Core Mortgage Risk Monitor

Q3 2008
JULY

A Quarterly Forecast of U.S. Residential Mortgage Risk and its Impact on Local Economies

EXECUTIVE SUMMARY

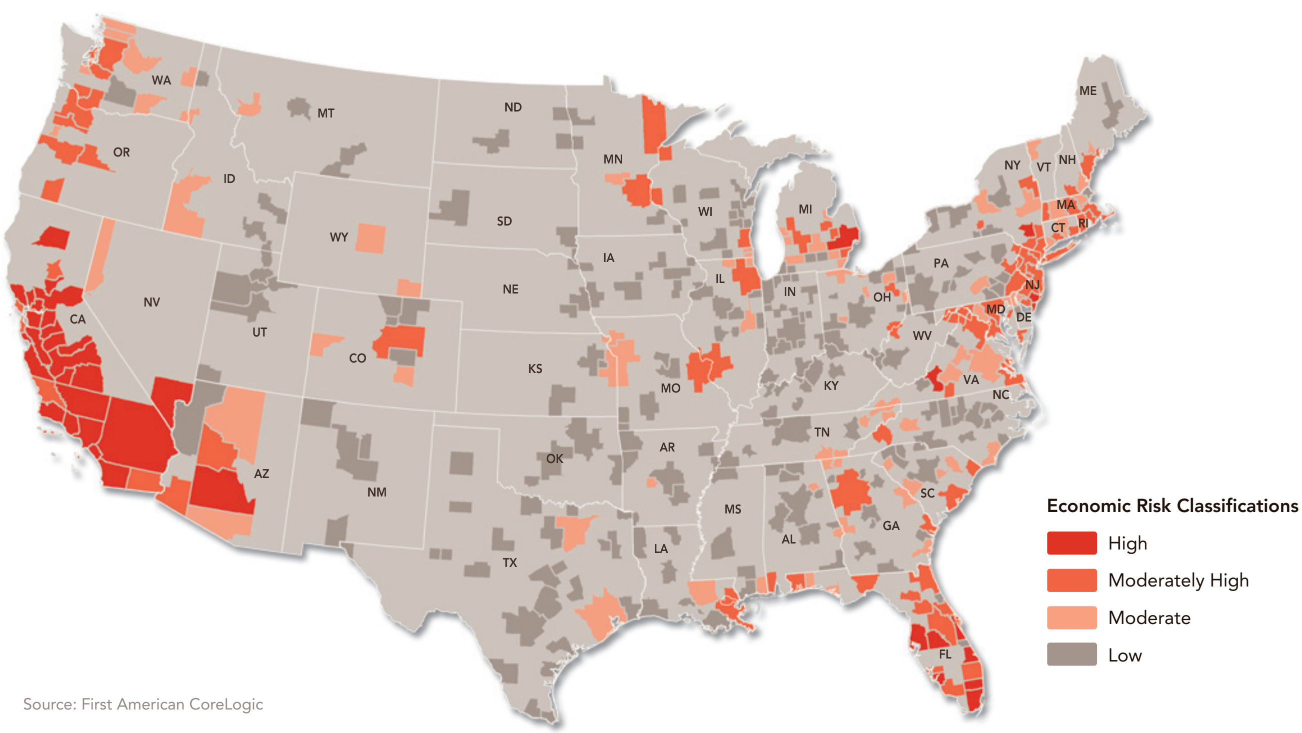
The Q3 2008 Core Mortgage Risk Index (CMRI) (Exhibit 2) has risen 12% above a year ago and increased for eleven of the last twelve quarters. The CMRI—which forecasts delinquency risk—is currently 55% above the base period of Q1 2002, a period near the end of the last U.S. economic recession. Although significantly higher now than during this base period, the CMRI is likely to continue rising nationally over the next 18 months.

The primary factor driving the most recent increase in mortgage risk is the decline in home prices. When the CMRI began to rise in late 2005, fraud and collateral risk were the driving factors—both the fraud and collateral risk indices had been rapidly rising since 2003. Late in 2007, however, and particularly in 2008, the rapid decline in home prices began to quickly overwhelm all other factors driving risk.

Markets with high levels of mortgage risk are typically characterized by home price declines, higher than average fraud and collateral risk, and a struggling local economy. However, in the current phase of the cycle, the largest factor driving mortgage performance—by far—is home price declines. California is currently the state with the largest price declines, and eight of the ten riskiest Core-Based Statistical Areas (CBSAs) nationwide are from the state. The two riskiest California CBSAs are Riverside and Los Angeles, where prices have declined roughly 25% from a year ago and the economy is struggling—particularly the labor market, with an unemployment rate that has increased by roughly two percentage points during the past year. The combination of rapidly declining prices and increasing unemployment significantly increases the likelihood of poor mortgage performance. Other very risky California CBSAs include the Central Valley, led by Sacramento.

CORE MORTGAGE RISK INDEX BY CBSA - Q3 2008

EXHIBIT 1

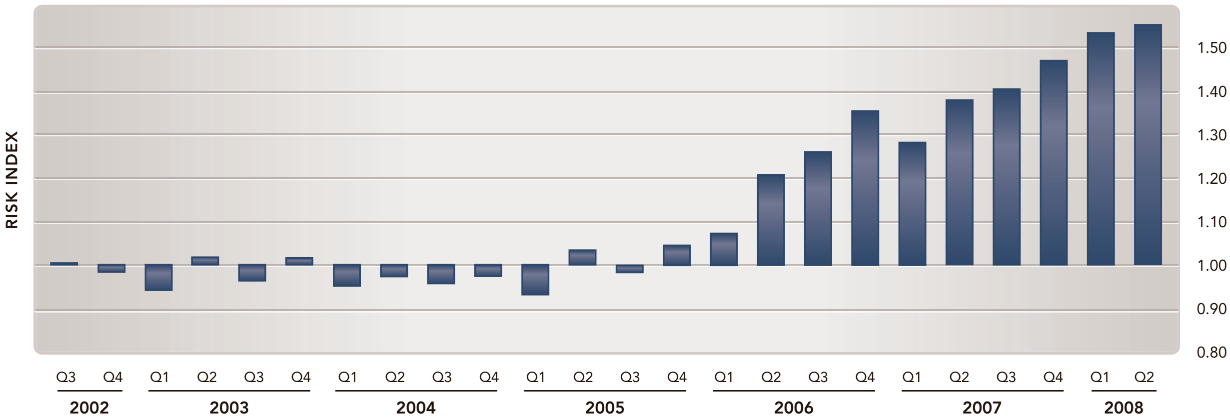


Source: First American CoreLogic

First American CoreLogic

NATIONWIDE CORE MORTGAGE RISK INDEX TREND

EXHIBIT 2

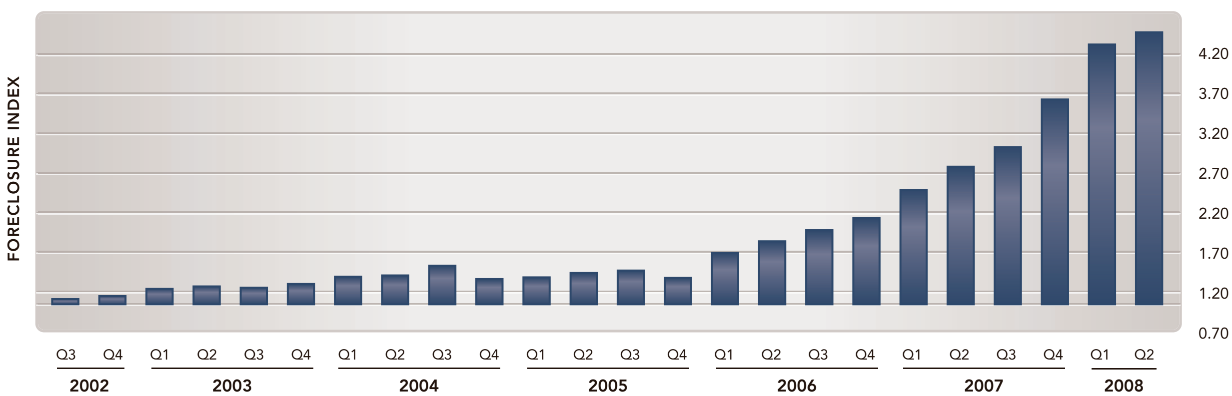


Source: First American CoreLogic

Outside California, Florida is the riskiest state, led by Miami, Cape Coral-Ft. Myers, and Port. St. Lucie. The riskiness of these markets is slightly less than Riverside and Los Angeles, but on par with the remaining poorly performing California CBSAs. Excluding California and Florida, the riskiest markets in the remainder of the country include the formerly booming cities of Las Vegas, Phoenix, and Washington DC, and the Warren MI CBSA, where the housing market has been struggling for several years. Although many markets are getting riskier, Allentown, St. Louis, Toledo, and Syracuse stand out this quarter among the 100 largest markets that exhibit the largest increase in risk. The driver in all four is a substantial quarterly acceleration in home price declines.

FORECLOSURE INDEX TREND

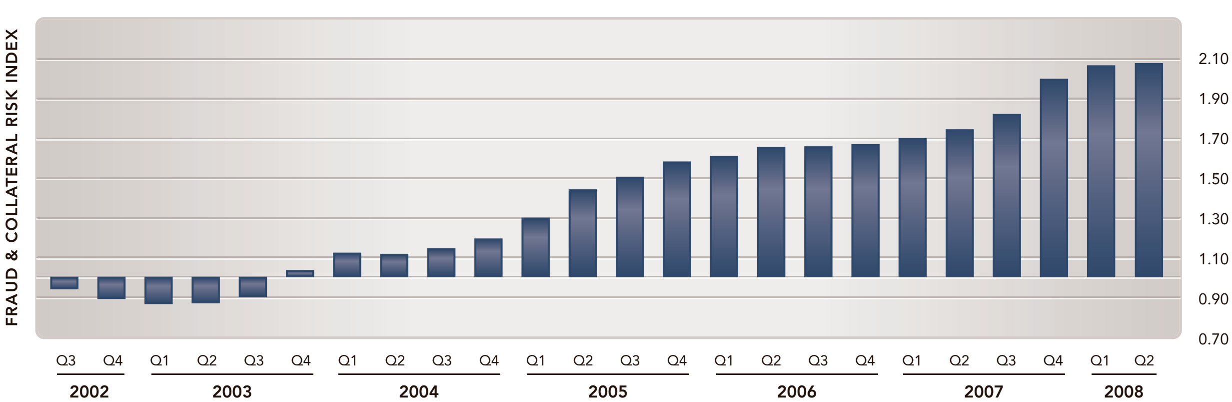
EXHIBIT 3



Source: First American CoreLogic

FRAUD AND COLLATERAL RISK INDEX TREND

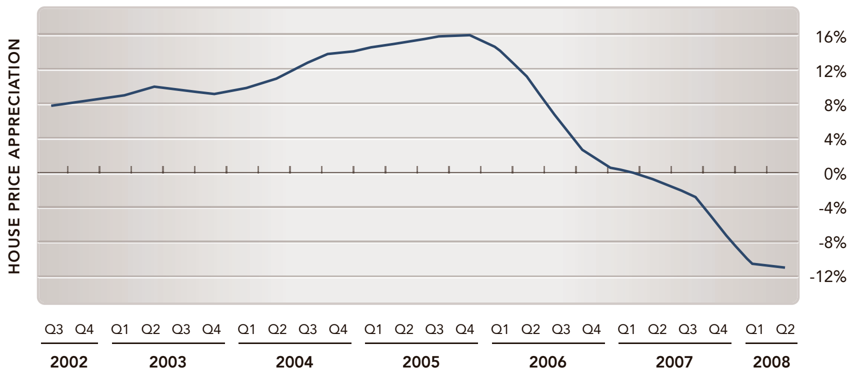
EXHIBIT 4



Source: First American CoreLogic

HOUSE PRICE APPRECIATION TREND*

EXHIBIT 5



*Estimates based on First American CoreLogic's LoanPerformance HPI year-over-year appreciation changes

Source: First American CoreLogic

HOUSE PRICE ACCELERATION TREND†

EXHIBIT 6

†Acceleration is the second-order rate of appreciation change, indicating how quickly the appreciation rate itself is changing

Source: First American CoreLogic

HOUSE AFFORDABILITY TREND

EXHIBIT 7

Source: First American CoreLogic

During Q2 2008, home price declines continued to broaden nationally, although the severity of price declines moderated somewhat. Home prices in U.S. metropolitan markets overall fell by an average of nearly 11% from levels a year ago. Of the more than 380 CBSAs tracked, nearly 200 are experiencing price declines, up from 176 in Q2 and 143 in Q1. Although price declines are spreading, the most severe price declines are still very geographically concentrated. The top 40 CBSAs with the most severe price declines are all located in California, Florida, Arizona, and Nevada. These 40 worst markets have all depreciated at least 15% during the last year. Outside those four states, the largest price declines are in some parts of Ohio, Michigan, Oregon, Massachusetts, and the Washington DC metropolitan area. Of the markets experiencing price appreciation, the majority are located in Texas, Pennsylvania, Indiana, Alabama, and Iowa. Each of these states has at least six CBSAs where prices increased more than two percent during the last year.

The house price acceleration rate, a measure of the rate of change in the appreciation rate itself, is beginning to show signs of moderation. This moderating trend over the last two quarters indicates that the house price rate of decline is slowing down, a first step toward the bottoming out of price declines, which must occur before any recovery can begin. There are other factors, of course, that could reverse this positive trend—seasonality, increasing stock of REO properties, the economy, inflationary risks—but for now we view the trend data as a glimmer of hope for the market.

Mortgage risk in any market depends on the interaction of housing prices, the local mortgage market, and area economic health. Geographic concentrations of mortgage risk are currently driven by house price declines, worsening economic conditions, and financial market dislocations. The decline in house prices has created a self-reinforcing feedback loop where lower prices lead to more defaults and excess housing inventory, which in turn reduces demand and causes prices to fall further.

Combinations of these factors will continue to put upward pressure on the CMRI in an increasing number of geographies, with amplified effects on high-concentration geographies. This downward spiral continues to pose difficult challenges for the U.S. economy, including the impact of the housing downturn on personal wealth and consumer spending.

TOP 10 HIGHEST RISK AMONG LARGEST 100 MARKETS

EXHIBIT 9

Of the 100 largest U.S. MSAs (out of 381), the following ten markets are at highest risk:

MARKET NAME	CURRENT[1] RANK	PRIOR QUARTER RANK	CMRI INDEX	FORECLOSURE INDEX	FRAUD RISK INDEX	HOUSE PRICE[2] APPRECIATION
1. Riverside-San Bernardino-Ontario, CA	1	1	4.02	1.55	1.09	-25.3%
2. Los Angeles-Long Beach-Glendale, CA	2	2	3.64	1.01	0.62	-25.2%
3. Sacramento--Arden-Arcade--Roseville, CA	3	3	2.46	2.67	1.18	-25.2%
4. Miami-Miami Beach-Kendall, FL	4	5	2.42	0.40	1.23	-21.5%
5. Oakland-Fremont-Hayward, CA	5	8	2.33	6.35	0.80	-23.9%
6. San Diego-Carlsbad-San Marcos, CA	6	10	2.32	4.04	0.84	-21.4%
7. Santa Ana-Anaheim-Irvine, CA	7	9	2.29	2.52	0.38	-21.6%
8. Stockton, CA	8	6	2.21	7.17	1.26	-24.8%
9. Phoenix-Mesa-Scottsdale, AZ	10	15	2.20	1.59	0.45	-18.7%
10. Bakersfield, CA	16	13	2.06	0.79	1.41	-23.0%

Source: First American CoreLogic

TOP 10 LOWEST RISK AMONG LARGEST 100 MARKETS

Of the 100 largest U.S. MSAs (out of 381), the following ten markets are at lowest risk:

MARKET NAME	CURRENT[1] RANK	PRIOR QUARTER RANK	CMRI INDEX	FORECLOSURE INDEX	FRAUD RISK INDEX	HOUSE PRICE[2] APPRECIATION
1. Dayton, OH	284	237	1.05	0.30	0.88	-6.1%
2. Indianapolis-Carmel, IN	294	236	1.04	0.16	0.89	2.1%
3. Austin-Round Rock, TX	307	326	1.03	0.74	0.89	5.2%
4. Omaha-Council Bluffs, NE-IA	312	254	1.02	0.37	0.99	-3.2%
5. Wichita, KS	317	331	1.02	1.41	1.03	2.4%
6. Louisville/Jefferson County, KY-IN	325	255	1.01	0.46	0.99	3.2%
7. Charlotte-Gastonia-Concord, NC-SC	328	356	1.00	0.39	1.16	-1.8%
8. Raleigh-Cary, NC	352	367	0.94	0.38	0.97	-1.6%
9. Gary, IN	356	351	0.94	0.47	0.99	2.3%
10. McAllen-Edinburg-Mission, TX	357	359	0.93	0.75	0.95	0.1%

NOTES: [1]Lower number compared to prior quarter indicates increased riskiness, [2]Year-over-year house price appreciation data from LoanPerformance HPI–negative change in risk rank from previous quarter indicates decreasing riskiness.

Source: First American CoreLogic

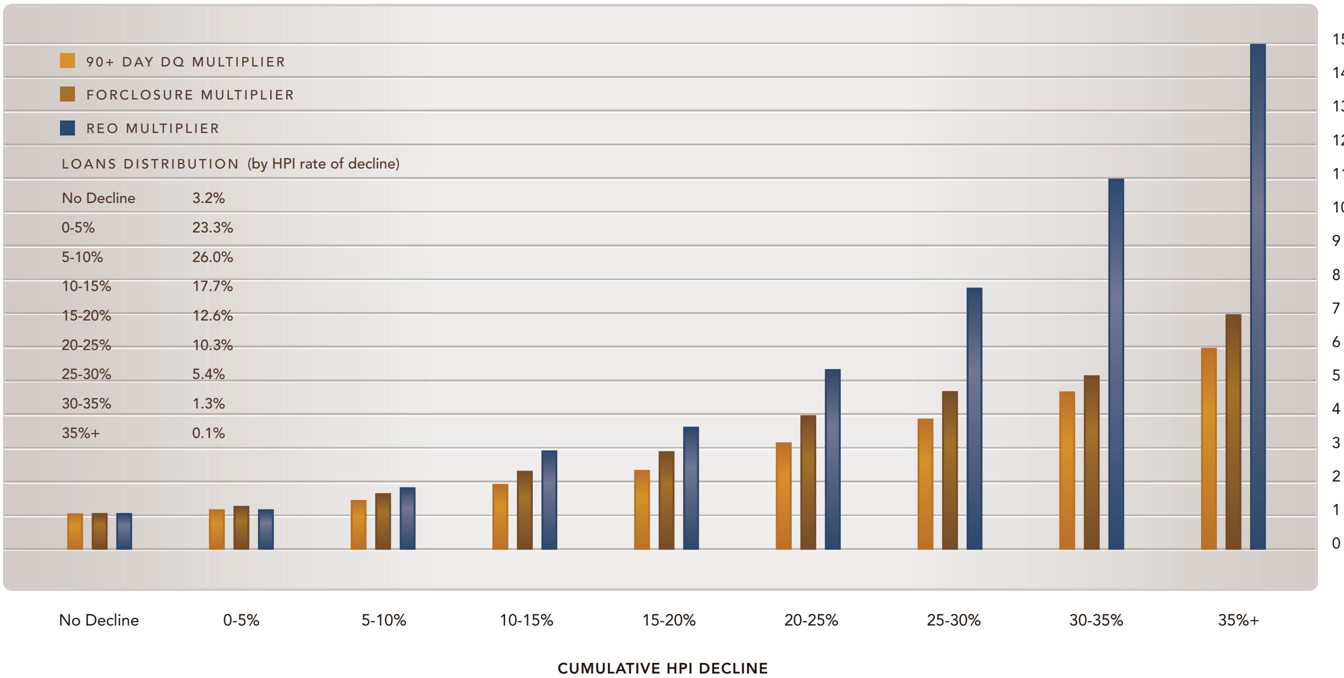
NEW MORTGAGE RISK ANALYTICS

As the current mortgage crisis unfolds, we are exploring new, non-traditional approaches to understanding it better—new tools to help project future effects more precisely and enable affected companies to identify and implement counter-actions early in the process.

To gain a deeper understanding of the relationship between price changes and mortgage performance, we analyzed monthly LoanPerformance Home Price Index and performance data for more than 30-million loans in 7,500+ zip codes. We segmented the zip codes by cumulative declines in home prices since the most recent peak, then analyzed performance trends as of June 2008. Exhibit 8 plots the multiplier[1] for various performance segments.

[1]*Each multiplier is the ratio of rates in zip codes with price declines, benchmarked against the same rate in zip codes with no price declines.*

MORTGAGE MULTIPLIER PERFORMANCE RELATIVE TO NON-HPI DECLINING ZIP CODES **EXHIBIT 8**



Source: First American CoreLogic

Our focus on the REO rate reveals that in areas with less than a 5% decline in home prices, the REO multiplier is 1.1—performance on par with areas with no price declines. Performance worsens noticeably in areas with more than a 5% decline in prices, and the associated multipliers increase dramatically. In zip codes with more than a 35% cumulative decline in HPI, for example, the REO multiplier is over 15. This means that loans in such severe-price-decline zip codes have at least a 15-times higher chance of falling into REO compared to loans in zip codes with no price declines. This uneuqivocally demonstrates the equity destruction caused by large home price declines, which leaves homeowners with no or negative equity and much more likely to default.

ABOUT THE MONITOR

The Core Mortgage Risk Monitor (CMRM) is a quarterly publication providing an economic forecast, analysis and commentary on the relative risk of residential mortgage loan delinquencies due to fraud propensity and collateral risk, house price dynamics, and the health of local market economies. The Core Mortgage Risk Index (CMRI) is the basis for the forecast. An elevated CMRI signals the increased potential for financially disruptive and costly economic consequences for consumers, their local community, and mortgage financiers. The CMRM tracks this risk in more than 380 metropolitan markets across the United States representing more than 89 percent of the U.S. population. For more information about the Core Mortgage Risk Monitor, contact Dr. Mark Fleming, First American CoreLogic, at mfleming@facorelogic.com.