Prospectus

Industry Outlook, 2013
Mortgage & Home Equity Loans

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SUMMARY OF THE STUDY

What we see now is <u>not</u> what we will see by 2015.

At the moment, a major refinancing boom is pushing 2012 loan production to the highest level since 2007. HARP 2 is working. The 2012 mortgage production estimate made in August by the Mortgage Bankers Association is too low by as much as $500 billion, maybe more.

Home equity debt continues to shrink, as the refis pay off many existing HE loans. Unhappily, those being paid off are some of the best credits.

But this is today's scenario, not tomorrow's.

Long-term interest rates will rise again – if not in 2013, then in 2014 or 2015. When it happens, mortgage production will drop hard, **and more importantly will stay muted for a very long time.** Modest future mortgage production, probably beyond 2020, now appears to be statistically inevitable.

But at the same time, starting in about 2015, we also see a new golden age emerging for the home equity product. For a while, home equity loans looked headed for oblivion. Instead, we see a future surge.

More than any other study we have done, this one, more than 145 pages, looks far ahead – with the numbers and analysis lenders need.

We cover lender-by-lender results (measured many ways) through the first half of 2012. And we project loan volumes for both mortgage and home equity loans in 2013. That's the warm-up.

Special sections look at the more distant future – the future that will come when mortgage rates rise again. **When that happens, today's landscape will be reversed.**

One section covers the coming crash in mortgage loan production. Another looks at why home equity lending will not only revive, but will zoom ahead.

Still another special section reports newly released metro area results of **the 2010 Census:** basic housing statistics, home ownership rates, and the most likely hot spots for reverse mortgages and first-time home buyers.

In the past, our annual September Outlook study has reported current results for the home loan industry, with an additional look one year forward.

We go a lot further this time, with a long-term view based on statistics, not just opinions.

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

HIGHLIGHTS

2012: A Good Year, And Another Ahead

The Federal Reserve's new round of quantitative easing ensures that the refinancing boom of 2012 will continue through the end of the year.

We are now estimating total 2012 mortgage production about $500 billion higher than the August estimate of the Mortgage Bankers Association. **We'll see who's right.** SMR's 2011 loan production estimate, made one year ago, came within 3% of the hard-counted actual amount.

Few clients will be surprised by a bullish full-year 2012 estimate for mortgages. **More may be surprised to learn that home equity loans, falling in production volume since the credit crisis began, now have stabilized.**

Equity in housing fell hard from 2007 through 2011. But now, equity is increasing again, and home equity loan production has ceased its decline.

We do not reveal in this brochure our projections for 2013, but we can tell you we are looking for a strong first half in mortgages, some change in the second half, and a generally upward year in home equity.

Section IV of the study has the details and the numbers.

The Coming Crash In Mortgage Originations

Sorry to rain on the current parade, where mortgage production has ballooned while foreclosures have declined. **But someone needs to take a longer look down the road, so we did.**

Mortgage interest rates are not only at historic lows, but also have been that way since 2009. Utilizing our property database, we find that more than 70% of borrowers now have loans below 6%, or else have short-term mortgages, or else have remaining mortgage balances below $100,000.

By the end of 2013, nearly everyone will be in this boat, no longer needing a refinance when interest rates go back up. Even the under-water borrowers are now using HARP 2 in droves (see counts in Section II).

A special 26-page section of this year's study shows the data and reaches two inescapable conclusions: 1) When rates rise, total mortgage production will fall hard and immediately, and 2) The ensuing period of low volume will last for a much longer time than most people might expect.

See the numbers – and the history of what happened after prior refi booms ended. This is going to be worse – not in 2013, perhaps, but possibly in 2014 and highly likely before the end of 2015.

HIGHLIGHTS (continued)

A New Golden Age For Home Equity Loans

Following this year's study theme – taking a longer look ahead – we also see radical change coming in the home equity loan business. **This time, the change will be very bright indeed.**

Home equity loans have performed so poorly since 2007 that many expected them to go the way of the Brontosaurs. **They won't.**

Home equity loan demand has tracked historically with the amount of equity in housing. Now, home values are rising again. See Section II of the study.

Owner equity is building even faster due to the consumer's shift toward short-term mortgages. A table in this study counts them up. At the same time, the millions of new low-rate mortgages produced over the last few years are making larger-than-normal principal repayments each month.

Already, the annual decline in home equity loan production has ended. When mortgage interest rates rise and refis shut down, the home equity loan will become the product of choice, and credit quality should be great.

We discuss this theme throughout the study, and especially in Section II.

More New Events: Change Gone Wild

Seldom has so much changed for home lenders in so short a time. **Thrift institutions,** for one thing, have suddenly turned into banks. We introduce them in Section III. Some have assets over $100 billion.

Harp 2 is showing explosive growth – especially in June, when Fannie and Freddie began accepting short-term mortgage HARP 2 applications. We have the year-to-date HARP 2 numbers.

We also have a presidential election. Will it matter? See Section II. And we have QE3 – which certainly does matter. We analyze the implications.

We still have a credit crisis. But the credit quality section finds major new improvement in the numbers, with hard counts of loans in foreclosure based on a sampling of some 70% of all existing loans.

Looking at loan competitors, change is everywhere. Wells Fargo – apparently feeling not big enough – has pushed further ahead. So have the credit unions, up a composite 66% in loan production in the first half of 2012 from one year earlier. Wholesale volume is shifting to entirely new players.

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About SMR Home Owner Data

A number of vendors sell property data: names and addresses of home owners, data on the mortgages they have, AVM values, and details on the house structure. SMR is among those vendors.

There are good reasons why you would want data on all the home owners in the nation – or in a region or state. It's hard to prospect for new customers without it – and hard to append key data to your own customer records.

So, you may wonder, what makes SMR's property data different? The answer is: A lot. To wit:

- **Our coverage is as broad** as that of any other vendor. We recently had data on some 91 million owner-occupied and non-owner-occupied homes.

- **SMR's data come with predictive scores – and they work.** We score some 38 million home owners for their short-term likelihood to get a **mortgage refinance** or **home equity loan**. We score more than 50 million households – rank-ordering them – by their **estimated incomes and cash assets**.

- Before you promote a refinance, you need to know if you can offer a home owner a lower rate of interest than he already has. Uniquely among vendors, SMR estimates **the borrower's current interest rate** when the courthouse documents fail to disclose it (which is most of the time).

- For internal analysis, you need to know which people are customers of your competitors. But how? Raw property data have separate names for every unit of a company, and dozens of different name spellings for the same outfit. SMR's data – also uniquely – include **a parent company name** for each raw-data lender name, making competitive analytics possible.

- **Need to know who qualifies for a HARP 2 refi?** They must be people whose loans were sold to Fannie Mae or Freddie Mac – and we have identified some 1.4 million of them (people who also have LTVs above 80% and got their loans prior to the HARP 2 deadline).

- **How about CLTV ratios?** We have a current estimate, and also a separate LTV for the first-lien mortgage only.

- **Our AVMs** (automated valuation model estimates) on the current value of homes are as good as you can find, we believe.

This is only a partial list of what makes SMR property data special. If you need the best – at a reasonable cost – let us know. Contact Jon Varone or Stu Feldstein: 908-852-7677, or: Jonathan.Varone@SMRresearch.com; Stuart.Feldstein@SMRresearch.com.