Residential Lending

"Changing Directions"

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Manager - Consumer Compliance Team

Community Banker Conference
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Federal Reserve Bank of Boston
Residential Lending

Then, Circa 1990....

- Homogeneous Products
- Securitization - Fannie / Freddie
- Lenders / Brokers - smaller players
- Technology - (HP12c?)
- Subprime?
- Regulatory Issue - Equitable Access to Credit
Residential Lending

Now - 2007.....

- Diverse Products
- MORE Securitization - Private Label
- Lenders / Brokers - significant players
- Robust use of Technology
- Subprime!!
- Regulatory Issue - Too Much Access to Credit?
Securitization

- Frees additional capacity - lenders lend more, people borrow more.
- Fuels the broker / lender boom.
- Model - "Take Deposits - Make Loans" becomes "old school."
- Securitization removes credit risk (ha ha!)
Securitization

GSE Securitizations as % of Mortgages Outstanding

Source: OFHEO
Brokers/ Non Bank Lenders

- Brokers have access to multiple investors - provides pricing flexibility.
- Improving technology allowed better pricing tools, faster credit decisions, and risk based pricing.
- Incentive structures creates a more "eager" originator.
Brokers Become Big Players

Two Takes on Broker Originations

According to a 2004 study by Wholesale Access Mortgage Research & Consulting, Inc., there are approximately 53,000 mortgage brokerage companies that employ an estimated 418,700 employees and originated 68% of all residential loans in the US in 2003.

<table>
<thead>
<tr>
<th></th>
<th>All Loans - 2005 H2</th>
<th>Subprime Only - 2005 H2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail</td>
<td>45%</td>
<td>27%</td>
</tr>
<tr>
<td>Direct - Internet</td>
<td>2%</td>
<td>1%</td>
</tr>
<tr>
<td>Direct - Other</td>
<td>3%</td>
<td>1%</td>
</tr>
<tr>
<td>Broker</td>
<td>50%</td>
<td>71%</td>
</tr>
</tbody>
</table>

Source: Mortgage Bankers Association
Technology

- DU and LP "brings the bank" to the borrower.
- Internet based banking allows for a 24/7 application process
Technology

2007 MortgageBot Study

Review of online lending practices and procedures implemented at more than 3,600 mortgage-lending websites maintained for its more than 700 clients nationwide.

- The study showed that a quarter of the lenders studied "now originate more than half of their loan volume via the online channel."

- Mortgagebot cited an August 2006 Forrester report showing the Internet as the fastest-growing channel for mortgages, with 70% of loan seekers going online to shop for rates.

Source: American Banker
Heavy Use of Internet Advertising

- Mortgage Lenders continue to advertise heavily on web.
- Three increased ad budgets --
  - ▲ Countrywide Financial, which increased ad spending from $34.8 million to $35.4 million.
  - ▲ Low Rate Source
  - ▲ InterActiveCorp (parent of LendingTree.com), and
  - ▼ Experian
# Internet Advertising

## Top 10 Advertisers by Estimated Spending (U.S.)

<table>
<thead>
<tr>
<th>Advertiser</th>
<th>Total Estimated Spending</th>
<th>Impressions (000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Low Rate Source</td>
<td>$51,670,100</td>
<td>25,076,624</td>
</tr>
<tr>
<td>2. NexTag, Inc.</td>
<td>$49,627,300</td>
<td>23,614,378</td>
</tr>
<tr>
<td>3. Experian Group Limited</td>
<td>$40,895,600</td>
<td>14,891,457</td>
</tr>
<tr>
<td>4. InterActiveCorp</td>
<td>$35,537,500</td>
<td>8,842,437</td>
</tr>
<tr>
<td>5. Countrywide Financial Corporation</td>
<td>$35,442,800</td>
<td>17,380,341</td>
</tr>
<tr>
<td>6. AT&amp;T Corp.</td>
<td>$29,774,300</td>
<td>10,748,844</td>
</tr>
<tr>
<td>7. Netflix, Inc.</td>
<td>$29,691,100</td>
<td>9,071,800</td>
</tr>
<tr>
<td>8. Verizon Communications, Inc.</td>
<td>$19,487,900</td>
<td>4,949,850</td>
</tr>
<tr>
<td>9. Monster Worldwide, Inc.</td>
<td>$17,355,500</td>
<td>3,264,426</td>
</tr>
<tr>
<td>10. Privacy Matters</td>
<td>$14,336,600</td>
<td>4,728,581</td>
</tr>
</tbody>
</table>

As of August 2007

Source: Nielsen
Internet Marketing

Mortgage resets: Record bill coming due
Billions in subprime ARMs will be subject to higher payments.

By Les Christie, CNNMoney.com staff writer
August 13, 2007: 11:45 AM EDT

NEW YORK (CNNMoney.com) -- More than two million subprime adjustable rate mortgages (ARMs) are poised to reset at much higher rates in coming months, worsening an already suffering housing market.

Borrowers who took out hybrid ARMs in 2004 and 2005 to secure low “teaser” rates for the first two or three years of the loan may see their monthly mortgage payments climb by 35 percent or more.

Consumer groups and politicians worry that hundreds of thousands of subprime ARM borrowers will be unable to keep up with their mortgage payments and will lose their homes.

“In October alone more than $50 billion in ARMs will reset,” according to Mark Zandi, chief economist and co-founder of Moody’s Economy.com. That’s a record, according to Zandi.
Foreclosures: Hardest hit zip codes

A buyer in 2005 with poor credit and limited means might have signed on for a $200,000 2/28 hybrid ARM, locking in a fixed rate of 4 percent for two years. After paying $955 a month, the bill would now be set to spike to $1,331, a 39 percent increase.

Until recently, rising home prices bailed out many ARM borrowers in trouble. They could raise cash with cash-out refinancings or home equity lines of credit. If worse came to worse, they could sell the house and get some money back.

But prices have stabilized or slipped in many markets. (Latest home prices.)

As a result, Doug Duncan, chief economist for the Mortgage Bankers Association (MBA), is expecting as many as 800,000 home owners will get into trouble with perhaps half of them actually losing their homes.

One of the reasons for the worsening situation, according to Zandi, is that just as the number of subprime ARMs being underwritten was reaching a high, the quality of loans was hitting new lows.

"There were increasingly poor quality loans made starting in the spring of 2005," he said, "with the poorest of all made during the fall of 2006."
The Home as an ATM?

- Nationwide home appreciation coupled with ongoing favorable rate environment had people tapping into home equity like never before.
- A "mortgage" becomes, for the first time, not something you have to get, but something you want.
Everybody Wants Some!

...or how subprime explodes.

- **Consumers** want to tap into their home equity.
- **Brokers/Lenders** want the fee income from the now frequent refinances.
- **Investors**, eager to take advantage of the US real estate market, tap into the higher yielding subprime tranches.
Subprime Originations

Non-Prime Mortgage Originations Backing PLS

 Percent

0% 10% 20% 30% 40% 50% 60% 70% 80% 90% 100%

2001 2002 2003 2004 2005 2006

- Fully Amortizing FRMs
- Fully Amortizing ARMs
- Interest Only/Negative Amortization ARMs
- Other Mortgages
- Interest-only FRMs

Traditional
Subprime and Private Label

Mortgage Related Issuance

1996 - 2006

Source: Securities Industry and Financial Markets Association
Who Buys MBS?

<table>
<thead>
<tr>
<th>Investor Type</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>Midyear 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$ bn</td>
<td>% of Total</td>
<td>$ bn</td>
<td>% of Total</td>
<td>$ bn</td>
</tr>
<tr>
<td>Commercial Banks</td>
<td>702.1</td>
<td>19.6</td>
<td>775.6</td>
<td>19.4</td>
<td>876.4</td>
</tr>
<tr>
<td>Thrifts</td>
<td>209.7</td>
<td>22.4</td>
<td>206.5</td>
<td>5.2</td>
<td>234.3</td>
</tr>
<tr>
<td>Federal Credit Unions</td>
<td>25.2</td>
<td>2.7</td>
<td>28.5</td>
<td>0.7</td>
<td>27.5</td>
</tr>
<tr>
<td><strong>Total Depository</strong></td>
<td>937.0</td>
<td>26.2</td>
<td>1,010</td>
<td>25.2</td>
<td>1,138</td>
</tr>
<tr>
<td>FNMA/FHLMC Portfolio</td>
<td>1,109.4</td>
<td>31.0</td>
<td>1,232</td>
<td>30.8</td>
<td>1,260</td>
</tr>
<tr>
<td>Foreign Investors</td>
<td>235.0</td>
<td>6.6</td>
<td>285.0</td>
<td>7.1</td>
<td>490.0</td>
</tr>
<tr>
<td>Mutual Funds</td>
<td>375.0</td>
<td>10.5</td>
<td>387.0</td>
<td>9.7</td>
<td>375.0</td>
</tr>
<tr>
<td>Personal Sector</td>
<td>120.0</td>
<td>3.4</td>
<td>200.0</td>
<td>5.0</td>
<td>235.0</td>
</tr>
<tr>
<td>Life Insurance Cos</td>
<td>235.0</td>
<td>6.6</td>
<td>240.0</td>
<td>6.0</td>
<td>265.0</td>
</tr>
<tr>
<td>Public Pension Funds</td>
<td>95.0</td>
<td>2.7</td>
<td>120.0</td>
<td>3.0</td>
<td>152.0</td>
</tr>
<tr>
<td>Private Pension Funds</td>
<td>90.0</td>
<td>2.5</td>
<td>105.0</td>
<td>2.6</td>
<td>115.0</td>
</tr>
<tr>
<td>FHLB</td>
<td>96.4</td>
<td>2.7</td>
<td>97.9</td>
<td>2.4</td>
<td>113.1</td>
</tr>
<tr>
<td>Securities Brokers/Dealers</td>
<td>40.0</td>
<td>1.1</td>
<td>35.0</td>
<td>0.9</td>
<td>50.0</td>
</tr>
<tr>
<td>REITs</td>
<td>12.7</td>
<td>0.4</td>
<td>28.6</td>
<td>0.7</td>
<td>79.0</td>
</tr>
<tr>
<td>** Depository &amp; Major Investors**</td>
<td>2,408.5</td>
<td>67.4</td>
<td>2,731</td>
<td>68.2</td>
<td>3,135</td>
</tr>
<tr>
<td>All other Investors*</td>
<td>230.2</td>
<td>6.4</td>
<td>261.9</td>
<td>6.5</td>
<td>201.2</td>
</tr>
<tr>
<td><strong>Total Outstanding</strong></td>
<td>3,575.7</td>
<td>4,003.5</td>
<td>4,474.4</td>
<td>5,189.1</td>
<td>5,450.6</td>
</tr>
</tbody>
</table>

Notes: Mortgage-related securities, include all securities or debt obligations collateralized by either residential mortgages. Estimates are in italics and from Inside MBS & ABS based on available Federal Reserve Board data.

*Other investors include hedge funds, nonprofits, other groups, property/casualty insurers, and state/local government where MRS data is not available.

Table from UBS Presentation dated May 22, 2007
Subprime and Private Label

January 2006 - August 2007

Mortgage Related Issuance

Source: Securities Industry and Financial Markets Association
So Why is This Important to New England Community Banks?
New England Community Banks are Heavy Residential Lenders

- Of top 150 community banks with largest first mortgage portfolios, 60 are New England banks as of 12/31/06
- Of those top 150 banks, New England banks own 43.1% of all the first mortgages held.
- NE has 13 of the top 22 institutions

Source: SNL Financial
New England is Heavy in Savings Banks

### Top 10 States Ranked by % of Savings Bank Deposits

#### 2006

<table>
<thead>
<tr>
<th>State</th>
<th>Deposits (in $000s)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Connecticut</td>
<td>$18,912,679</td>
<td>22.3%</td>
</tr>
<tr>
<td>Maine</td>
<td>$4,486,579</td>
<td>19.5%</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>$28,021,388</td>
<td>16.7%</td>
</tr>
<tr>
<td>New Hampshire</td>
<td>$1,785,085</td>
<td>7.6%</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>$1,302,007</td>
<td>5.3%</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>$9,227,218</td>
<td>3.5%</td>
</tr>
<tr>
<td>Delaware</td>
<td>$535,471</td>
<td>2.8%</td>
</tr>
<tr>
<td>New Jersey</td>
<td>$4,513,425</td>
<td>2.1%</td>
</tr>
<tr>
<td>Alaska</td>
<td>$205,374</td>
<td>2.0%</td>
</tr>
<tr>
<td>Washington</td>
<td>$2,302,849</td>
<td>1.9%</td>
</tr>
<tr>
<td><strong>US</strong></td>
<td><strong>$105,524,984</strong></td>
<td><strong>1.6%</strong></td>
</tr>
</tbody>
</table>

*dollars in 000s

Source: SNL Financial
National Housing Appreciation Rates

Four Quarter Appreciation Rates: Most Recent Year vs. Prior Year

- Appreciation in "Purchase-Only" Index: 2005Q1-2006Q1
- Appreciation in "Purchase-Only" Index: 2006Q1-2007Q1

USA: 9.7% (3.0%)
Pacific: 16.0% (4.5%)
Mountain: 14.6% (5.2%)
West North Central: 2.1% (5.9%)
West South Central: 3.1% (3.9%)
East North Central: 8.2% (5.54%)
East South Central: 5.0% (5.0%)
New England: -1.2% (2.7%)
Mid-Atlantic: 10.7% (3.1%)
South Atlantic: 12.1% (3.1%)

Map showing regional differences in housing appreciation rates.
Rhode Island now has 5th-highest foreclosure rate in country. The highest state foreclosure rates is MI, down to 1%; ND has the lowest at 0.2%.

Percent of loans with foreclosure initiation in quarter, with state rank

Source: Mortgage Bankers Association/Haver Analytics
First District
Experiences
1-4 Family Past Due Rates

The good news, is delinquency rates are still relatively low
First District Experiences

- Home mortgage business volume is down.
- Secondary market underwriting standards have not changed.
- Real estate market is the pressing concern.
- Some consumer pullback due to subprime.
- Increasing commercial mortgage activity.
- May be slow going for home mortgage lending.
Fed Subprime Study

- All subprime loans made in Middlesex County, MA
- 1992-2006, over 2 million loans
  - 30% of subprime hold more than one property.
  - 18% subprime borrowers have credit scores over 700.
  - Many may have held on long enough for property to appreciate.
  - "Teaser" rates (2/28s and 3/27s) not so much of a teaser
    2005 average - 7.3%, 2006 average - 8.35%.
  - 15% in default, but 85% are good.
First District Experiences

Mortgage Lenders Report

- Subprime has dried up.
- Investor pool is much smaller and are looking for "prime" underwriting standards.
  - This coupled with soft RE market has made it hard to originate any loans
  - Difficult to originate subprime loan to applicant with a 680 credit score.
- Good news - resets may not be as bad as originally thought.
- Still - this is not good news.
Community Banks Not Immune

- Pressures are real!
  - NIM Compression
  - Core Deposit Gathering
  - Earnings Pressure

- Subprime was tempting
  - Creativity is key!
  - 3rd Party relationships

First District Experiences

One bank's story....

- Business volume is up.
- Originate to sell on secondary market (conforming)
- Underwriting standards have not changed.
- Subprime situation has redirected potential borrowers from mortgage companies to banks.
- It’s the ability to repay.
- Business as usual.

FEDERAL RESERVE BANK OF BOSTON™
Silver Lining?

- Overall, community banks are sitting tight
- Jumbos – bank niche product?
  - Banks competitive:
    - ½ to 1 point lower than mortgage lenders.
- Portfolio lenders – good prognosis
- Funding sources – remain solid
- Advertising trends – banks exploit stability.
- Rebuilding market share.
Questions?