foreclosure rates based on: • Piggyback versus free-standing loan origination • Vintage of the loan by year • CLTV ratio ranges • Subprime status • Home equity loans in the junior versus senior lien position (gigantic variance) • Single versus co-borrowers, and • A "layered risk" scenario that spikes the default rate by more than 10-fold beyond the norm.

Results of this study provide a road map to risk-avoidance using data beyond what the credit bureaus have.

On-Again, Off-Again Housing Recovery

A year ago, we published our home equity study just as a housing recovery was taking shape. We became bullish. Home sales had bottomed in January, 2009, and so had home prices.

Historically, a trend in home sales and prices lasts for years at a time. **But not now.** The early 2009 recovery was real, but by the end of the year had collapsed entirely. Finally, as 2010 got underway, recovery was back. Home equity loan delinquency trends followed suit, slightly declining.

We show the trends with charts and analytic text. **Is the recovery for real this time?** We examine the bear and bull cases and reach a conclusion.

Sections I and II of the study have all the data – plus a new SMR forecast for the size of the home equity market and loan originations.

HIGHLIGHTS (continued)

Changed Top Players

Most home equity lenders experienced serious reductions in both portfolios and loan originations in 2009. Some certainly wanted that to happen.

Among top players, JP Morgan Chase and Citigroup had double-digit declines as they reduced their exposures. At JPM, approved but unused home equity credit lines over two years have been cut to $58.4 billion from $134.8 billion. **Now, you see why we subtitled this year's study: Loss Mitigation.**

Yet, the "retreat" stories are not universal. **We smell change in the wind. PNC Bank** just began advertising home equity loans on television. A major thrift has resumed direct marketing to new prospects.

And firms that weren't hurt much by the credit crisis are taking the market share left behind by others. **They include Charles Schwab Bank, Northern Trust, UnionBancal, and Sovereign Bank.** Still other players, such as **M&T Bank** and **Capital One**, advanced via acquisitions.

Section III of this year's study looks at **Heloc credit line cuts** in 2009, company by company. They were even more severe than those of 2008.

Section IV ranks all major players as of year-end 2009 in a variety of ways, and also comments on some very divergent strategies.

New Ideas To Spur Profits

Let's summarize one line of thinking prevalent today: "We're losing money in home equity and there's nothing we can do about it until home values turn up."

People who think that way should do so on the way out the door. Lenders can spur the turn back to profitability, pro-actively. We offer several ideas in the final section of this study on industry profits.

Some involve marketing. Use good data (beyond credit scores) to find truly credit-safe new prospects, and you add profitable business that dilutes the errors of the past.

One hint, from our Foreclosure study: **Debt-free home owners who get home equity loans very rarely default.** The trick is to find the ones who really want the loan.

Another thought: **marketing by occupation.** Recently, the unemployment rate for construction workers was 24.6%; for health care workers, just 1.9%.

Bad thinking got us into this mess. Good thinking can resolve it.

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Summary Portfolio, Delinquency, Net Chargeoff, & Line Draw-Down Data On Each Of The 252 Largest Players With Portfolios Of $200 Million-Plus

Finding Low-Risk Home Equity Customers

As an optional supplement to the annual home equity study, we are offering a 209-page report called **Finding Low-Risk Home Equity Customers.**

This study, relying on our property database, creates a "cascade" of counts within each of 344 major U.S. counties.

The counts begin with all home owners, and end with what we call an "extreme" low-risk universe.

From the total home owners, we first eliminate those with known **subprime borrowing** histories and look at how many are left. **Then, we cut everyone with an existing CLTV ratio over 60% and again see how many are left.**

We parse the remaining home owners into groups with CLTVs of 40% or less, 30% or less, 20% or less, and 10% or less.

The cascade continues down. We next count solely **debt-free** home owners who, if they got a home equity loan, would have that loan in the first-lien position.

Our final count – of extreme low-risk home owners – adds additional criteria. To qualify, they can't be subprime. They must have zero home-secured debt. They must have above-average estimated incomes. They must have equity of at least $100,000. And, they must have lived in their homes at least 5 years.

Even the toughest credit risk managers would like these extreme low-risk folks. We estimate there are more than 5 million of them nationwide. Los Angeles County alone has about 140,000. (And, by the way, we have their names and addresses.)

This is a data study, but we do add some analytical text. And, we rank-order counties by various low-risk criteria.

Clients get this report in print, plus an Excel spreadsheet version so that you can re-sort the counties as you see fit.

Note that while county names are often unfamiliar, we include the **metro area name** in which each county is located.

If you want to know where the low-risk potential borrowers are, this is the study you need.

Clients who purchase the main home equity study get the optional Volume 2 supplement at 50% off its regular retail price. See the Order Form for details.