Recent Developments in the Subprime Mortgage Market

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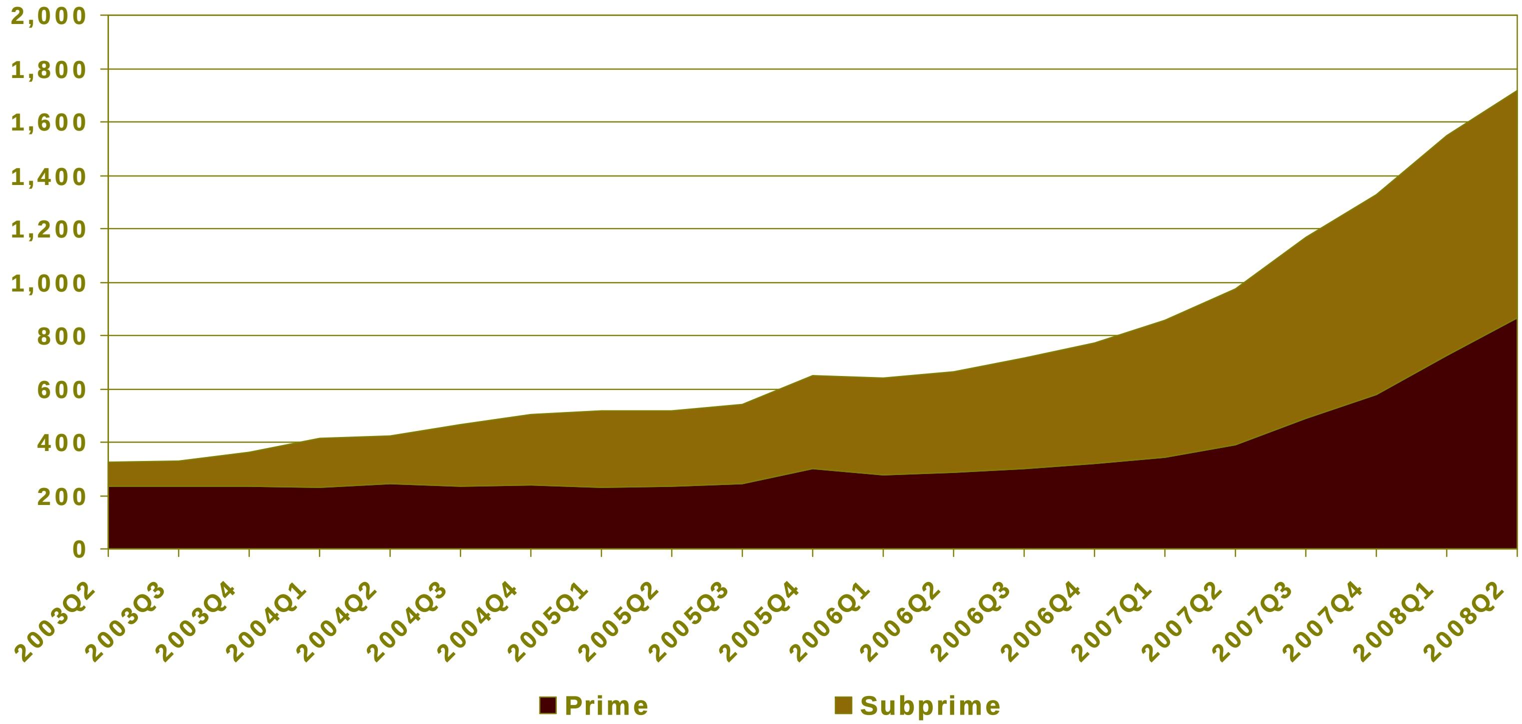
Foreclosures on the Rise

Serious Delinquencies Continue to Move Up Sharply

Number of Seriously Delinquent Loans, Thousands

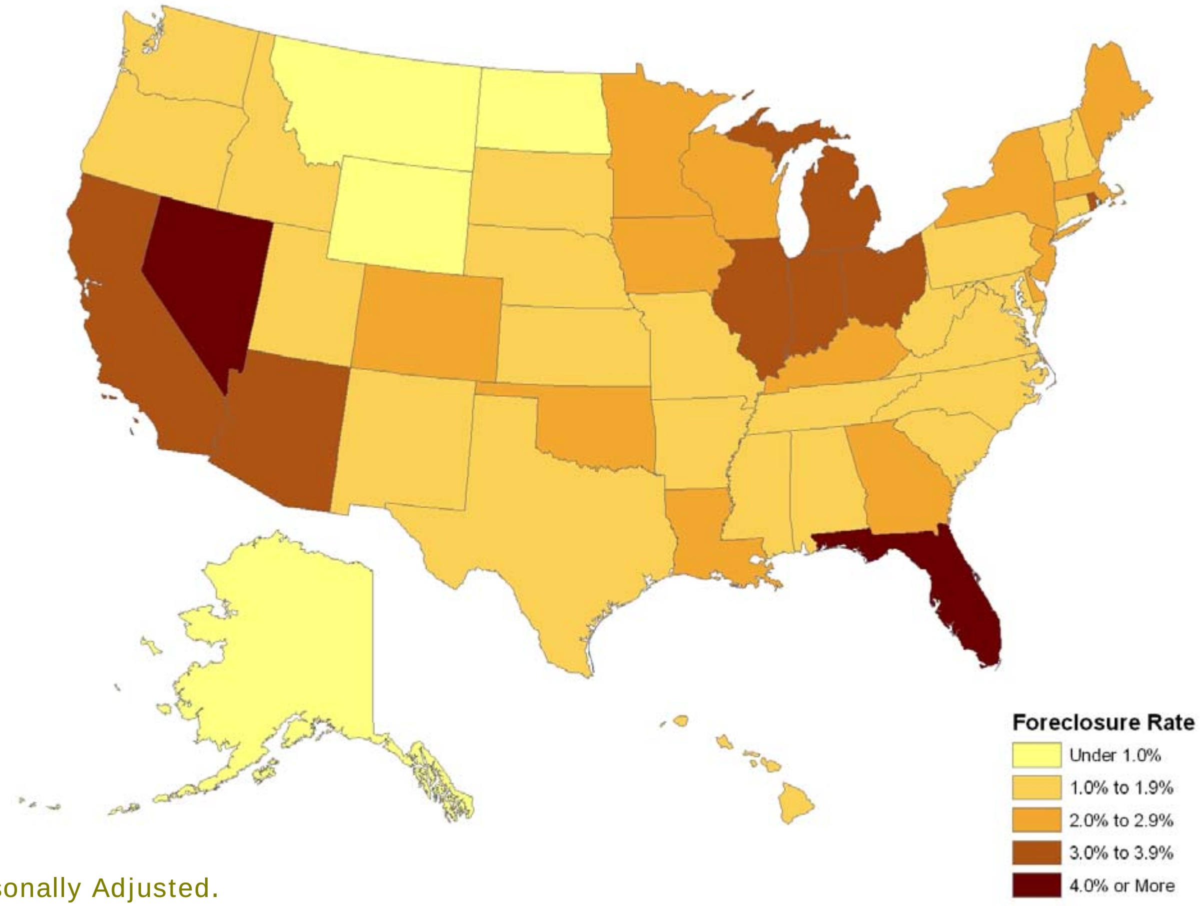


Note: Serious delinquency is defined as loans 60+ days late or starting foreclosure. Based on seasonally adjusted rates.

Source: Mortgage Bankers Association, National Delinquency Survey.

Foreclosures Now Stand at Record Levels in States Across the Country

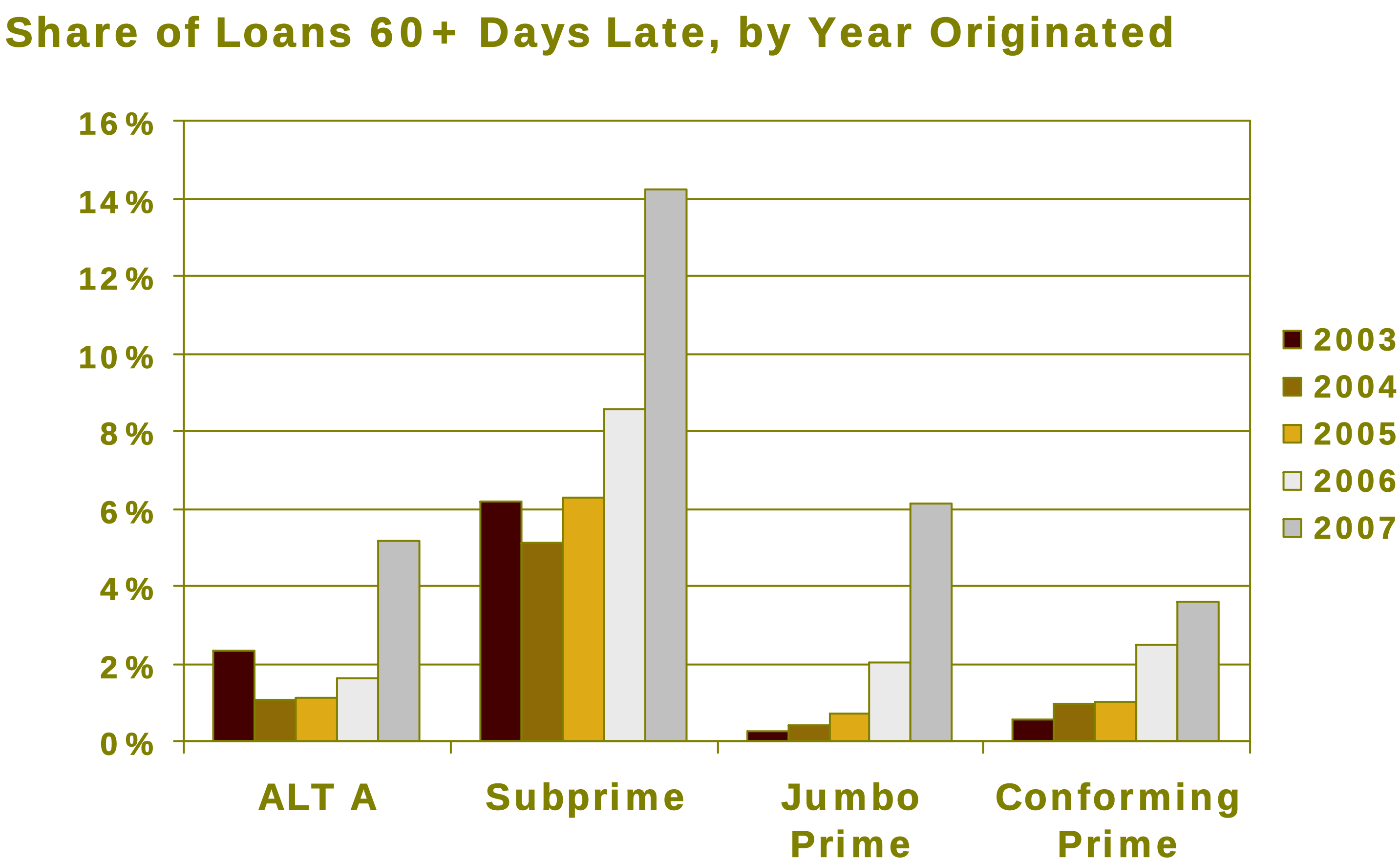
Share of Loans in Foreclosure, 2nd Quarter 2008



Note: Not Seasonally Adjusted.

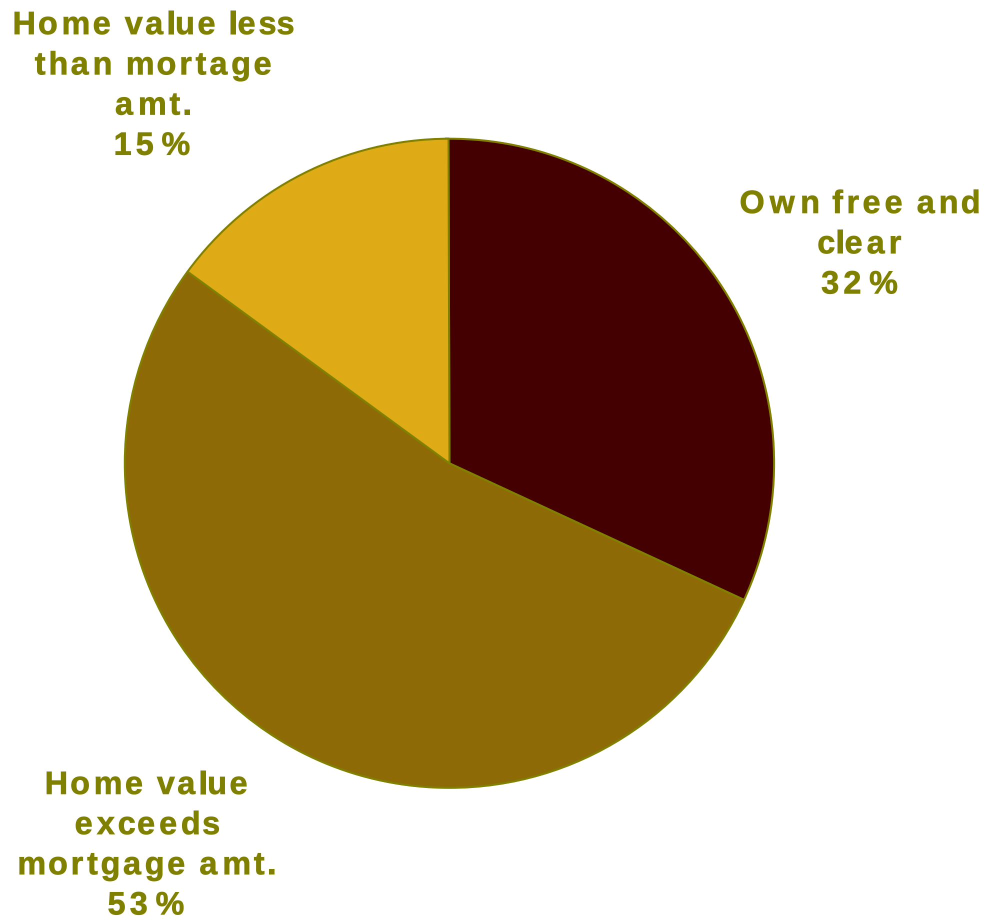
Source: Mortgage Bankers Association, National Delinquency Survey.

Loan Performance Continues To Deteriorate



Source: Loan Performance.

Mortgage Debt Exceeds Home Value for One In Six Homeowners



Note: Share of all owner-occupied homes, Q3-2008.

Source: Estimates from Moody's Economy.com published in Wall St. Journal October 8, 2008.

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THE RISE OF SUBPRIME LENDING

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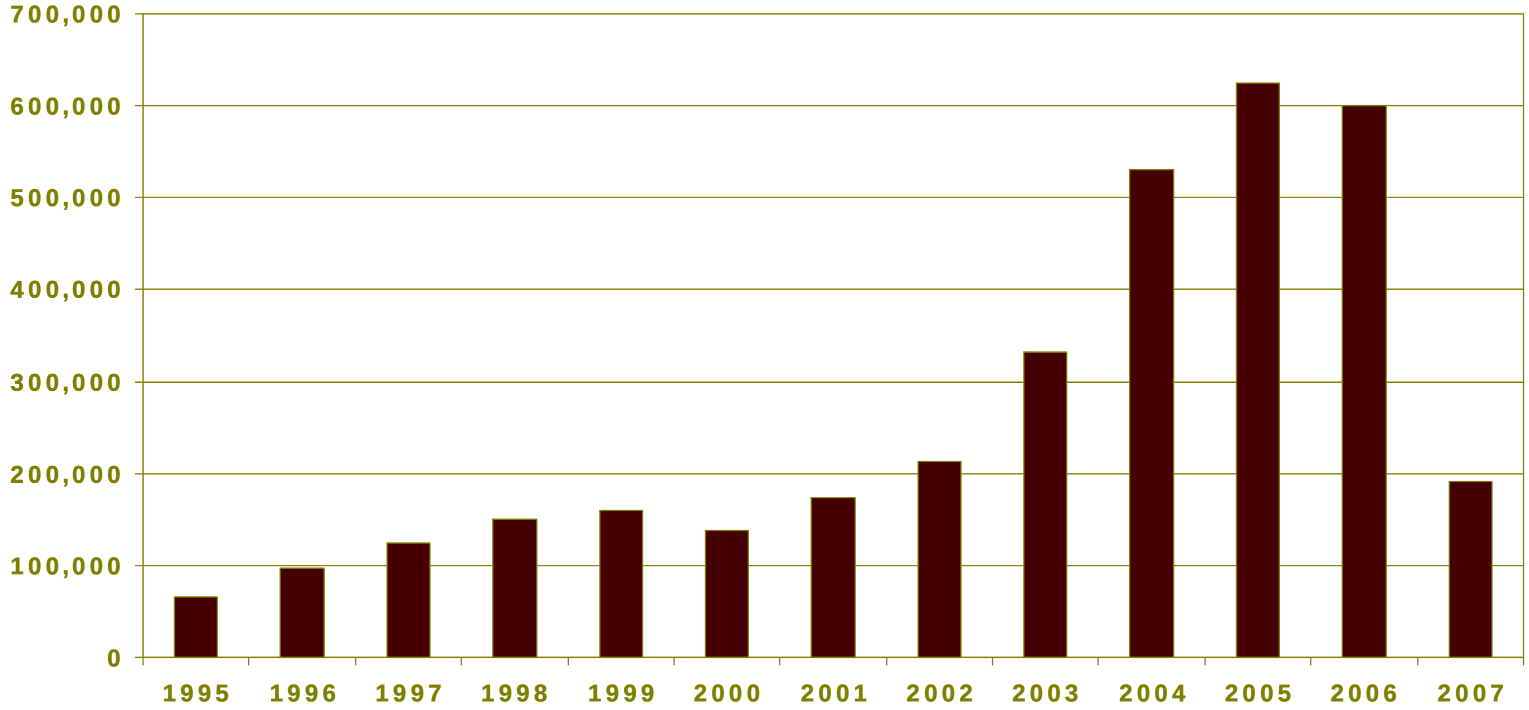
Subprime Lending Grew Rapidly in Recent Years

Aggressive marketing and lack of uniformity of regulations allowed higher-priced subprime lending to flourish in low income and minority neighborhoods.

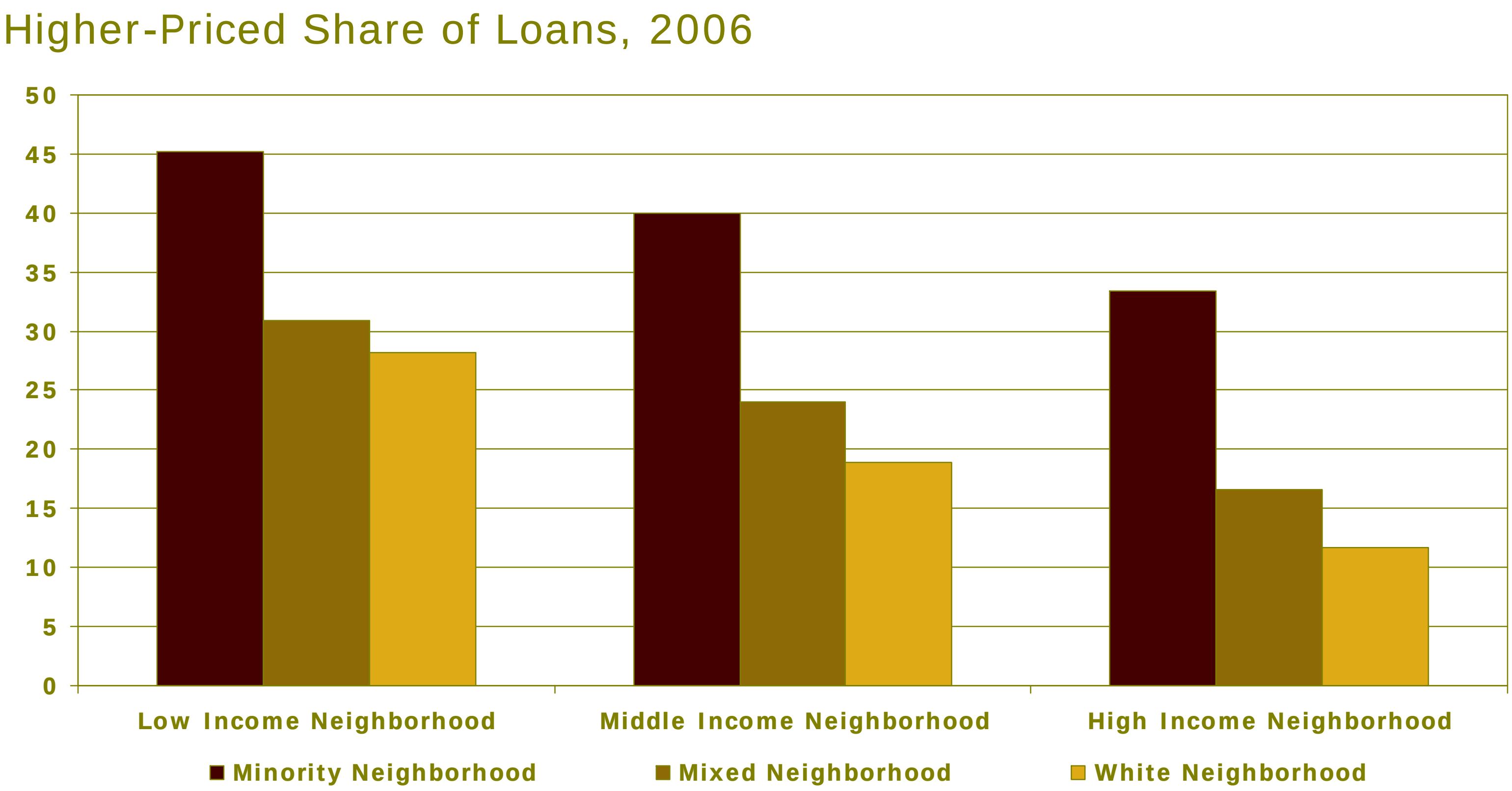
Following a Decade of Boom, the Subprime Market Collapsed in 2007

Number of Subprime Loans



Source: Inside Mortgage Finance.

Higher-Priced Lending Focused on Low Income and Minority Neighborhoods



Note: Loans are originated first lien home purchase loans. Excludes manufactured homes. Low income neighborhoods are defined as Census tracts with a median family income less than 80% of the MSA/MD, middle income neighborhoods are 80-120% of the MSA/MD, and high income neighborhoods are greater than 120%. Minority neighborhoods are defined as a census tract with a minority share of the population greater than 50%. Mixed neighborhoods are 10-50% minority, and white neighborhoods are less than 10% minority.

Source: JCHS Enhanced HMDA Database, 2006

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STRUCTURAL FLAWS IN THE MORTGAGE MARKET

The Ability of Consumers to Make Informed Choices is Limited

Behavioral economic analysis and market research suggests that consumers often make choices that may not be in their best interests and that they may later regret.

Consumers are Vulnerable to "Push Marketing"

Mortgage sales and marketing efforts may exploit various consumer decision making weaknesses. In particular, some mortgage brokers, retail loan officers, and lending organizations use their knowledge of consumer decision making tendencies to aggressively market specific mortgage products that are not in the best interests of the borrower.

Mortgage Market Structure Creates Challenges

The tendency to deploy aggressive marketing and sales techniques is reinforced by the structure of the mortgage industry, particularly the wide spread use of targeted incentives designed to encourage mortgage brokers and loan officers to convince consumers to select specific and often higher-priced mortgage products.

Access to Good Loans Proves Elusive

As a result of the current market structure, consumers often fail to obtain a “good loan” product, where:

- The consumer understands both the advantages and risks associated with a loan product
- The loan is priced in a manner consistent with the underlying loan risks and costs
- The loan choice reflects both the short- and long-run interests of the borrower
- Borrowers have a reasonable prospect of being able to repay the loan

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UNEVEN REGULATION AND MARKET DISTORTION

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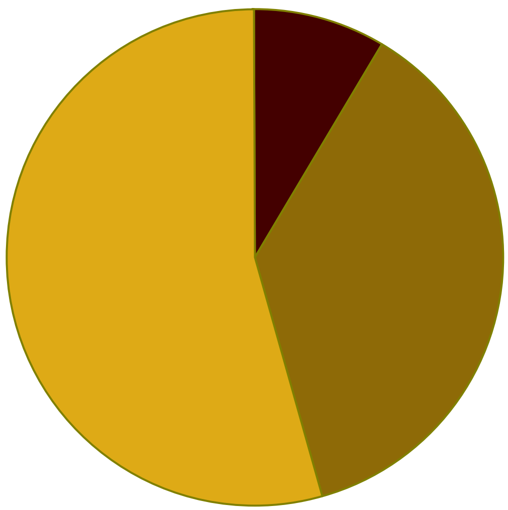
Regulatory Systems Differ Across Channels

Higher-priced loans are more likely to flow through less regulated mortgage delivery channels.

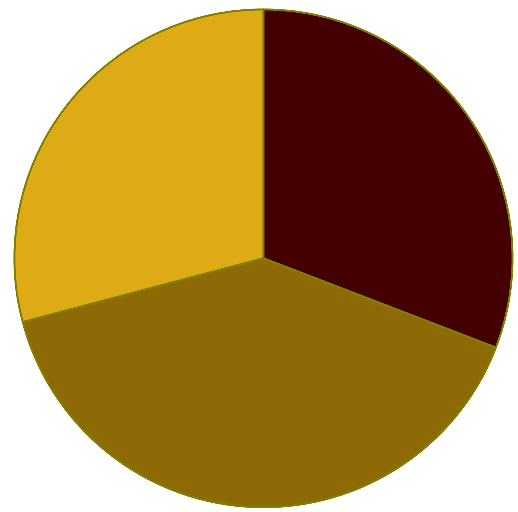
Consequently, mortgages made in individual metropolitan areas, neighborhoods are subject to differing degrees of regulatory oversight.

CRA-Regulation Applied to Only a Small Fraction of Loans to Low Income Borrowers or Low Income Neighborhoods

Higher-Priced Loans



Lower-Priced Loans



Banking Organizations
- **Inside CRA Assessment-Areas**
- **Outside Assessment-Areas**

- **Independent Mortgage Companies**

Source: JCHS Enhanced HMDA Database

Note: Conventional first lien loans for owner-occupied site-built one-to-four family properties. Includes purchase and refinance, between 2004 and 2006. Low income borrower (neighborhood) defined as personal income (tract median household income) less than 80% of the MSA/MD median household income.

Largely Unregulated Mortgage Conduits Dominated Secondary Market Activity

HMDA data indicate that Fannie and Freddie (the GSEs) purchased less than 5 percent of higher-priced whole loans originated from 2004-2006.

In contrast, Wall Street and Private Label issuers purchased more than 60 percent of higher-priced whole loans originated over the same period.

Facing pressure to maintain profitability over this same period, the GSEs did increase purchases of the lower-risk segments of mortgage backed securities containing subprime and other higher-risk mortgage loans.

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LACK OF DATA HINDERS FULL UNDERSTANDING OF THE MAGITUDE OF THE FORECLOSURE

Other Risk Factors: Investors and Second Home Owners

Rapid increase in loans to highly leveraged investors added to market risk— especially in low income and minority neighborhoods.

Other Risk Factors: Foreclosures of Small Multi-Family Rental Properties

The plentiful supply of mortgage capital also fed a substantial rise in high-risk lending to absentee owners of one-to-four-unit rental properties. Nearly 20 percent of foreclosures involve absentee owned one-to-four-unit rental properties.

Other Risk Factors: Piggyback Lending

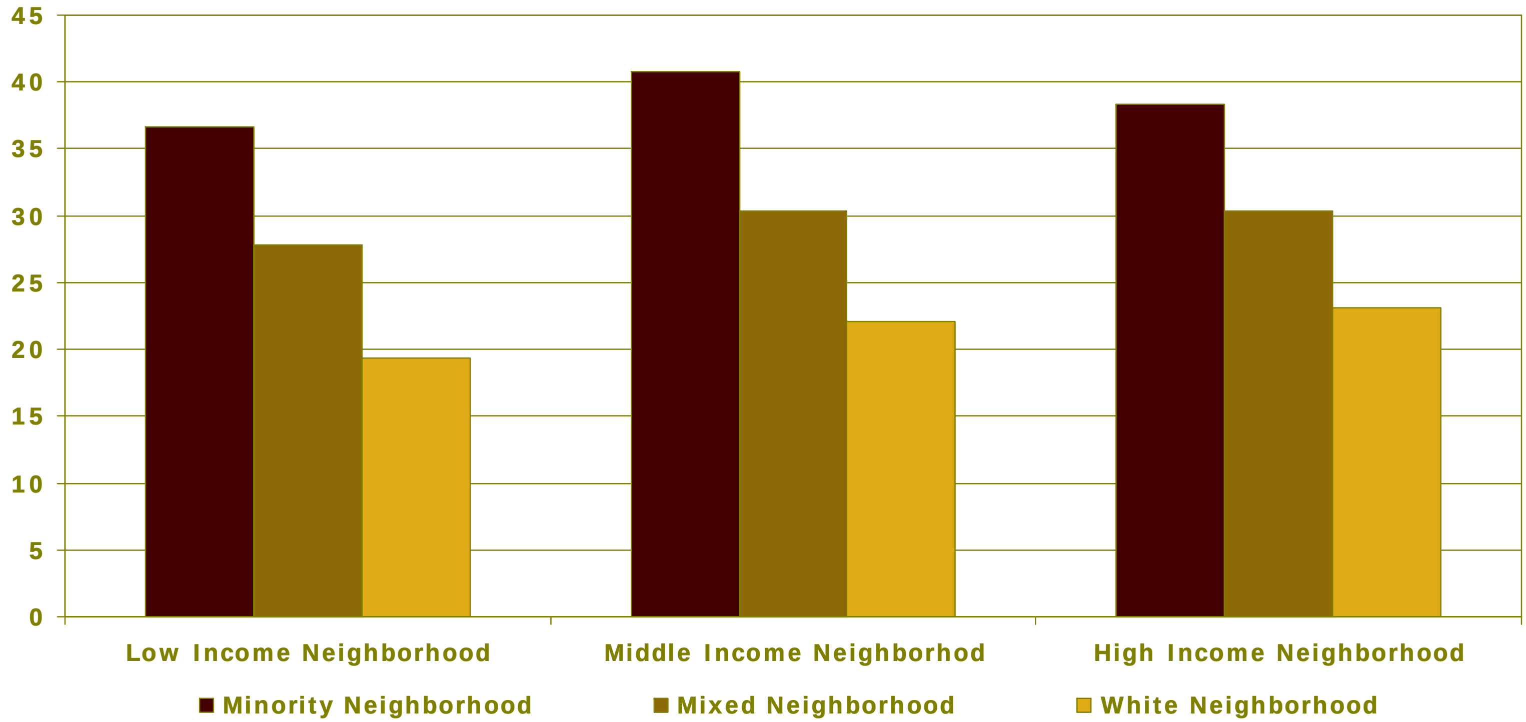
Piggyback lending added to overall mortgage risk by enabling borrowers to have combined loan to value ratios of 100 percent or higher.

Piggybacks accounted for fully one third of all home purchase lending in low income neighborhoods

Since the first lien and second lien are often held in differing security structures, the rise in piggyback lending hinders orderly loan workouts and restructuring.

Piggyback Home Purchase Loans Were Most Common in Minority Neighborhoods of All Income Levels

Share of First Lien Loans With Subordinate Lien, 2006



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Source: JCHS Enhanced HMDA Database, 2006.

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SOLVING THE FORECLOSURE PROBLEM IS KEY TO RESTORING STABILITY TO THE HOUSING SECTOR OF THE ECONOMY

Restoring Liquidity to Credit Markets is Just the First Step

Stabilizing national and international financial markets, and restoring confidence in banking organizations around the world is critical to halting the severe deterioration of world wide economic activity.

Equally important are efforts to halt the downward spiral in home prices that erodes consumer confidence and lowers the wealth holdings of millions of middle and low income households

The Overhang of Foreclosed Properties Limits the Prospects of an Housing Recovery in the Near Future

Despite massive growth in the number of completed foreclosures over the past two years, the rise in foreclosures has yet to crest.

Until the overhang of foreclosed properties in market areas across the country is resolved, any rebound in home sales, home construction, and remodeling activity will be muted at best.

Complex Security Procedures Slow the Process of Resolving Distressed Mortgage Assets

- Under current securitization procedures, the cash receipts from any single home loan may flow to scores of individual investors scattered about the world, and be governed by a wide range of contract and tax laws, and accounting practices.
- A loan foreclosure will force the unwinding of these tightly wrapped securities, but under current procedures this process is slow and expensive.
- To expedite efforts to clear the overhang of foreclosed properties from the market will require a substantial rethinking of laws and accounting rules governing loans held in complex security structures, a process that is only now beginning.