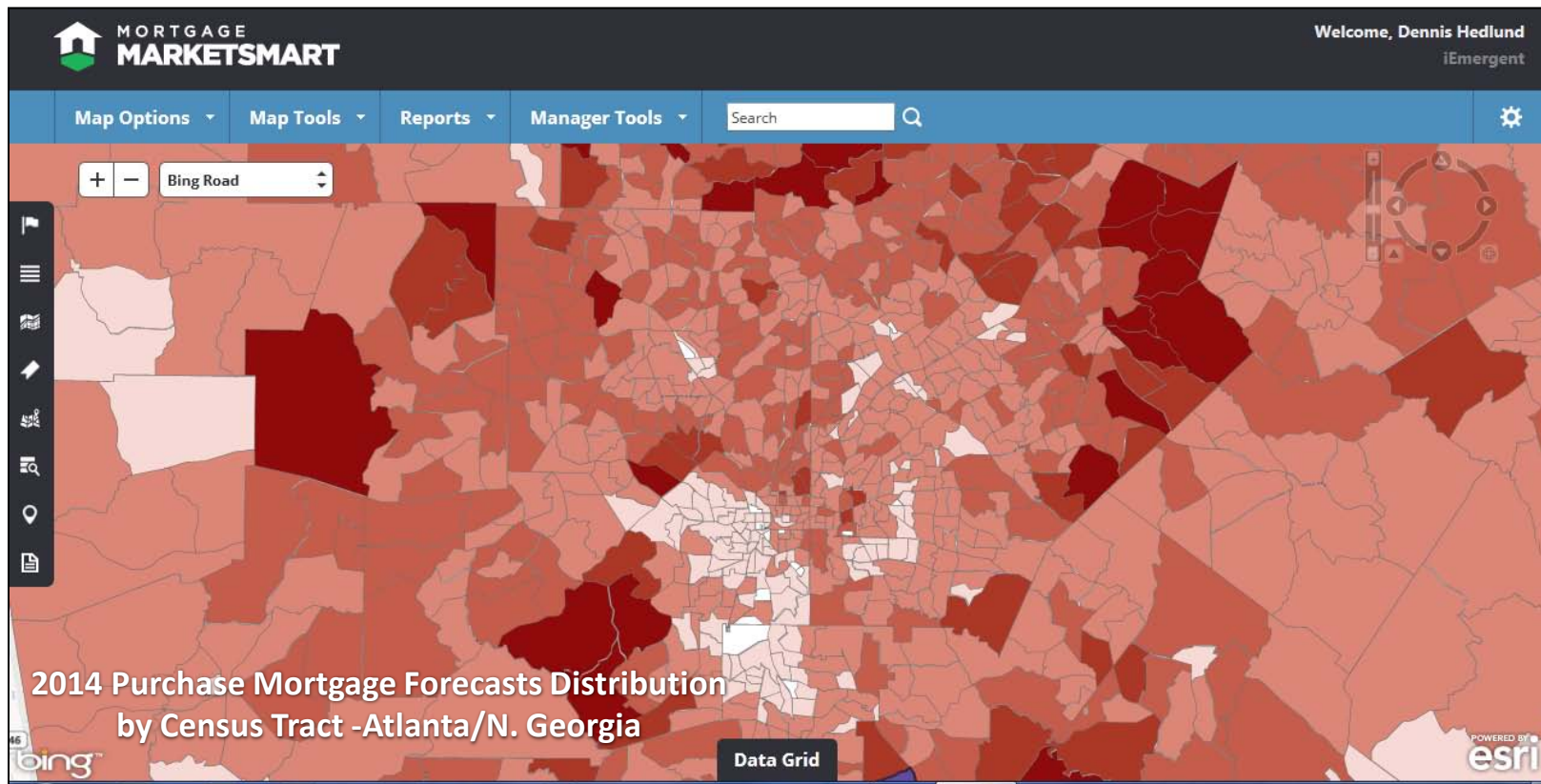


*Notes on 2014-2018 PRELUDE Mortgage Finance Forecasts



“Welcome to Purchase World”

(An Opinion in Pictures)

PRELUDE to 2014

At this point in time, we're 72% of the way through the 2013 calendar year, yet the mortgage lending year is close to being over. It's a good bet that at least eighty-five percent (85%) of 2013's EOY total purchase volume has either been closed or is already in the pipeline hoping to close before the year subsides. While purchase lending has been improving ever so slightly up to now, refinance activity took a nasty turn for the worse. Neither situation was unexpected.

The "taper tantrum" volcano erupted when the Federal Reserve FOMC hinted that a slow tapering of the QE3 bond purchase program would likely begin to take place sometime in the 3rd or 4th quarter this year. The tantrum's instantaneous impact on Wall Street optimism, the acceleration of residential mortgage rates, layoffs by lenders and pullback on housing finance demand demonstrated the weak foundations and limited resilience of households, homeowners and lenders in the mortgage space. The susceptibility of 2014 mortgage lending growth to volatile external forces, real or imagined or rumored, could not be more clear.

Downside pressures have the potential to negate any burgeoning upside volume trends in 2014. The list of negatives and potential disruptions is scary. Mortgage banking anxieties over new regulatory compliance issues pales in comparison to political anarchy, governance collapse, endless economic brinkmanship, U.S. government shutdowns, and the insanity of debt-ceiling default that are now being scheduled by our beloved Congress to play in theaters everywhere. Add to the mix economic imbalance and recession problems in the EuroZone and slowdowns in China and India. The conditions for sustained growth in mortgage lending look very iffy and shaky. , and rising mortgage rates, the conditions for mortgage financing are shaky. Purchase originations will be lucky to grow at a run-rate only slightly better than flat when compared to 2013. The prognosis for 2014 refinance lending looks to fall by 50%.

Despite all the headline hype about a recovery in housing this year, a purchase lending recovery has yet to gain sustainable traction. Home sales might appear to be up, but distressed properties , investors, and all-cash sales still constitute big portions of total home sales. Even new household formations won't be the factors they once were for growth; too many down-payment, credit, debt-to-income, cash and savings obstacles are in the way for *First Time Home Buyers*. It doesn't look like a mortgage lending "recovery" in 2014 by any stretch of our collective imaginations.

		2013		2014		2013-2014 Δ	
		Units (000's)	Dollars (Billions)	Units (000's)	Dollars (Billions)	Units	Dollars
Owner Occupied Purchase		2,065	\$472.0	2,092	\$490.8	1.31%	3.98%
Non-Owner Occupied Purchase		251	\$51.5	253	\$53.1	0.80%	3.11%
Total Purchase Volume		2,345	\$523.5	2,422	\$543.9	3.28%	3.90%
Refinance Volume Range							
	<i>Low</i>	2,787	\$621.4	1,479	\$335.3	-46.93%	-46.04%
	<i>High</i>	3,374	\$752.2	1,790	\$405.9		
Total EOY Mortgage Volume							
	<i>Low</i>	5,132	\$1,144.9	3,901	\$879.2	-23.99%	-23.21%
	<i>High</i>	5,719	\$1,275.7	4,212	\$949.8		

September 2013

Industry Oracles	2013 EOY Estimate			2014 Forecast			2014 Purch/Refi
	Purchase	Refinance	Total	Purchase	Refinance	Total	
Fannie Mae	\$625	\$1,119	\$1,744	\$736	\$339	\$1,075	68%/32%
MBA	\$616	\$989	\$1,605	\$703	\$388	\$1,091	64%/36%
Freddie Mac	\$684	\$1,116	\$1,800	\$796	\$554	\$1,350	59%/41%

We project a **2014 total purchase volume** at **\$543.6 Billion**, which translates to an increase of only 3.28% in units and 3.9% in dollars over 2013. We expect **2014 refinance dollar volume** to drop to a range of **\$335.3 Billion to \$405.9 Billion**, which will be about -47% or more down from expected 2013 EOY refinance volumes.

We see no burgeoning behavior changes nr booming trends, such as accelerated economic growth, or fast-rising employment levels, or big gains in wage and household earnings for the bottom 90%, or rapid growth in consumer spending, or rapidly improving household balance sheets that would prompt us to make significant changes to 2013 or 2014 at this point.

The Three Oracles



As is usual, Fannie Mae, Freddie Mac, and the MBA, *The Three Industry Oracles*, have differing views of 2013 and 2014 national mortgage finance volumes.

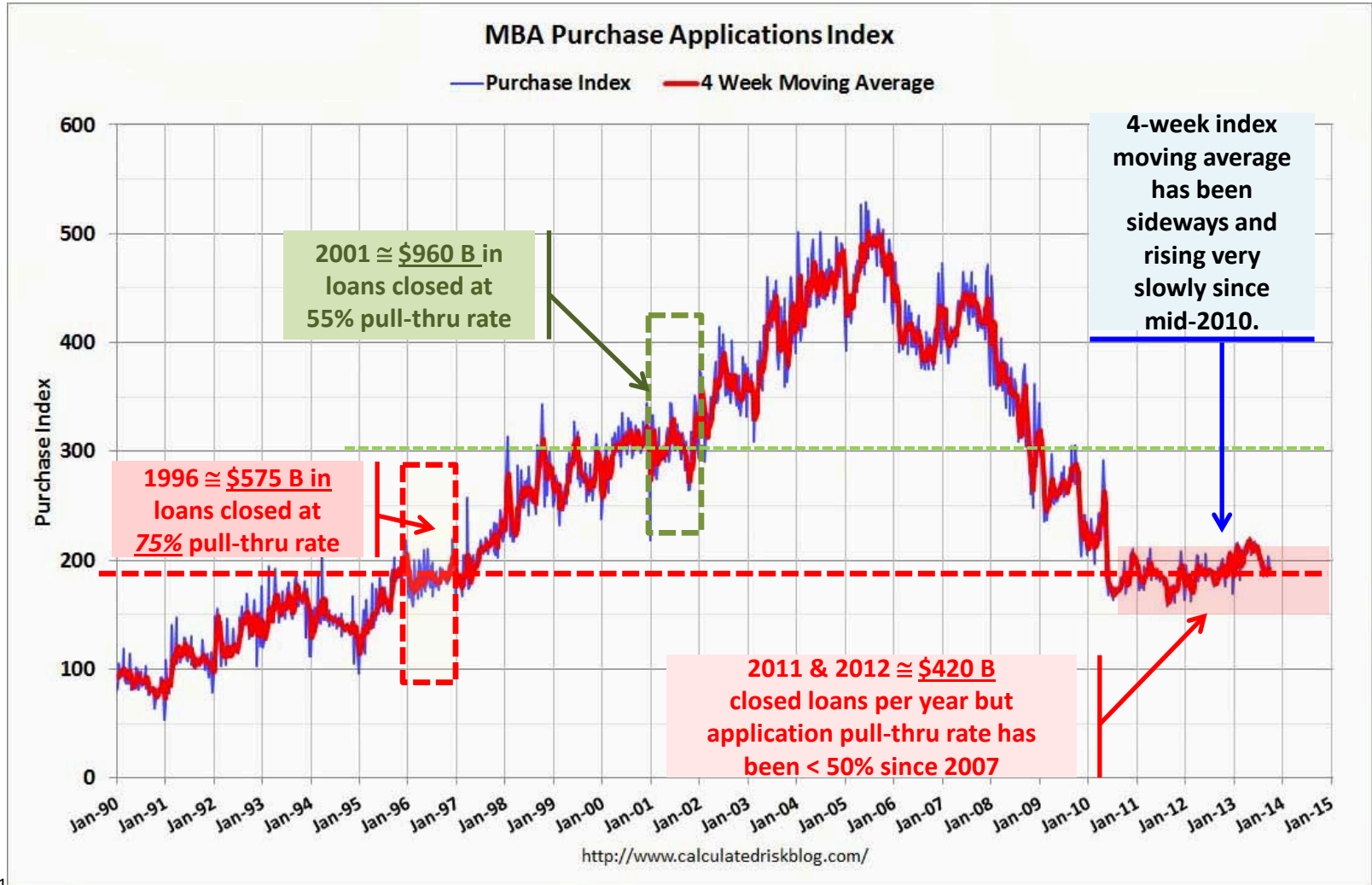
Keep in mind that national and state real estate (NAR), builder (NAHB) and mortgage lending associations (MBA, NAMB), secondary market participants (Fannie Mae, Freddie Mac), big bank analysts, big non-bank independent mortgage lenders, Wall Street analysts, and think-tank experts/economists all too often function as cheerleaders of positive mortgage lending growth dynamics in their future projections, no matter how faint or unsustainable the signs of recovery and growth in mortgage financing might be.

It's the nature of their advocacy roles. Advocates tend to discount evidence that doesn't fit upbeat narratives. Even if or when serious economic storms are on the horizon, advocates must still focus their reports and opinions how sunny it is today.

It falls to mortgage bankers, lenders and loan originators to take greater responsibility for analyzing and understanding for themselves the reality of the future lending opportunities in the communities and market segments they serve. Lenders that depend on hopes, hearsay and "I think" suppositions to determine and compare the variety and diversity of 2014 lending opportunities in all aspects of your markets are not that much different than potential home buyers that wait on the sideline for the opportunities they "think" or their intuition tells them will eventually come, but never does. And sadly, they miss the boat.

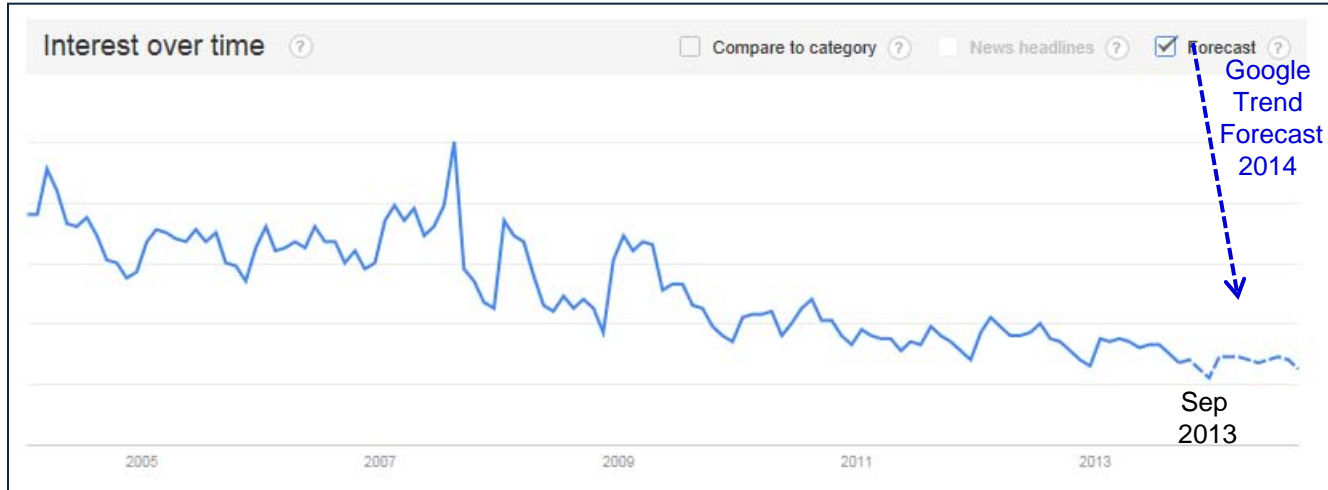
2014 U.S. Purchase Volume Forecast

- Consider the simplest of leading-edge trend indicators - the MBA's *Weekly Purchase Applications Index* -- for signs of growing strength. There aren't many. The *Index* has been flat-lined for three years at what amounts to 1996-97 levels. The index has shown a very slow rising trend this year that might, or might not, be sustainable.

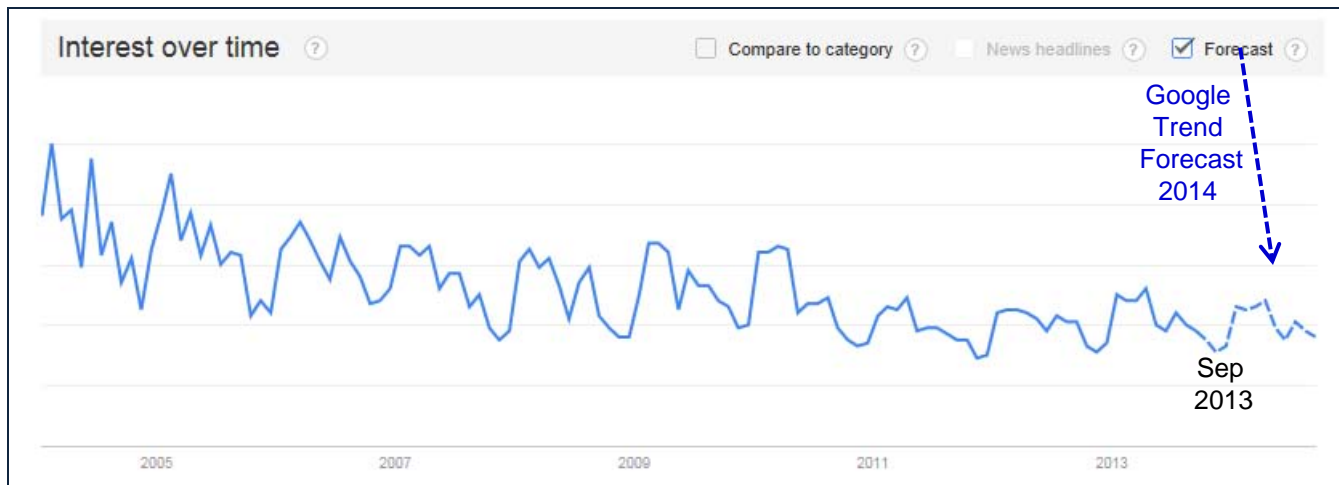


- Other leading indicators: Google Search Trends for “purchase home” and “home mortgage” queries mirror the flat *MBA Purchase Application Index* behavior during the same period with no sustained upturn in sight.

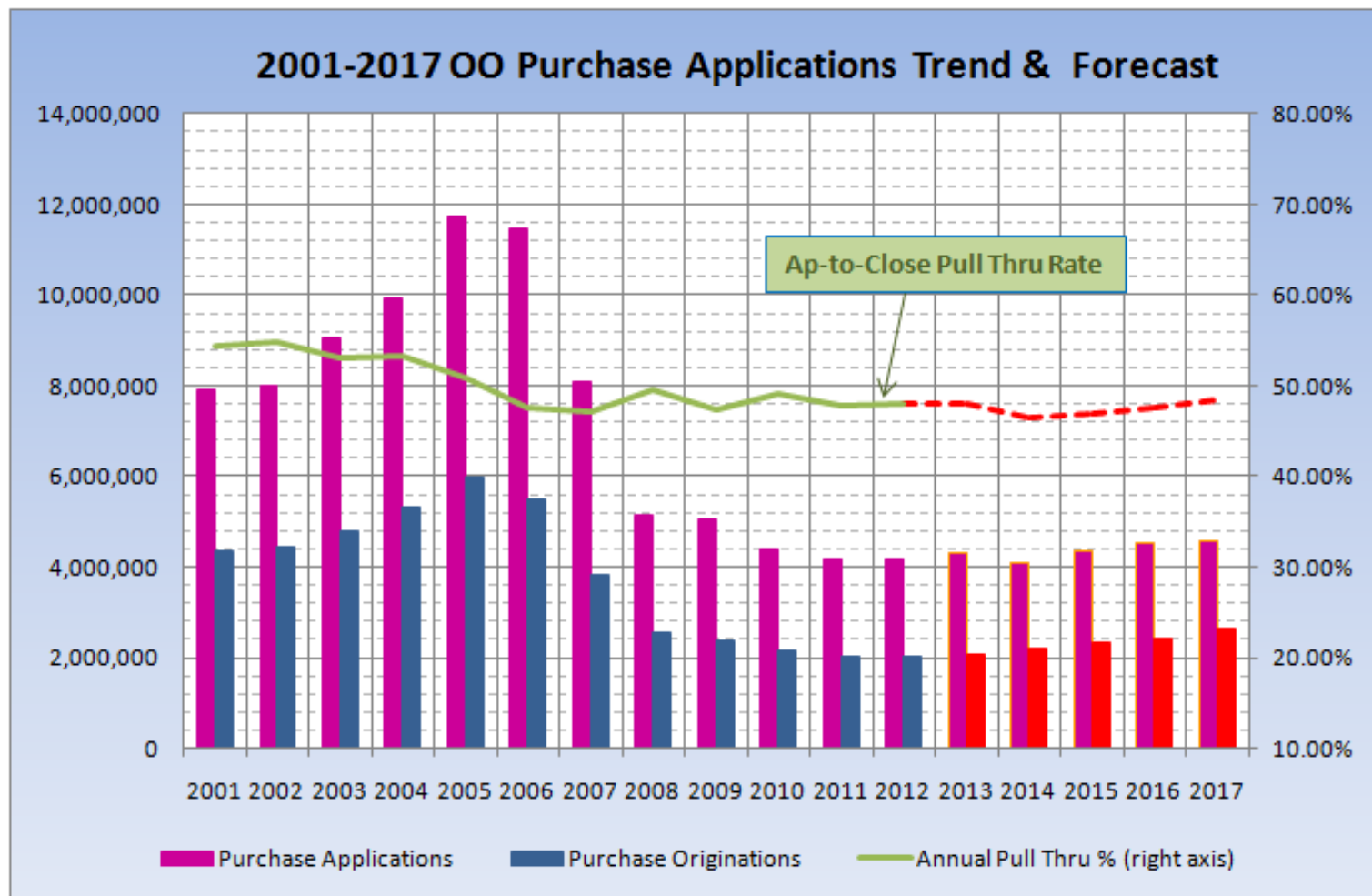
Google Trends Research – United States 2004-2014 – Term: “Home Mortgage”



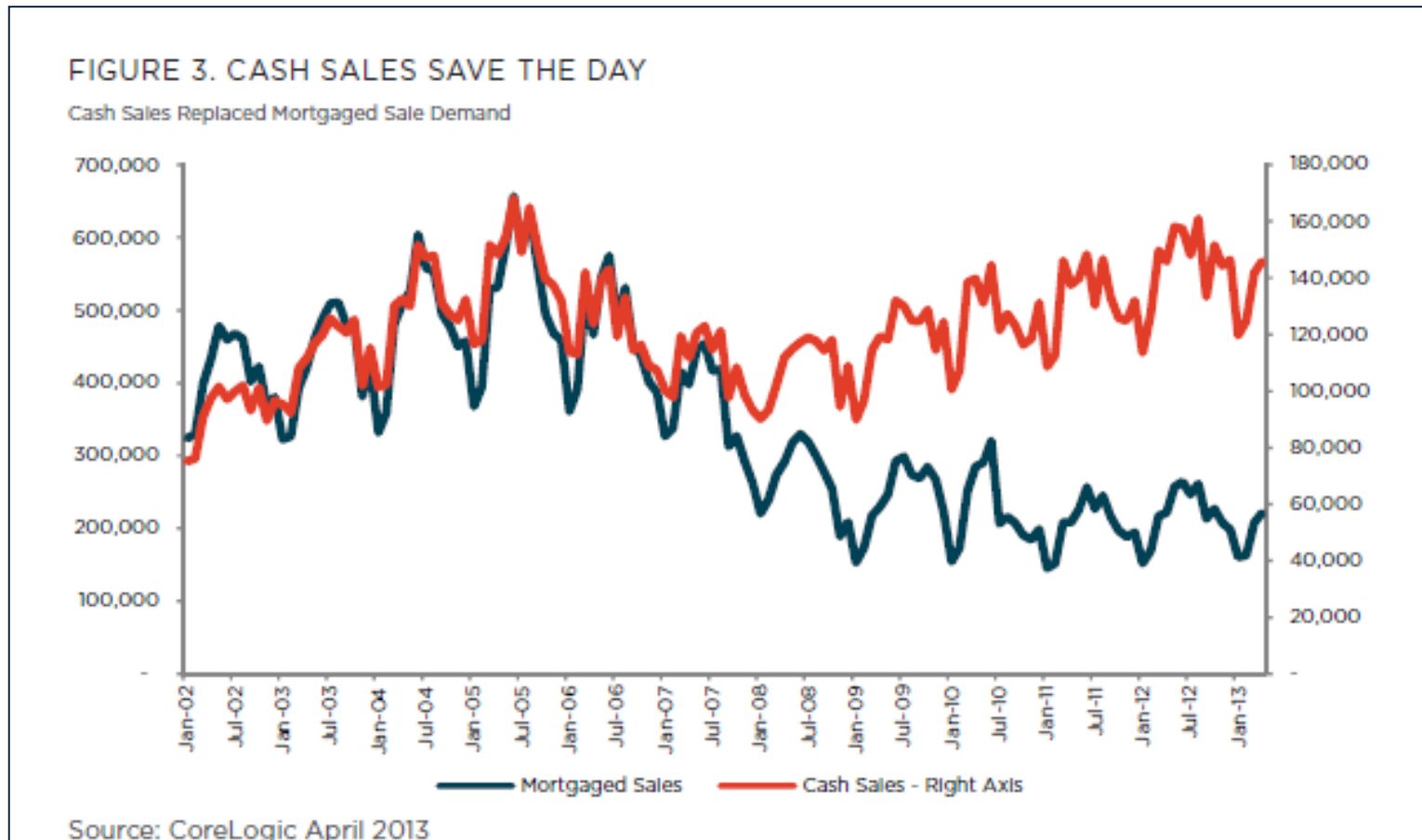
Google Trends Research – United States 2004-2014 – Term: “Purchase Home”



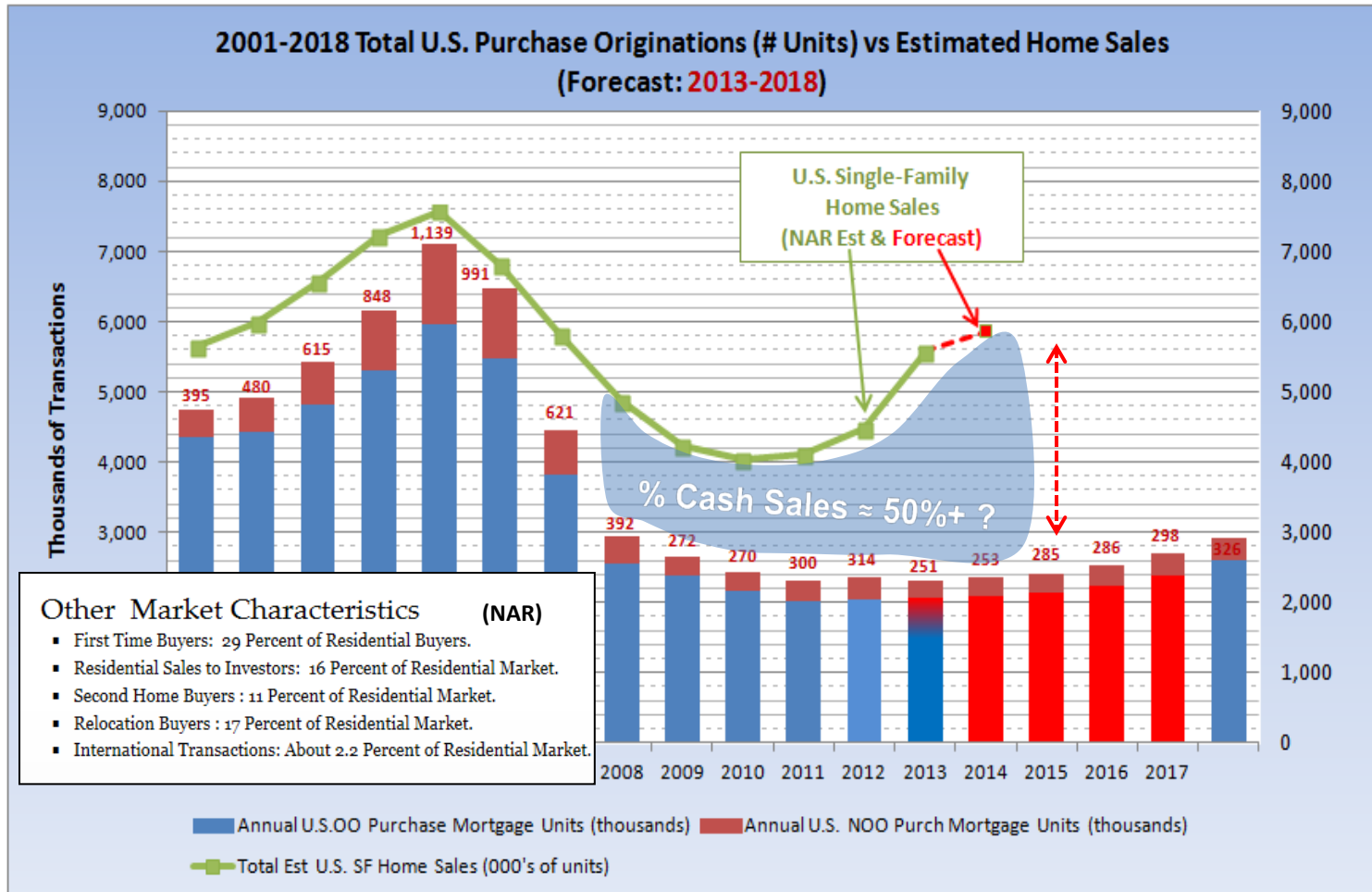
- Purchase Application activity has not only been weak through 2012, the application-to-close pull-through rate has been well below 50% since 2007 as well, with no signs of improvement on the horizon due to continuing tighter lending/credit demands by risk-averse lenders.



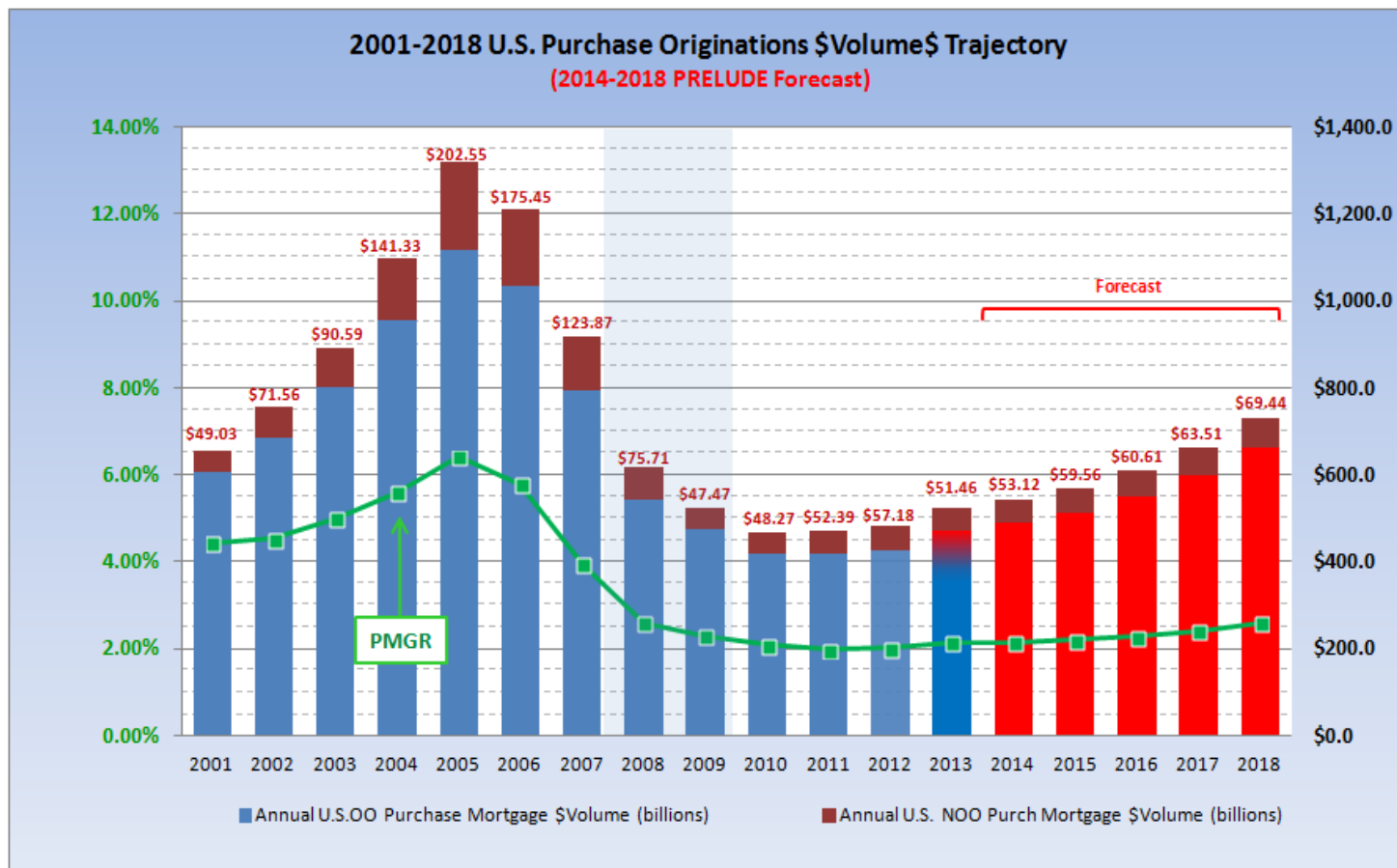
- Existing and new home sales are seen as proof of a housing recovery, but the portion of total home sales that are non-owner, investor, cash transactions continue to widen. Owner occupied mortgage financed home purchases are flat. Headline news of purchase growth are simply seasonal patterns.



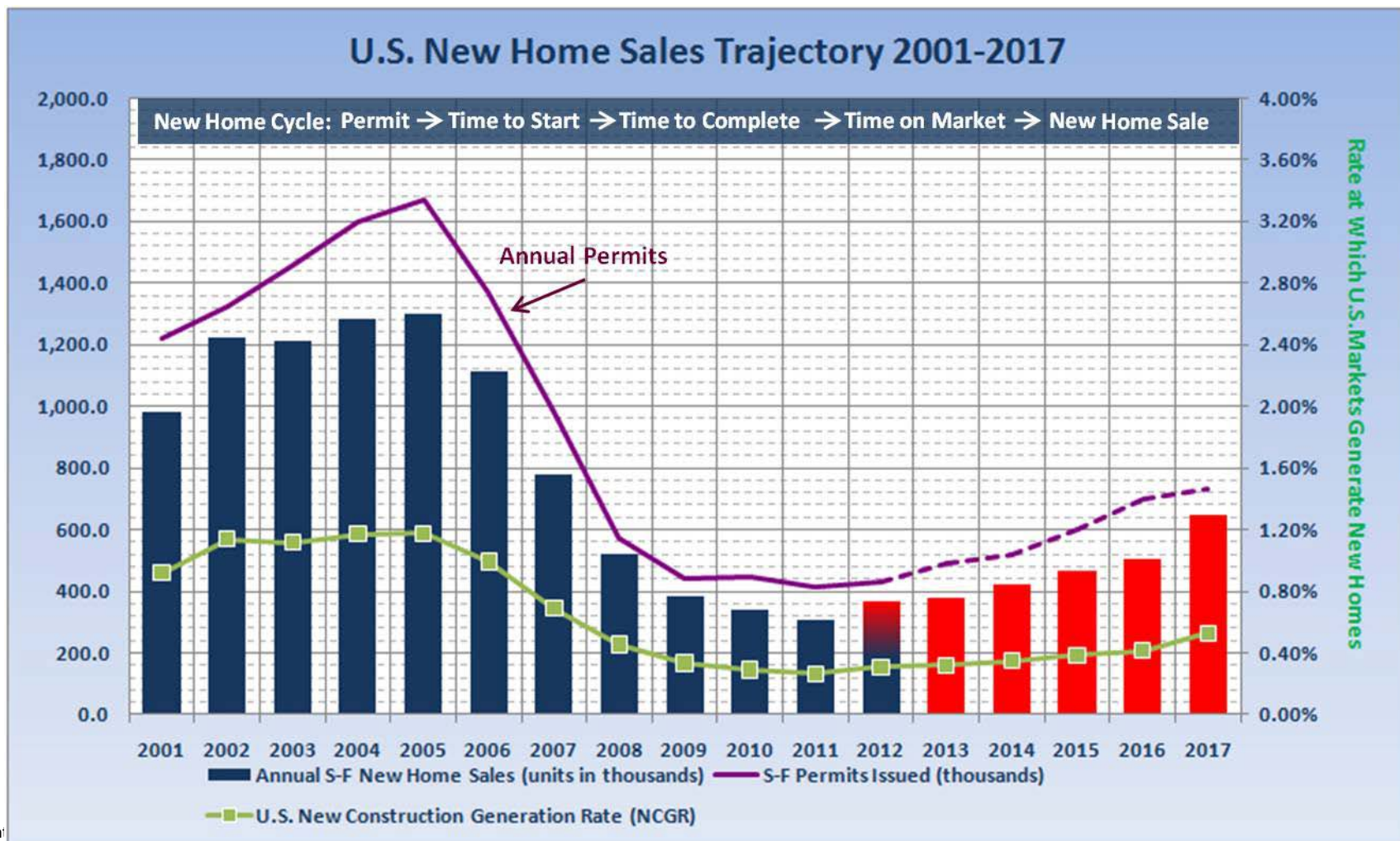
- The difference between the National Association of Realtors' (NAR) home sales data and the official HMDA mortgage transaction data reveals the same ever-widening gap since 2008. The wide owner occupied mortgage financing to home sales gap indicates that a broad recovery of U.S. households and communities does not match reality.



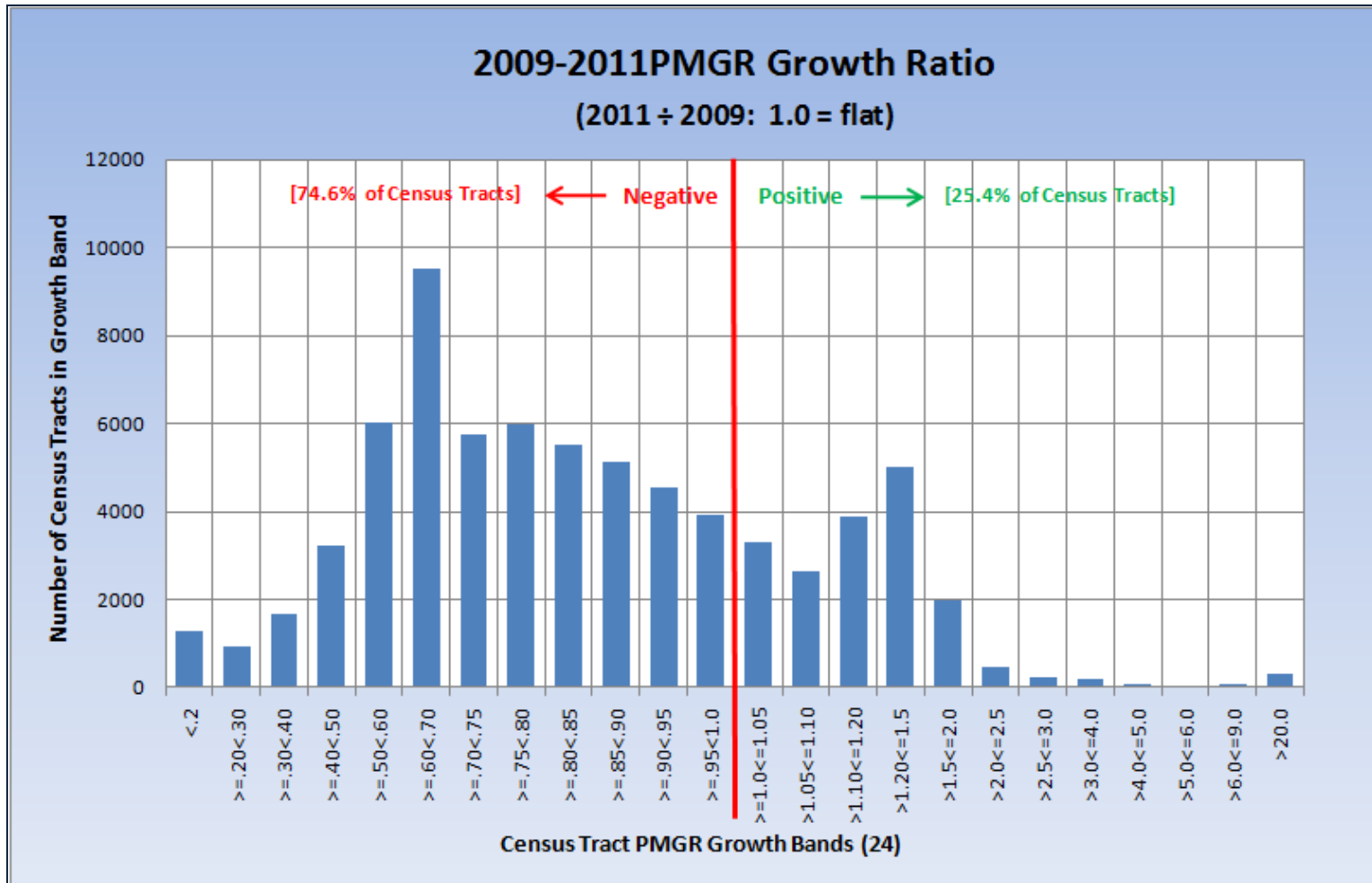
- The annual rate at which the U.S. mortgage finance market generates purchase mortgages has been flat for four years. Conditions for a big break-out in 2014 aren't in the cards. Net household growth and slow improvement in household balance sheets are the major, but limited, positives for owner occupied purchase volume and less so for non-owner occupied investor and second home purchases.



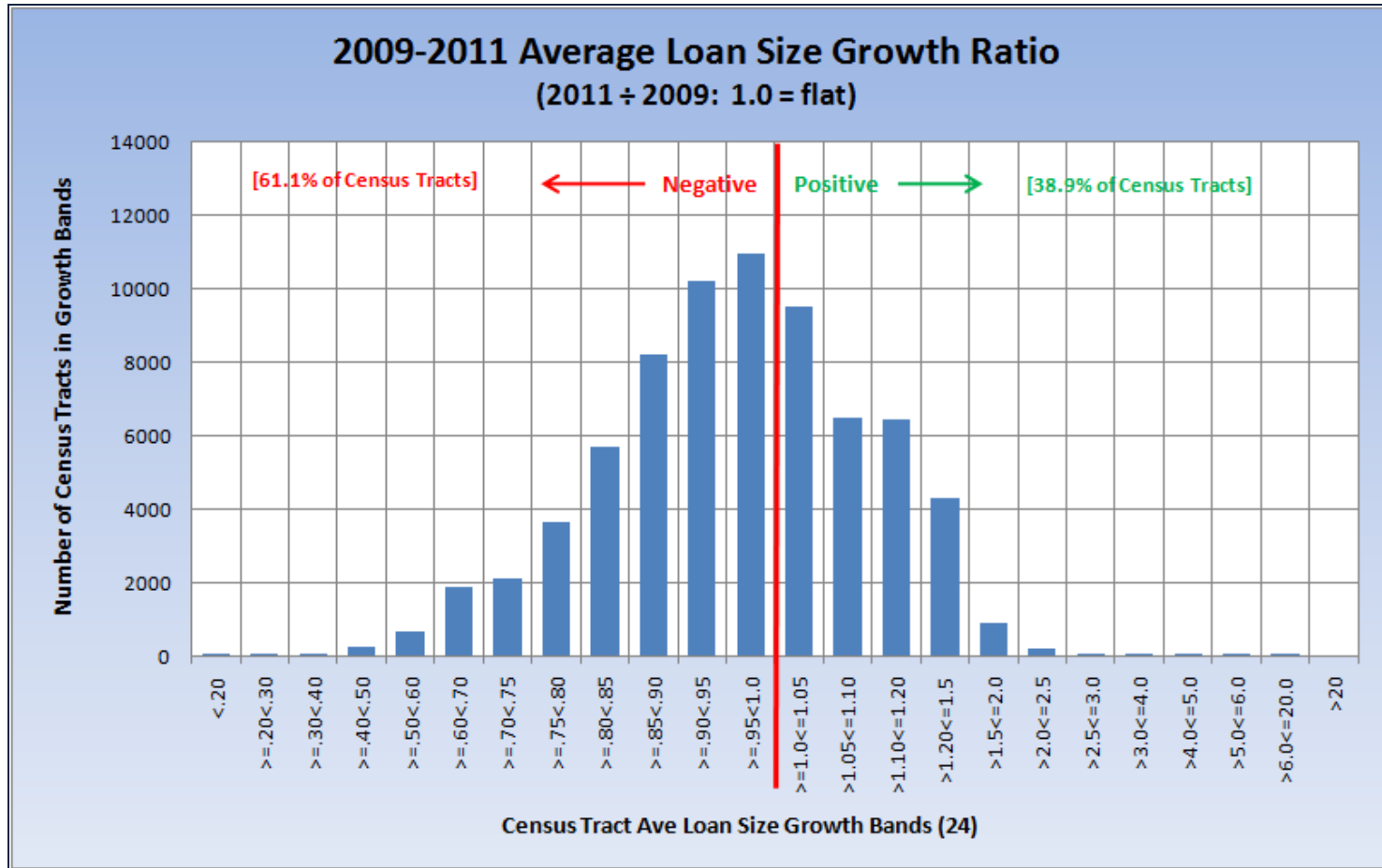
- New Home Construction and Sales activity, the drivers of “housing recovery” will continue to rise, but permits, housing start-times, completion cycles and time-on-market-to-sell will require time to rebuild new home inventories. Economic conditions and new home buyer demand aren’t conducive to a big boom in new home sales growth in 2014 even though NAR and NHBA recently reported permits at an annualized 800k.



- The annual rates at which mortgage markets generated purchase mortgages (PMGR) over the period 2009-2011 fell in 76.4% of all U.S. Census Tracts and gained in but 25.4%. The relatively flat volumes in 2012 may shift the bars on the left a little to the right and the ratio of growing versus falling census tracts 2009-2012 may improve slightly, but not enough to signal sustained recovery.

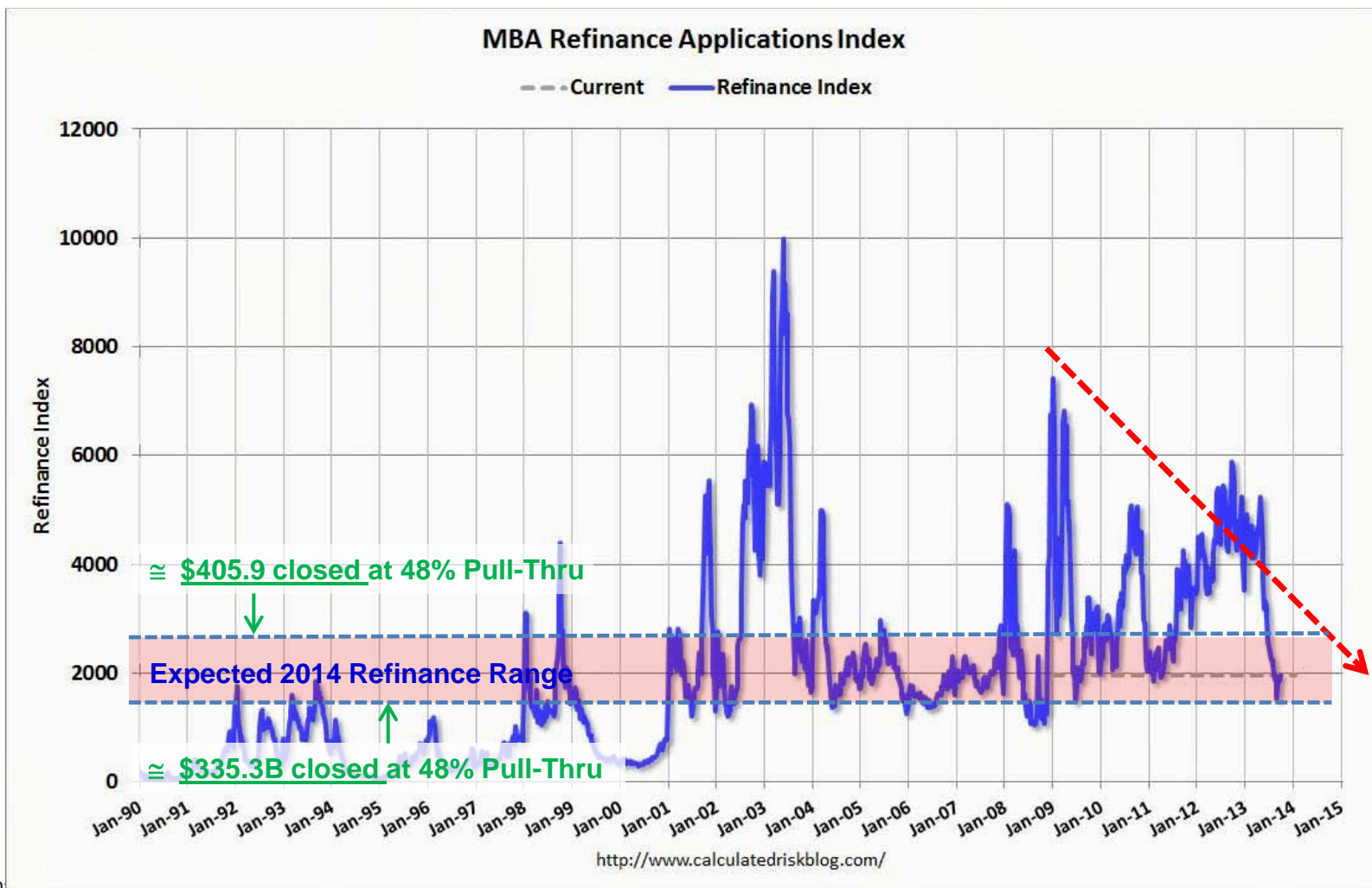


- Average loan sizes for owner-occupied purchase transactions have remained relatively “sticky” around the “no-change” point (red line) throughout the bust and fledgling recovery. Historically, loan sizes do not follow housing prices in lock-step, thus tending to keep total mortgage dollar volumes up even as loan units fall.

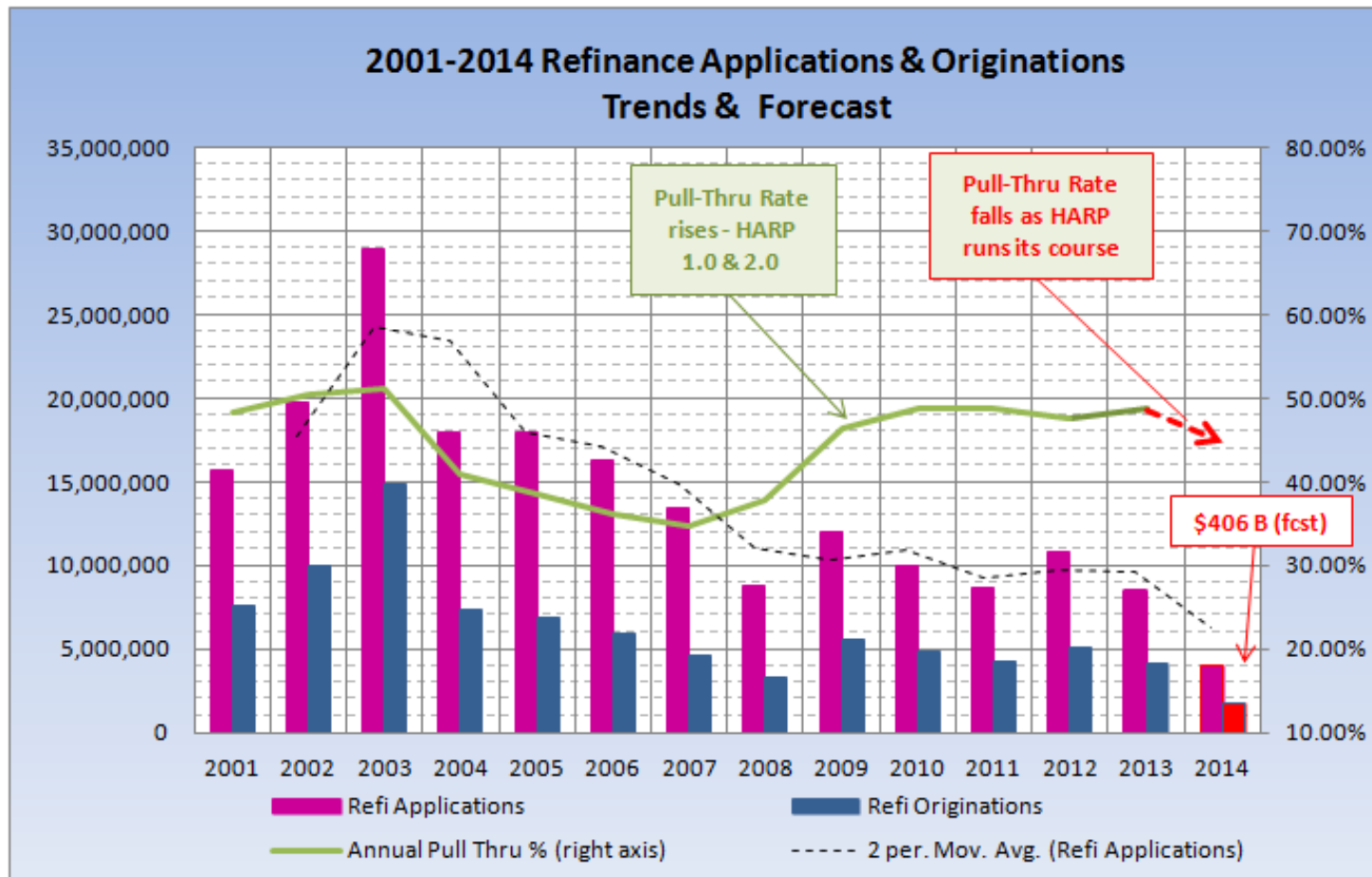


2014 Homeowner Refinance Volume Forecasts

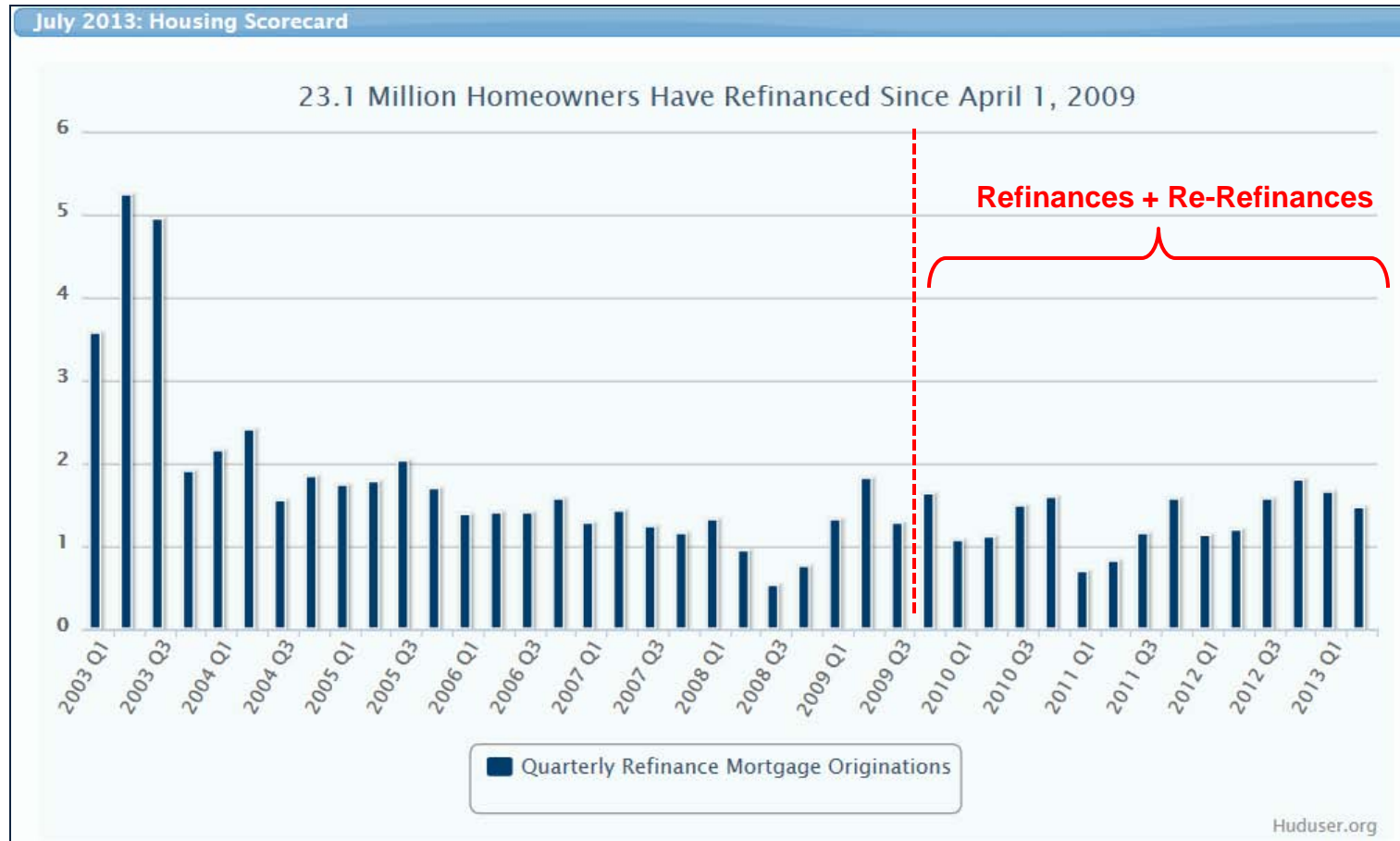
- The recent collapse of refinance applications activity implies that the sustainability of current *refinance* and *re-refinance* depends on a lowering of current mortgage rates. The *Refinance Index* will likely hover within the 1900 to 2900 range in 2014 as rates fluctuate, which translates into a dollar volume range of \$335.3 billion to \$406 billion, depending on application pull-through rates.



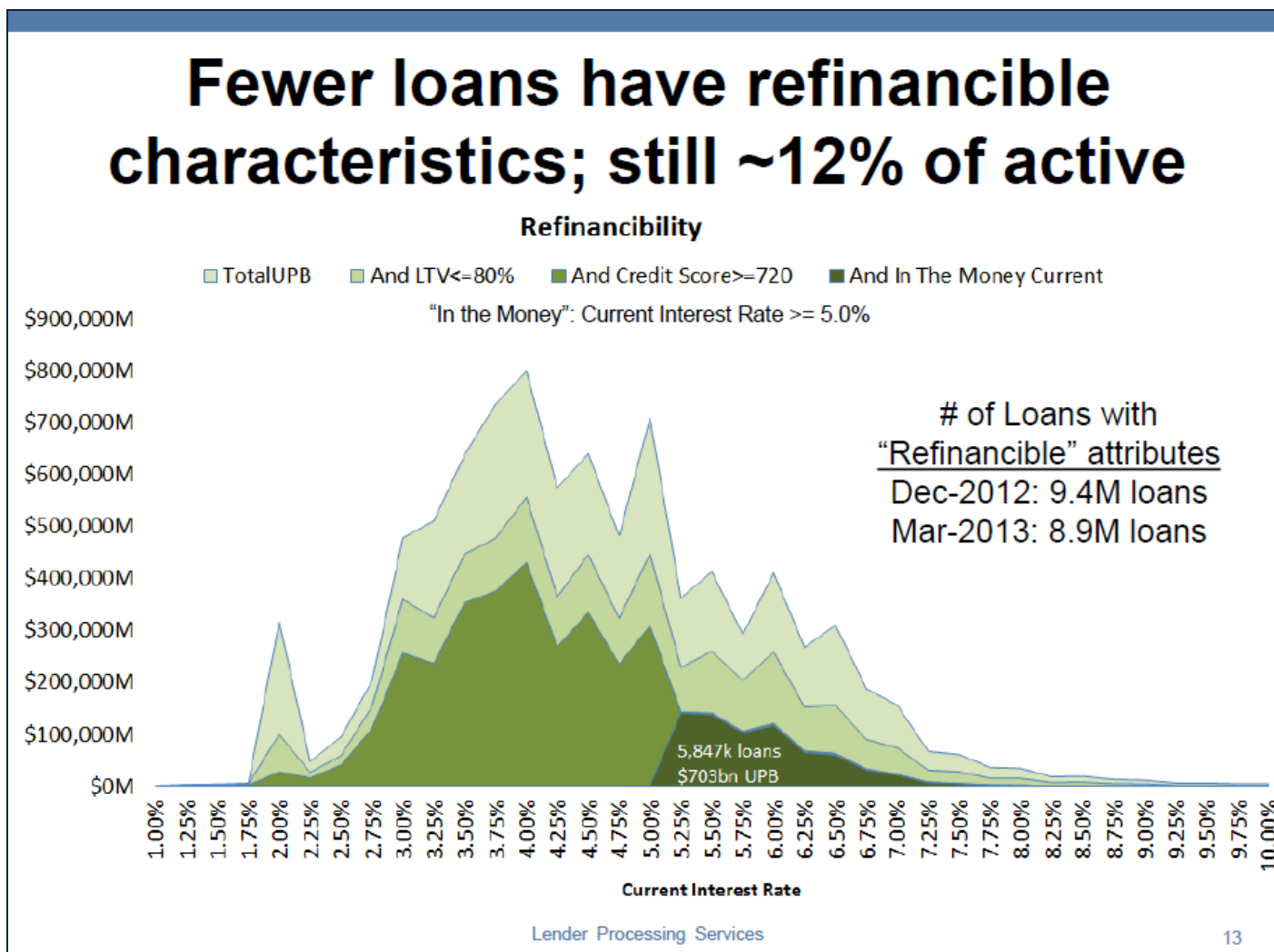
- Refinance applications-to-origination pull-through rates have been elevated since 2009, much of it due to generous HARP rules. As HARP-eligible applications dissipate over time and qualification thresholds sunset, the refinance application pull-through rate will likely diminish.



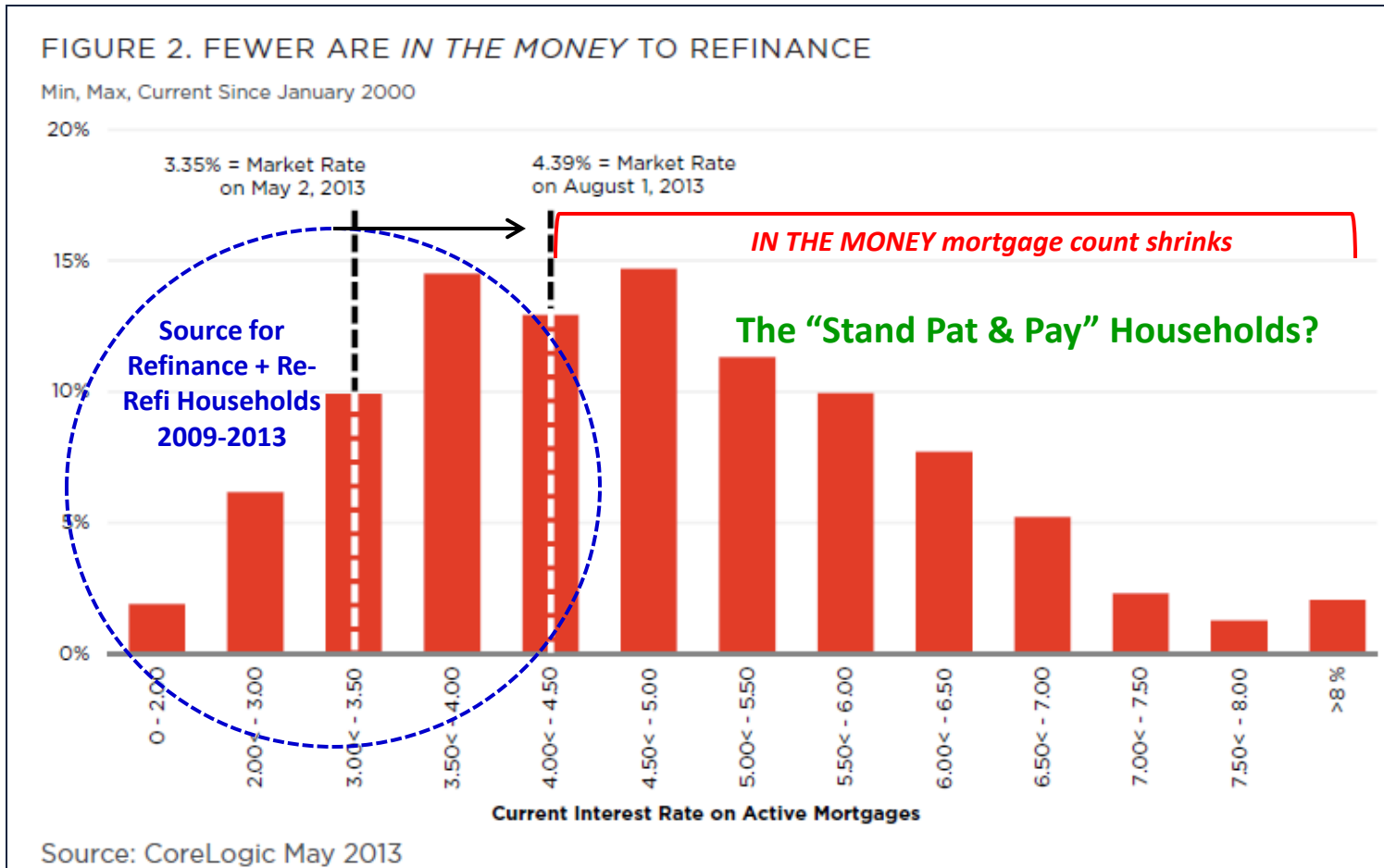
- The pool of households for 2014 refinances has been significantly reduced by the sheer number of refinance and re-refinance transactions during the last five years.



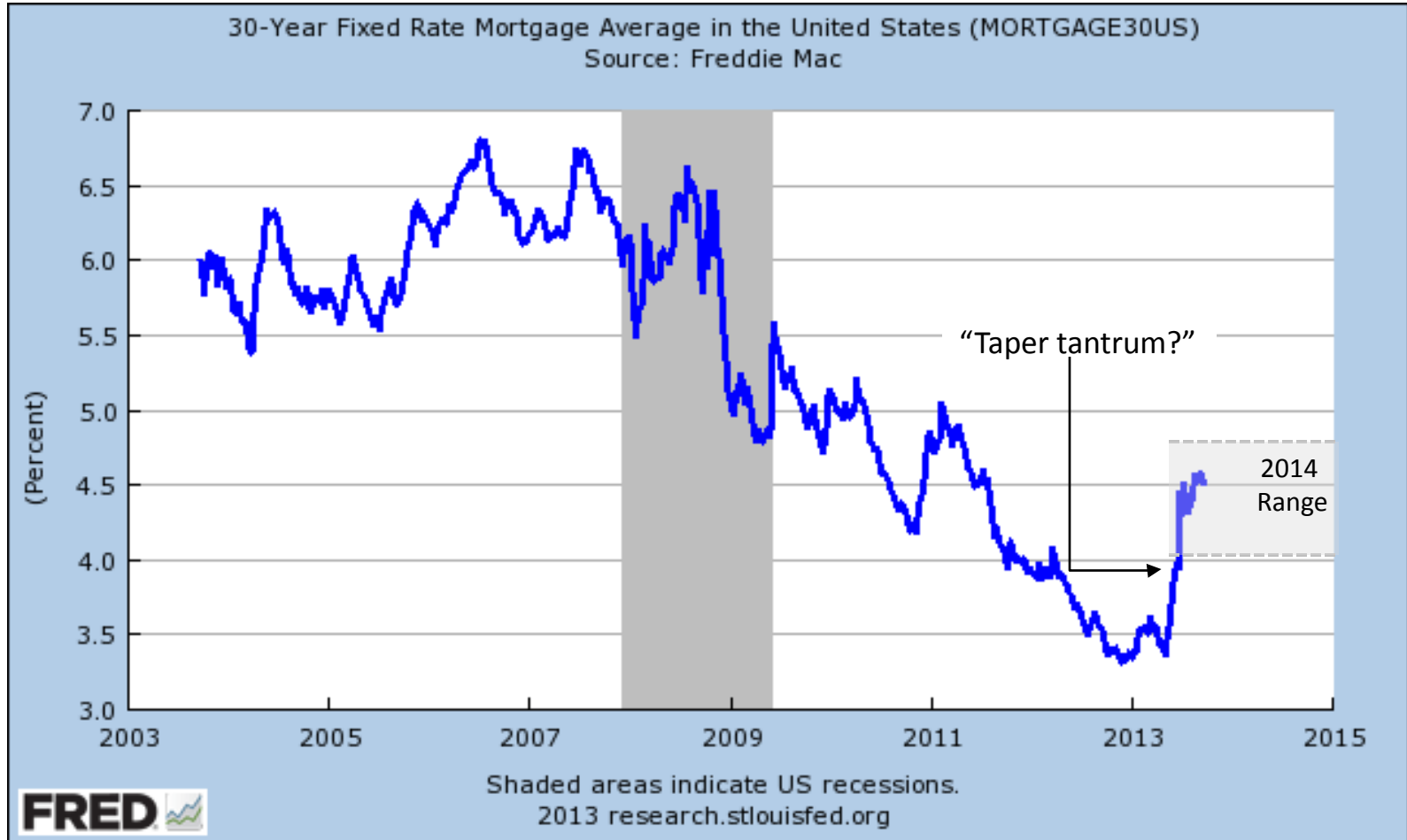
- **Lender Processing Services (LPS) “Refinancibility”** homeowner mortgage characteristics point to a 2014 “refinancible” pool of less than 4 million homeowners if rates are greater than 5%. Even if rates fall from the current 4.5% range, the *refinancible* pool won’t likely be much greater, based on many other non-financial behavioral factors by households in the pool.



- Unless mortgage rates turn downward and reach new all-time lows, the demand for refinance/re-refinance from homeowners who qualify will continue to fall. Application-to-origination pull-through rates are likely to fall in tandem.

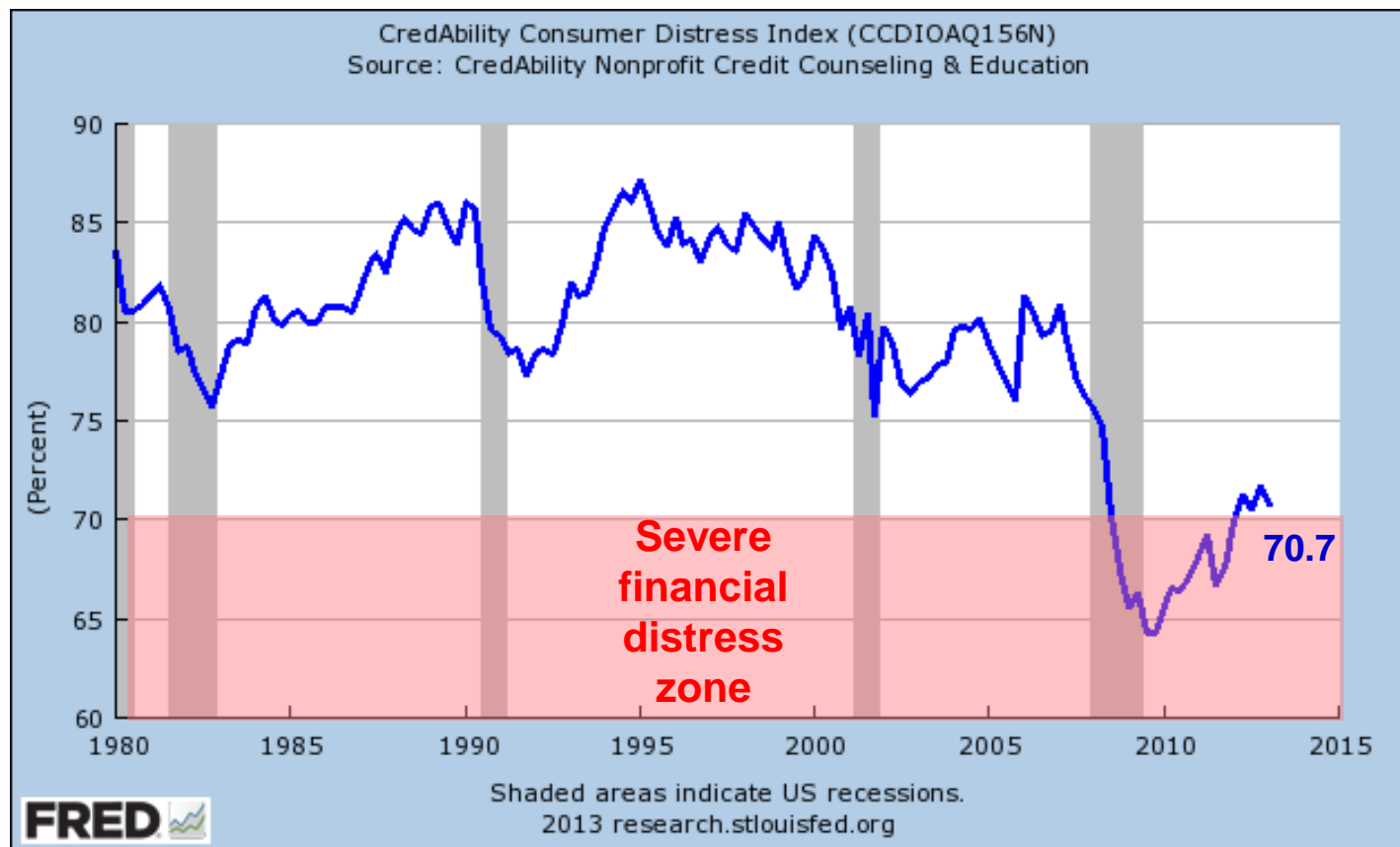


- Now that the Federal Reserve/FOMC, in September’s guidance, put “taper talk” on-hold, mortgage rates are likely to fall back a bit going into 2014. However, mortgage rates, like fuel prices, will resist falling back once they’ve jumped, due to uncertainties caused by other economic factors.



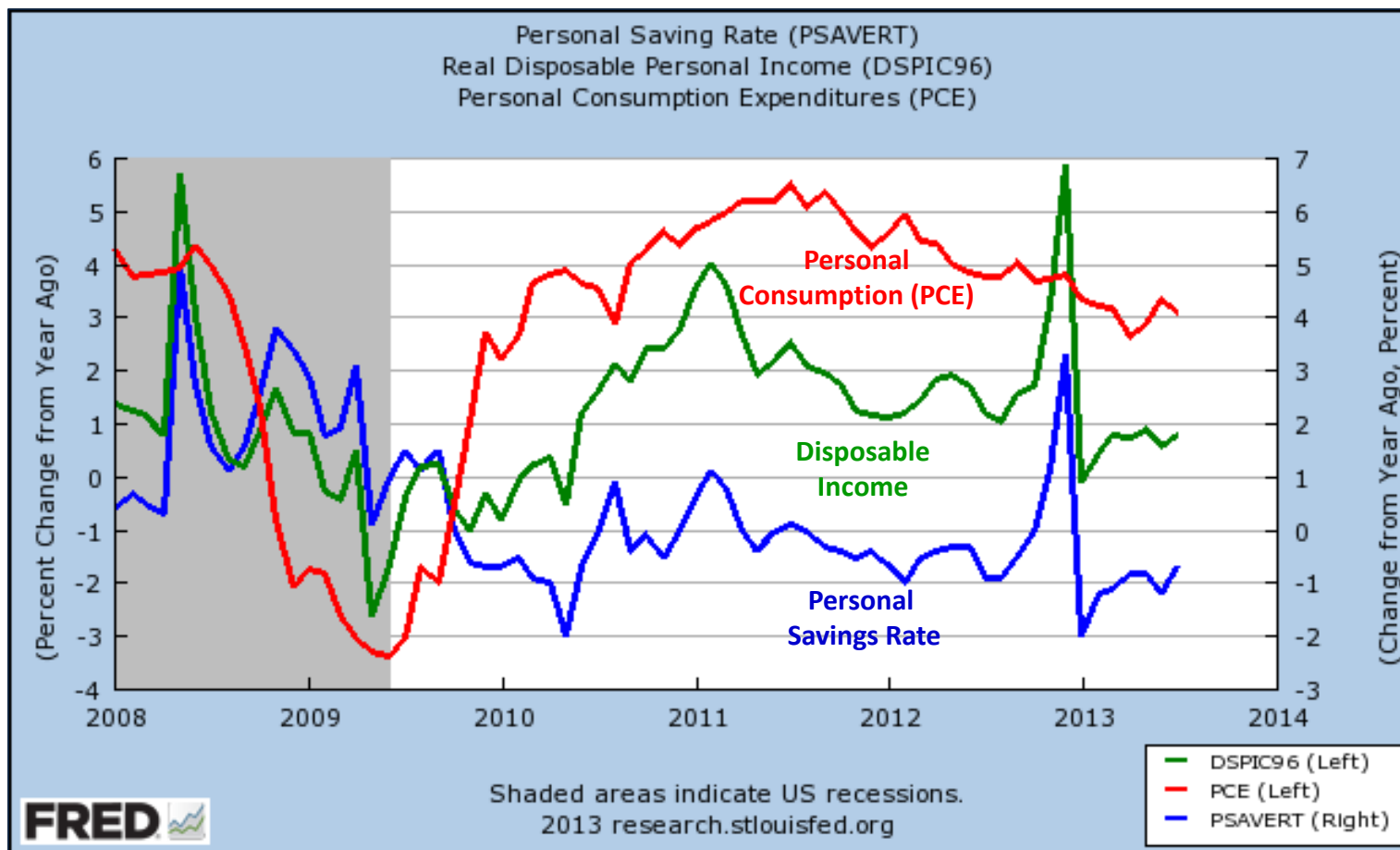
2014 U.S. Households Under Stress

- The U.S. average CredAbility Consumer Distress Index score is approximately 70. Consumer scores that 70 or less are considered conditions of severe financial distress. As a whole, U.S. households remain close to being under severe financial pressure.

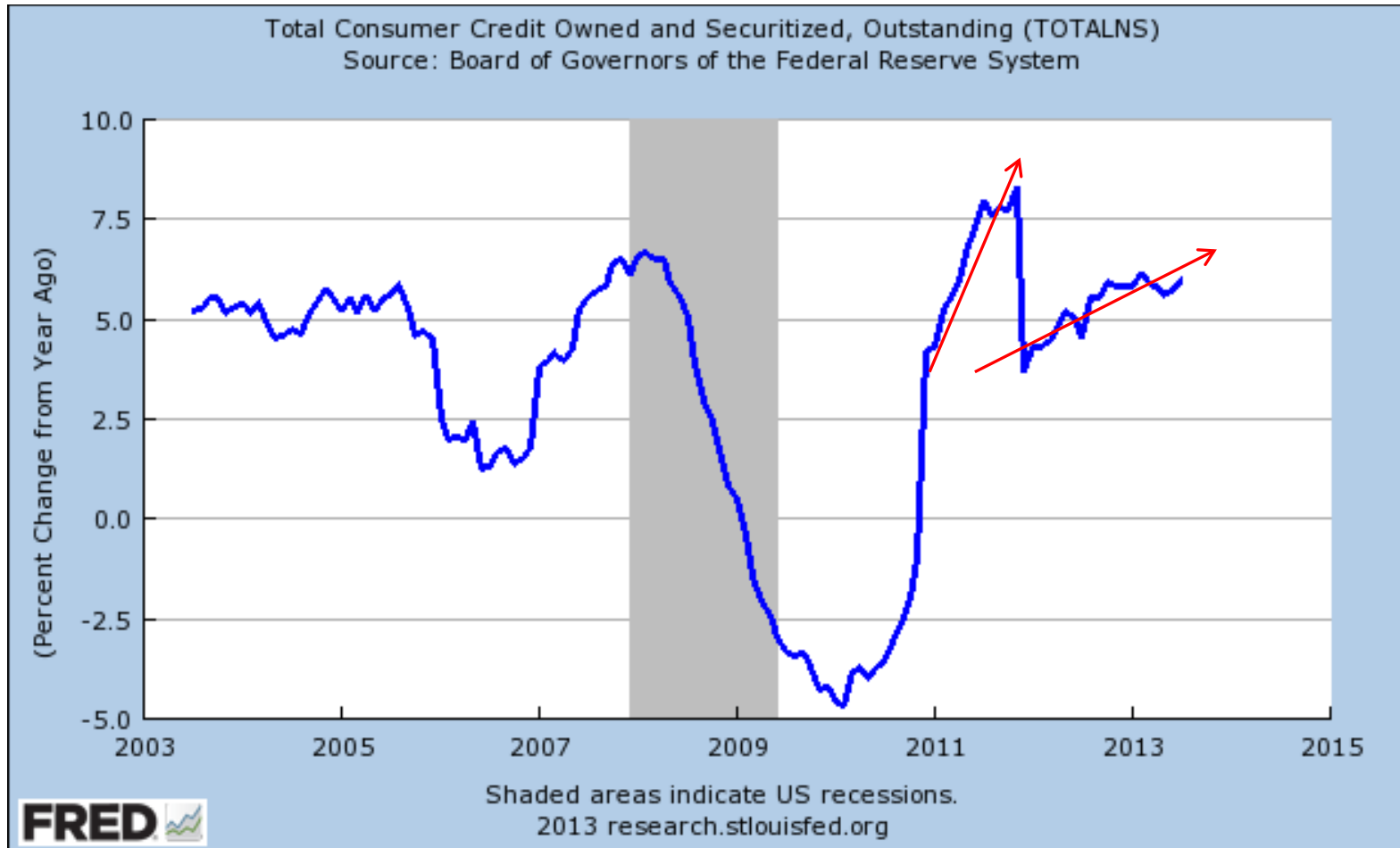


Distress Index measures five categories of personal finance that reflect or lead to a secure, stable financial life—Employment, Housing, Credit, Household Budget and Net Worth. All are equally important, so each category is given equal weighting. A score less than 70 indicates individuals, counties, cities, MSAs, states, and the nation are in severe financial distress.

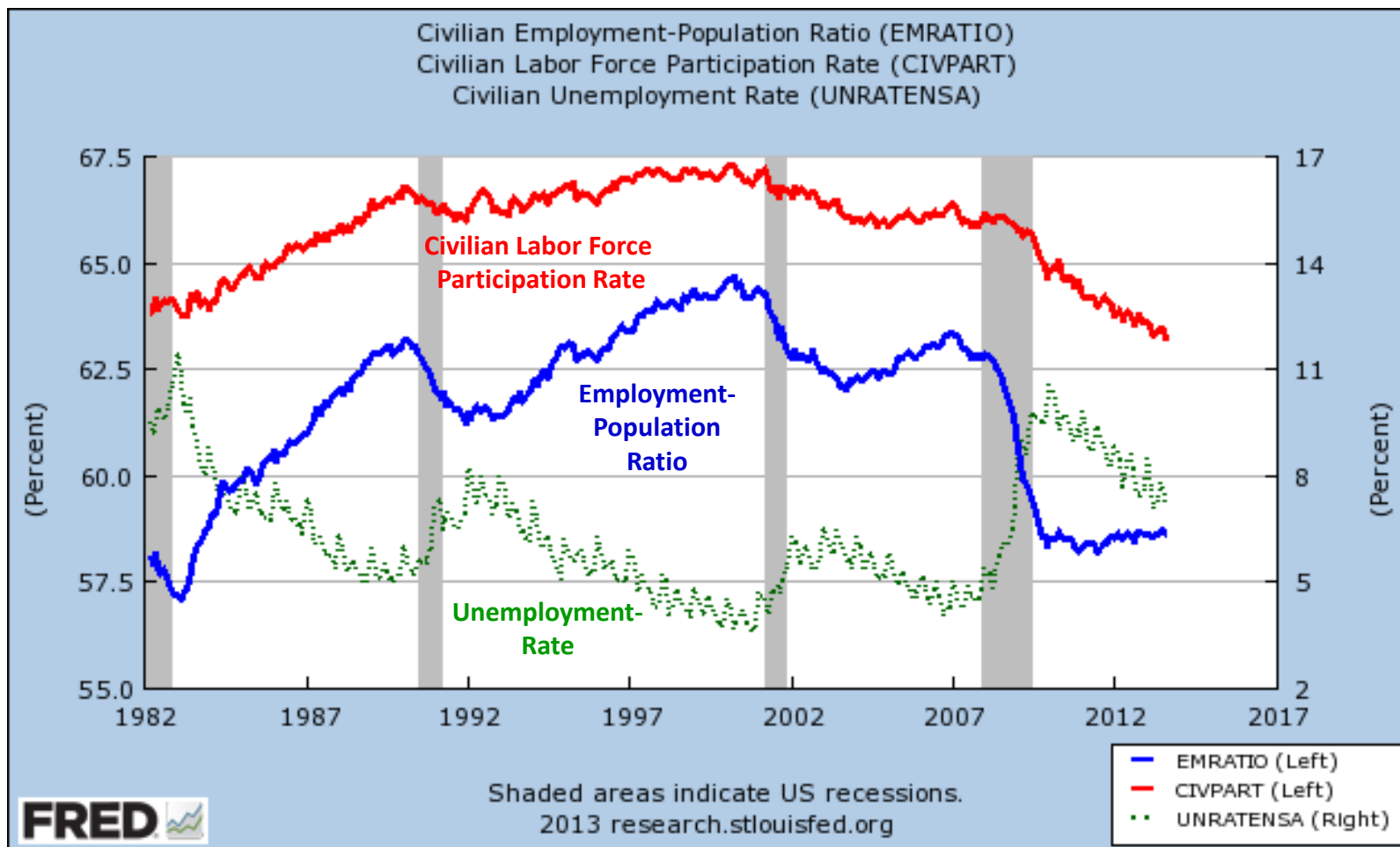
- The overall trend in consumer demand and consumption measures (PCE) has been down since 2011. Disposable Income has fallen and with it Personal Savings, although 2013 indicates an upturn that may or may not be sustainable in an very slow economic recovery. (Spikes in late 2012 are due to tax treatment code changes that caused taxpayers to pull future 2013 taxable income back into Q4 2012.)



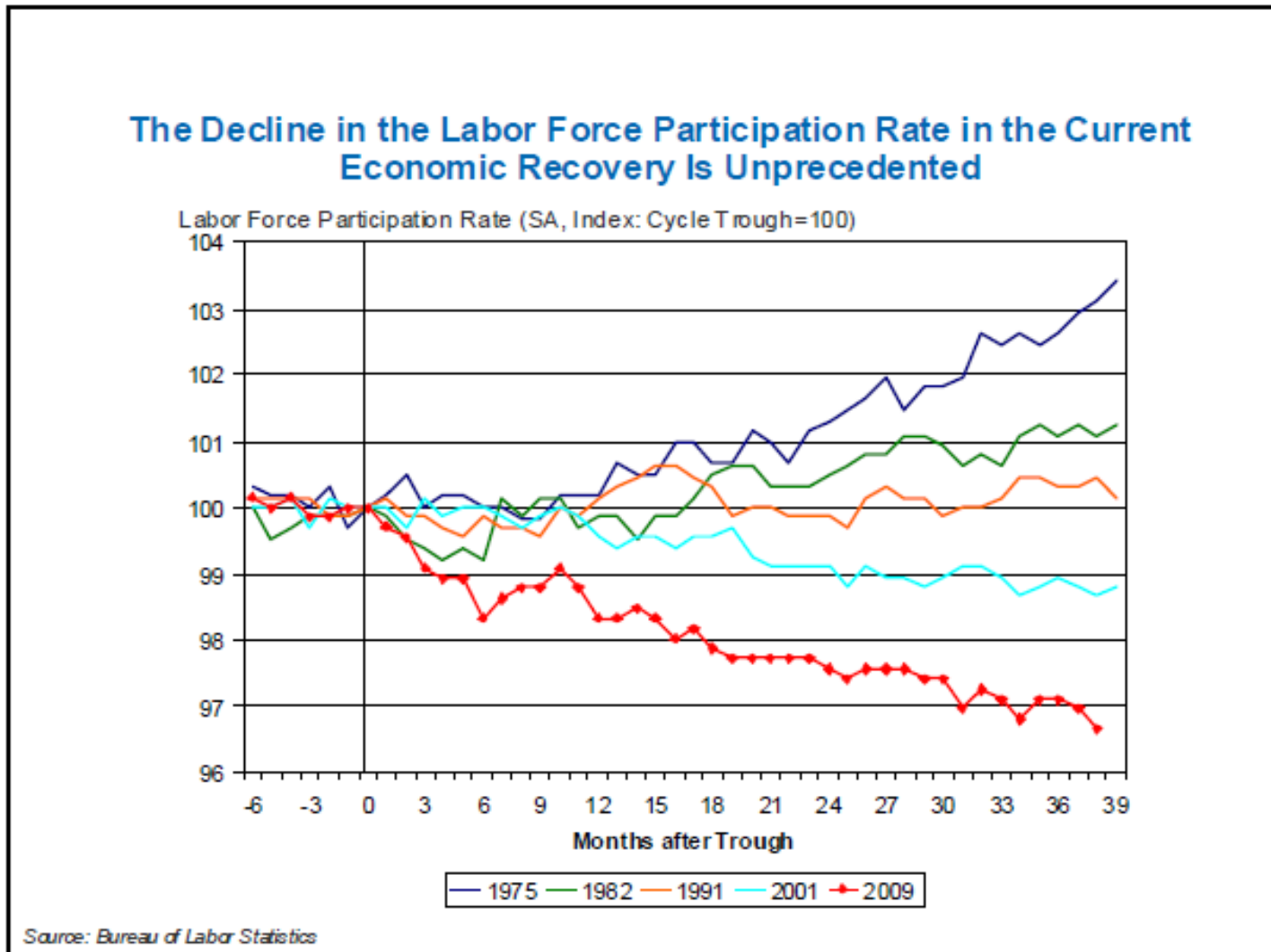
- While disposable income and savings rates fall, cycles of increased consumption re-occur. Consumer credit rises to fill the income gaps, thus adding to total consumer debt, a sign that the bottom 80% households are still struggling to hold their position.



- The best barometers of employment health are the Employment-to-Population Ratio and the Labor Force Participation Rate. Both indicators remain dismal, even while the standard U3 unemployment rate shows downward improvement. The long-term unemployed have taken themselves out of the labor force. The employment situation hasn't really improved much going into 2014.



- A continued decline in the Labor Force Participation Rate decline will be a negative economic force, especially since net population and household formations continue to grow. Participation is declining relative to growth in population and consumer demand. The U.S. economy continues to operate under its productive capacity potential.



- 4.6 million active mortgages (9.2%) remain non-current. The cumulative number of households with severely damaged credit scores due to delinquencies and foreclosures since 2009 is staggering in their negative impact on the 2014 Available Household Pool of potential home buyers.

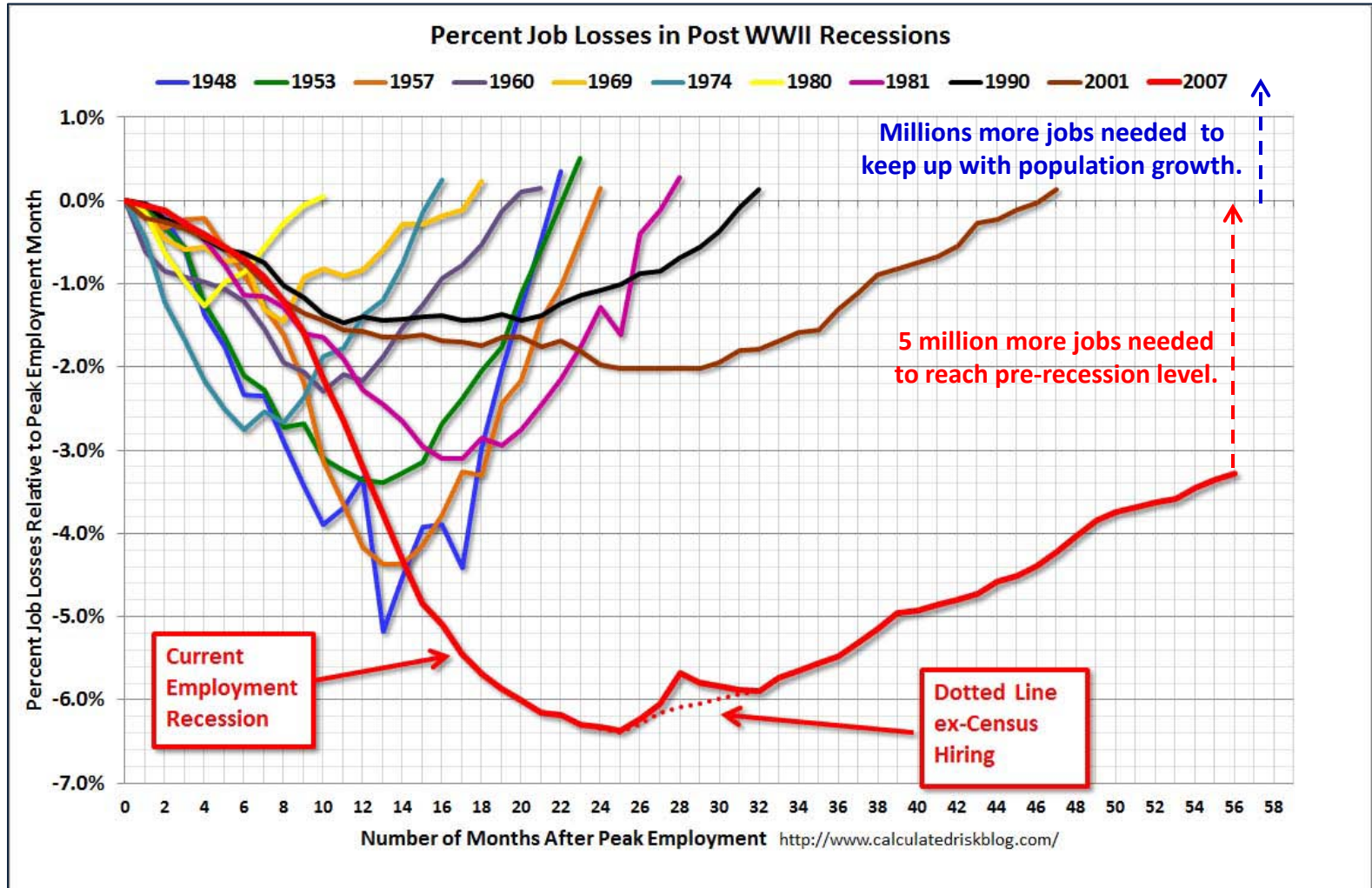
Loan counts and average days delinquent

Month	TOTAL ACTIVE COUNT	30 DAYS	60 DAYS	90+ DAYS	FC	Total Non-Current	FC Starts	Average Days Delinquent for 90+	Average Days Delinquent for FC
1/31/2008	54,094,282	1,701,163	664,956	940,832	817,948	4,124,899	197,210	189	255
1/31/2009	54,267,187	1,945,997	909,744	1,817,809	1,318,840	5,992,391	249,655	191	321
1/31/2010	53,476,523	1,897,603	882,089	2,870,204	2,031,020	7,680,916	282,601	252	417
1/31/2011	52,138,710	1,682,266	715,350	1,988,781	2,162,601	6,548,999	261,272	332	528
1/31/2012	51,111,780	1,531,458	627,874	1,758,894	2,163,659	6,081,884	219,750	397	668
2/29/2012	50,992,550	1,441,378	560,901	1,708,908	2,142,675	5,853,862	182,184	408	678
3/31/2012	50,894,038	1,322,231	512,511	1,624,223	2,130,388	5,589,352	195,128	425	688
4/30/2012	50,751,364	1,371,185	518,345	1,596,030	2,131,478	5,617,039	183,489	430	702
5/31/2012	50,602,018	1,390,010	533,183	1,571,354	2,110,279	5,604,827	218,909	436	717
6/30/2012	50,427,221	1,464,660	547,533	1,589,729	2,060,619	5,662,541	173,556	441	731
7/31/2012	50,064,842	1,410,175	552,881	1,556,632	2,042,142	5,561,830	185,811	448	743
8/31/2012	49,986,240	1,370,660	544,506	1,518,036	2,018,584	5,451,786	201,173	451	753
9/30/2012	50,044,415	1,590,658	578,216	1,533,569	1,939,159	5,641,601	159,078	452	760
10/31/2012	49,852,808	1,403,340	560,996	1,542,703	1,801,047	5,308,085	124,292	461	778
11/30/2012	50,337,897	1,438,015	561,158	1,584,112	1,767,002	5,350,287	130,053	465	795
12/31/2012	49,865,000	1,454,875	575,845	1,545,186	1,715,648	5,291,554	136,289	465	808
1/31/2013	49,896,142	1,407,343	567,022	1,531,216	1,702,715	5,208,297	147,593	468	814
2/28/2013	50,123,564	1,400,311	526,649	1,483,423	1,693,699	5,104,081	131,826	473	824
3/31/2013	50,186,364	1,346,310	495,352	1,465,953	1,688,809	4,996,424	121,012	492	834
4/30/2013	50,117,188	1,252,302	464,676	1,394,132	1,588,138	4,699,249	127,496	503	843
5/31/2013	50,076,535	1,243,193	465,129	1,334,699	1,524,837	4,567,859	116,812	511	852
6/30/2013	49,823,992	1,471,134	511,731	1,344,818	1,457,699	4,785,382	109,042	512	860
7/31/2013	49,784,184	1,335,498	510,585	1,347,161	1,406,121	4,599,365	112,849	517	876

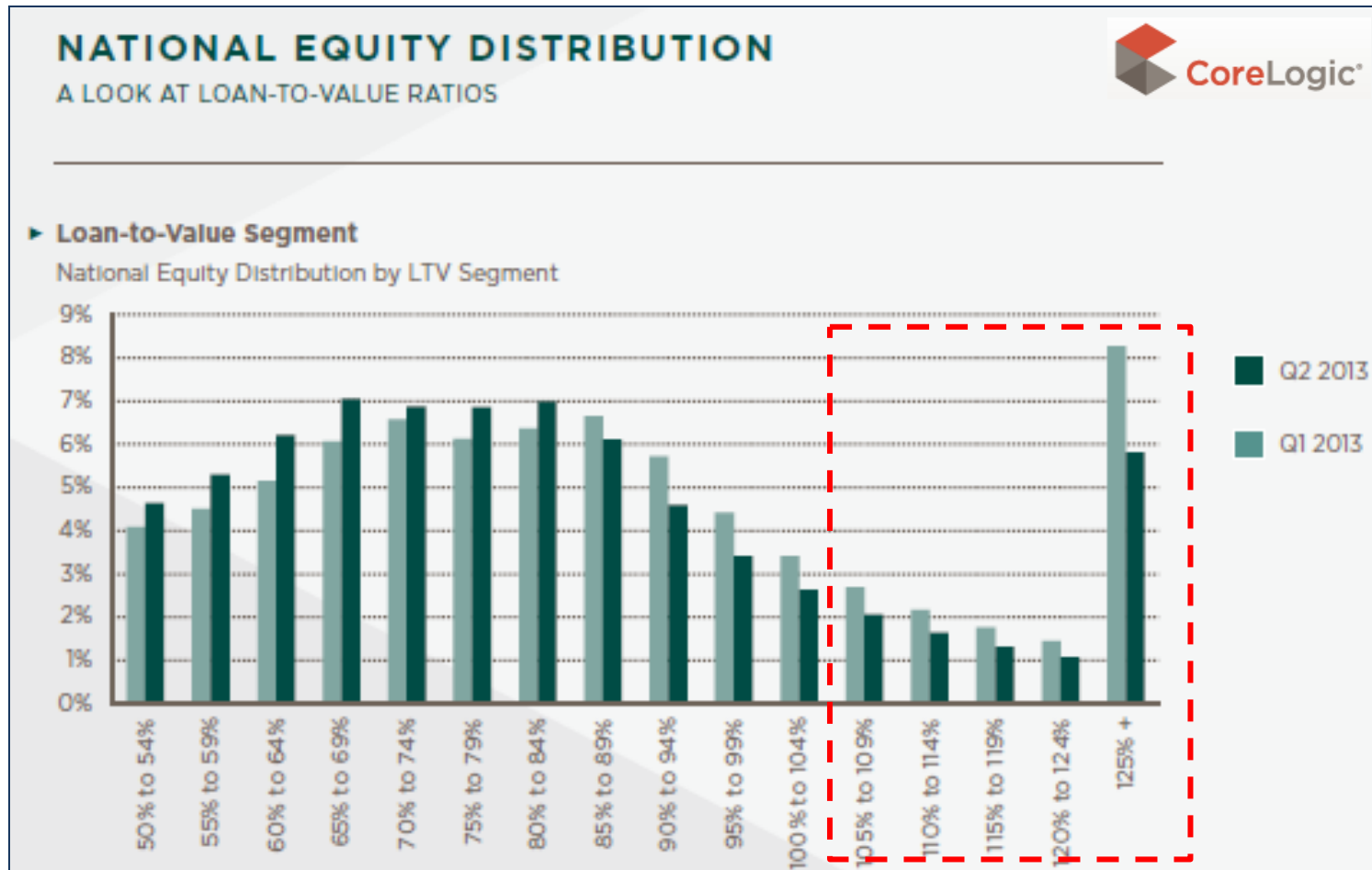
Lender Processing Services

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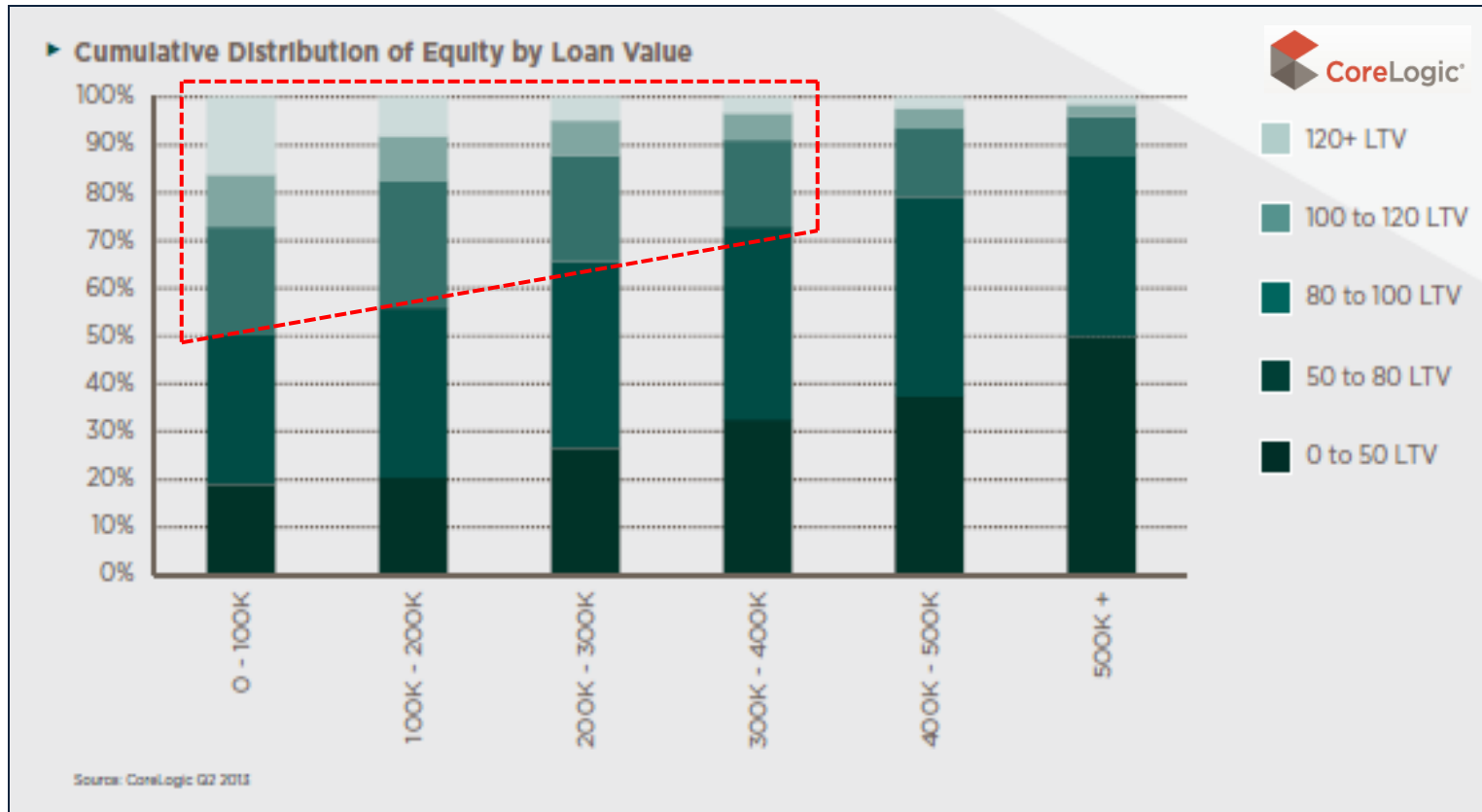
- The most distressing graph of the Great Recession! Regaining jobs to the level experienced prior to the recession will take more years. New jobs likely to be lower paying too. Unfortunately, net gains in new jobs will not immediately translate into accelerated home buyer demand.



- While 2.5% of mortgaged homes have moved out of negative equity position due to increases in housing prices, 14.5% of mortgaged homes still have negative equity going into 2014 – approximately 7.12 million homes in which homeowners cannot afford to sell in order to buy another home.

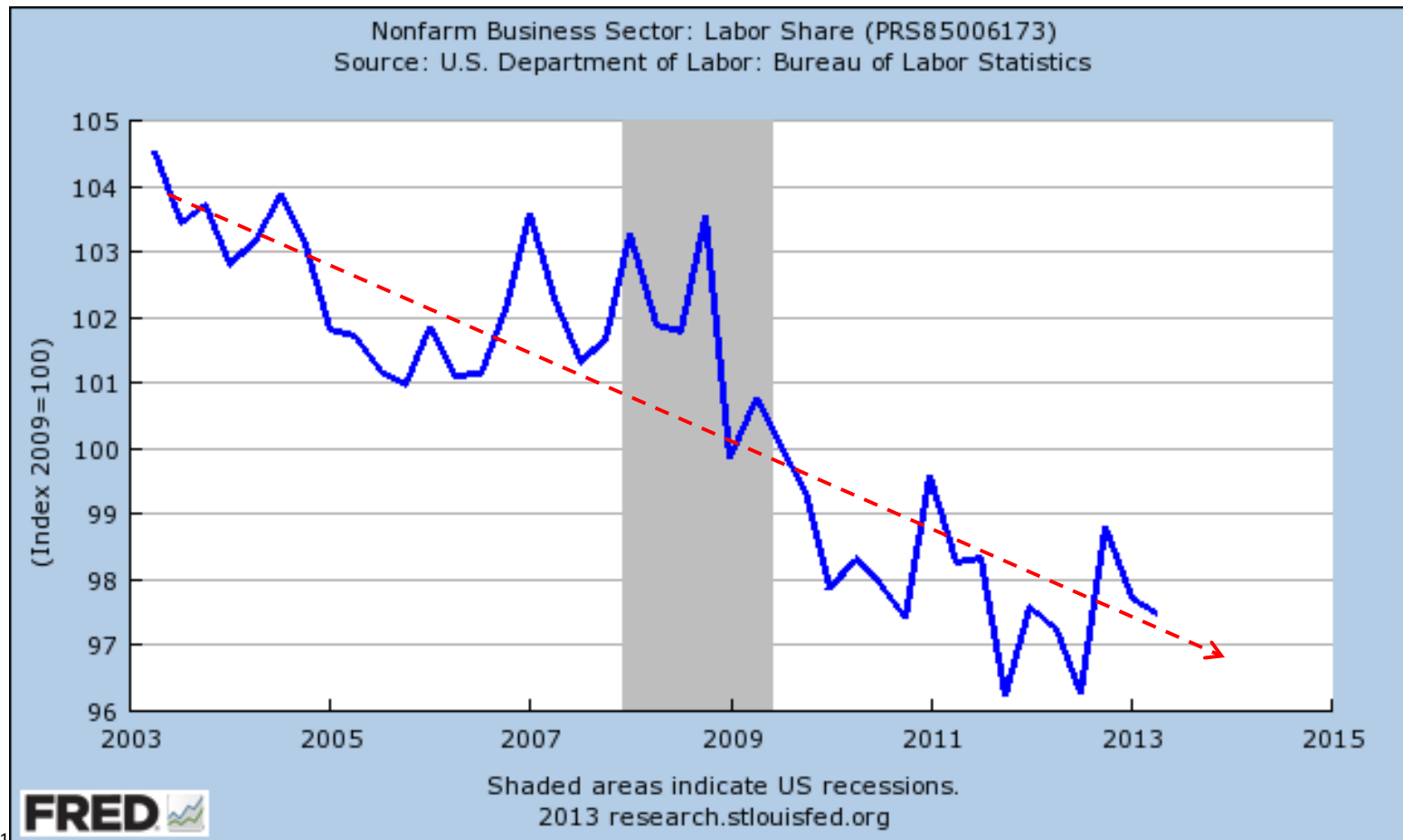


- According to CoreLogic's analysis, 21.1% of mortgaged properties (10+ Million) have less than 20% equity. CoreLogic considers this an "Under-Equitized" situation such that the owners may not be able sell without giving up most of their equity.

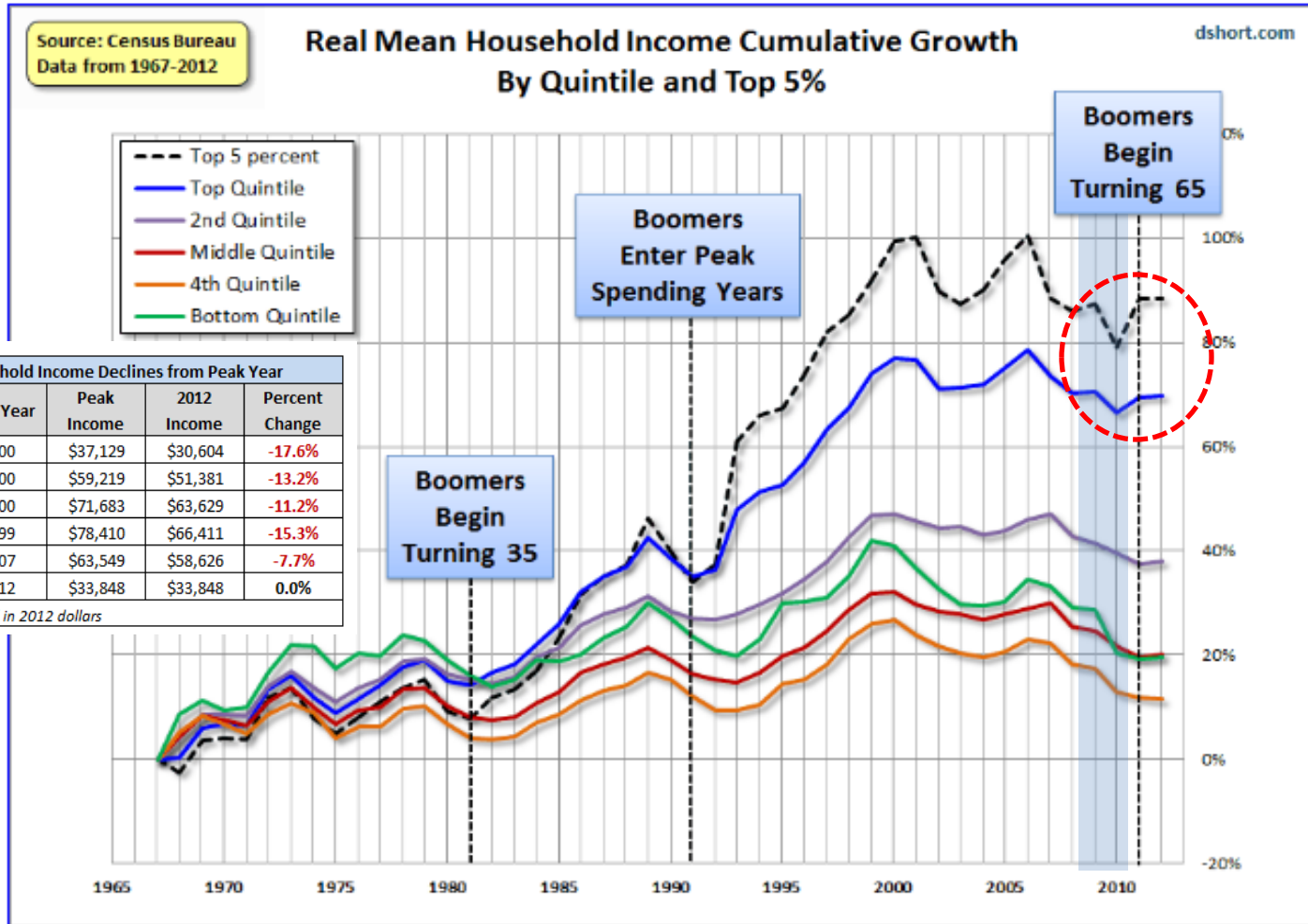


- Labor's share of total GDP, compared to capital's share has been falling steadily since 2000 and shows no sign of finding a bottom. Future housing and home buying will continue to be held back by the imbalance.

Labor Share of National Income 2002-2012 (Indexed to 2005 = 100)

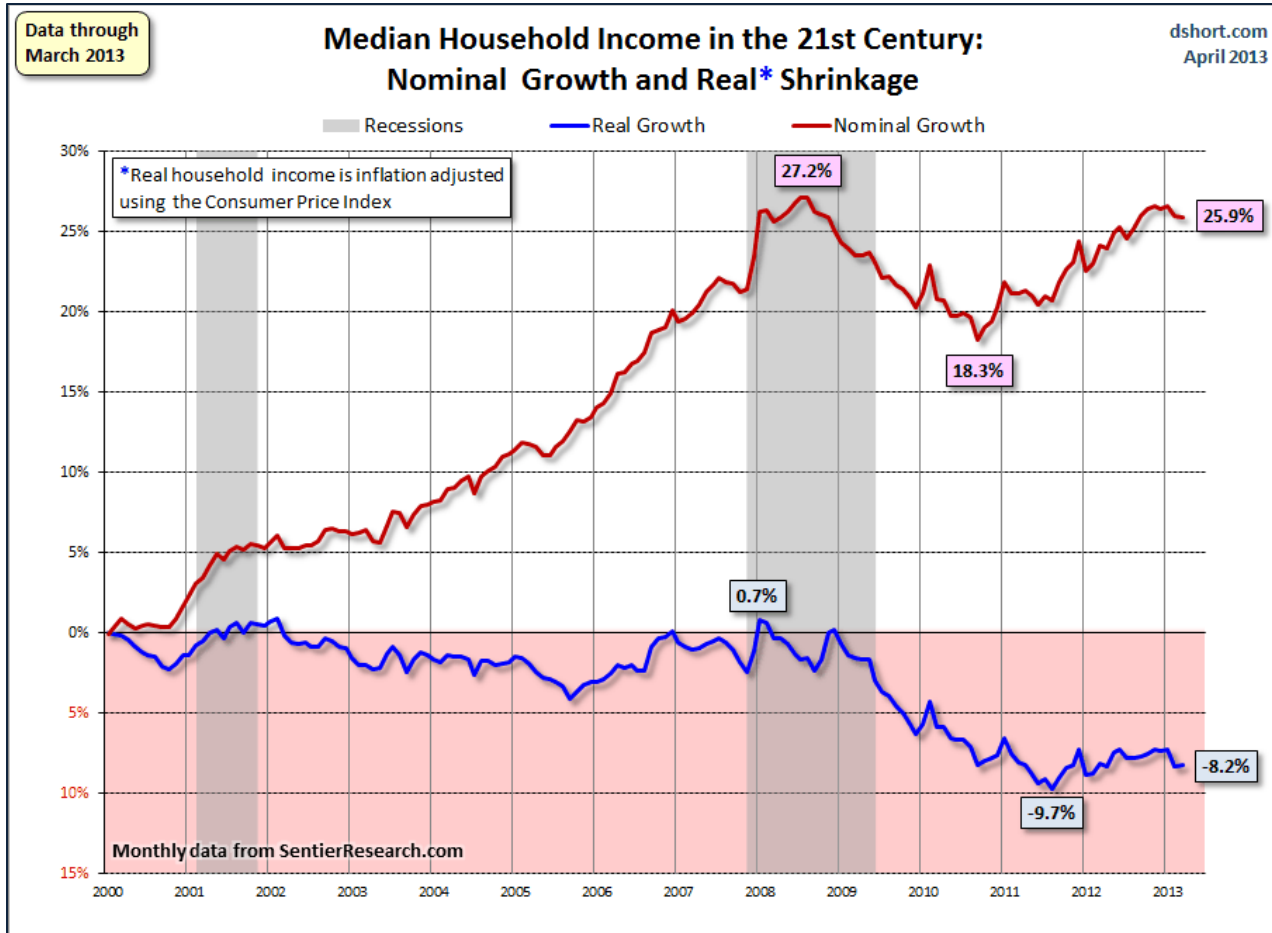


- Real Mean Household Income for the bottom 80% of U.S. Households have fallen since 2007, while the top quintile has almost recovered pre-2007 levels. Only the top 5% of households have gained in income since 2007. Not good news for home buying demand potential from 80% of households.



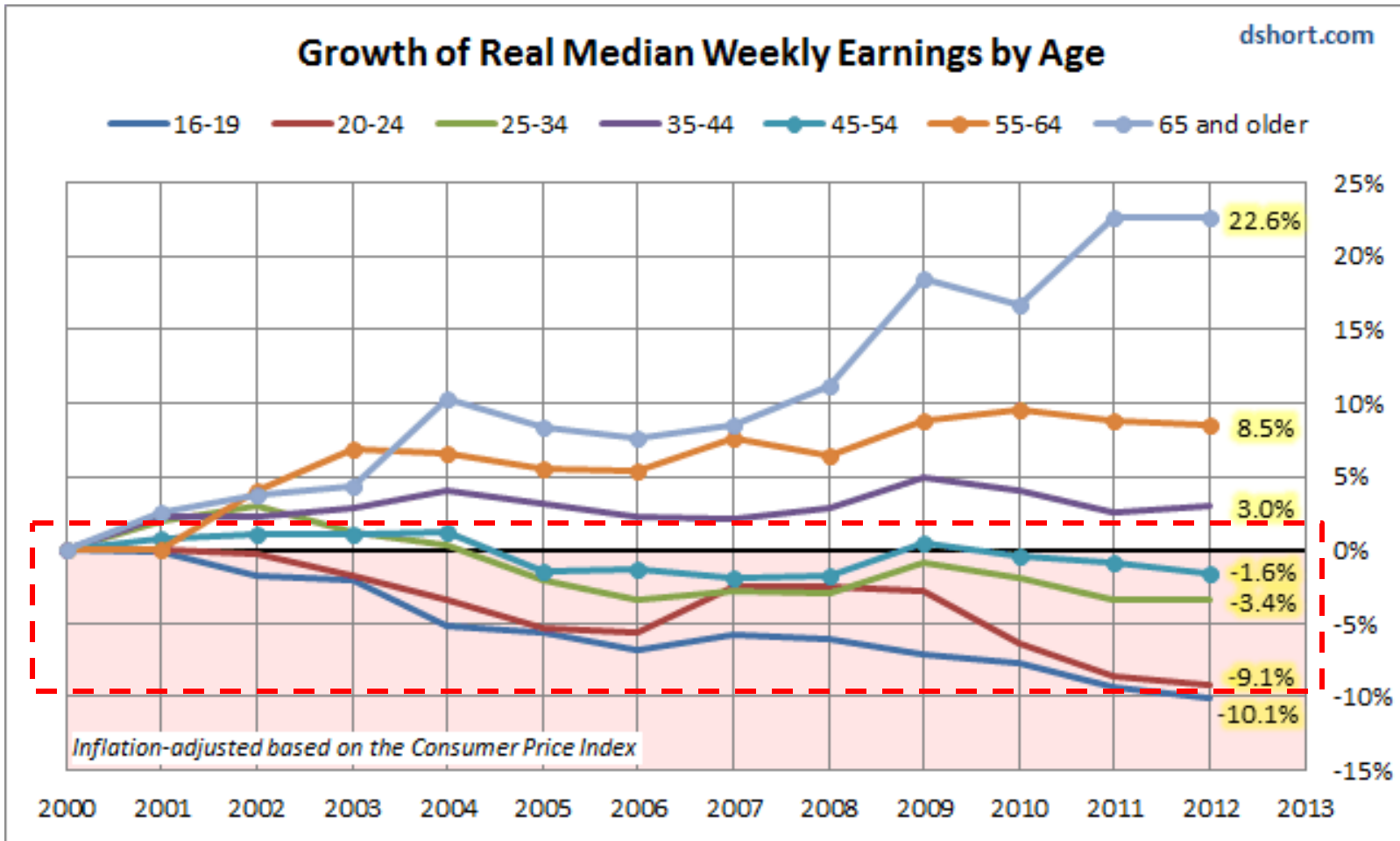
[Graph and Table courtesy of Doug Short – Advisor Perspectives]

- Median household income has declined in real terms even though nominal median income shows apparent increases. When the incomes of the top 5% are removed, the nominal and real income trends are worrisome for the 2014 available homebuyer household pools.



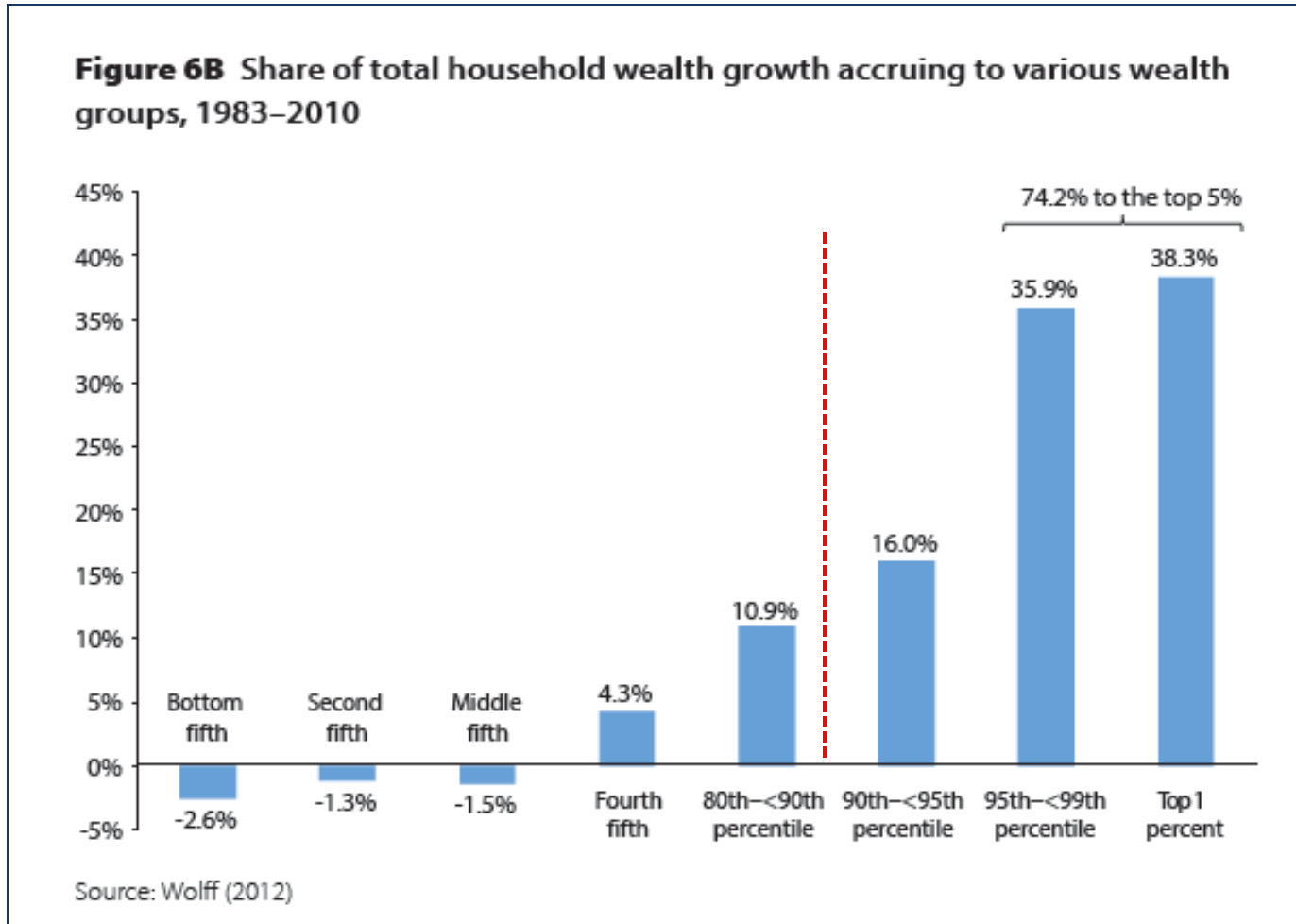
Courtesy :Doug Short (dshort.com Advisor Perspectives)

- Real median weekly earnings for the 25-44 age cohort has continued to fall since 2009, holding back home buying opportunities for *First Time Home Buyers* and *Move-Up Buyers*.

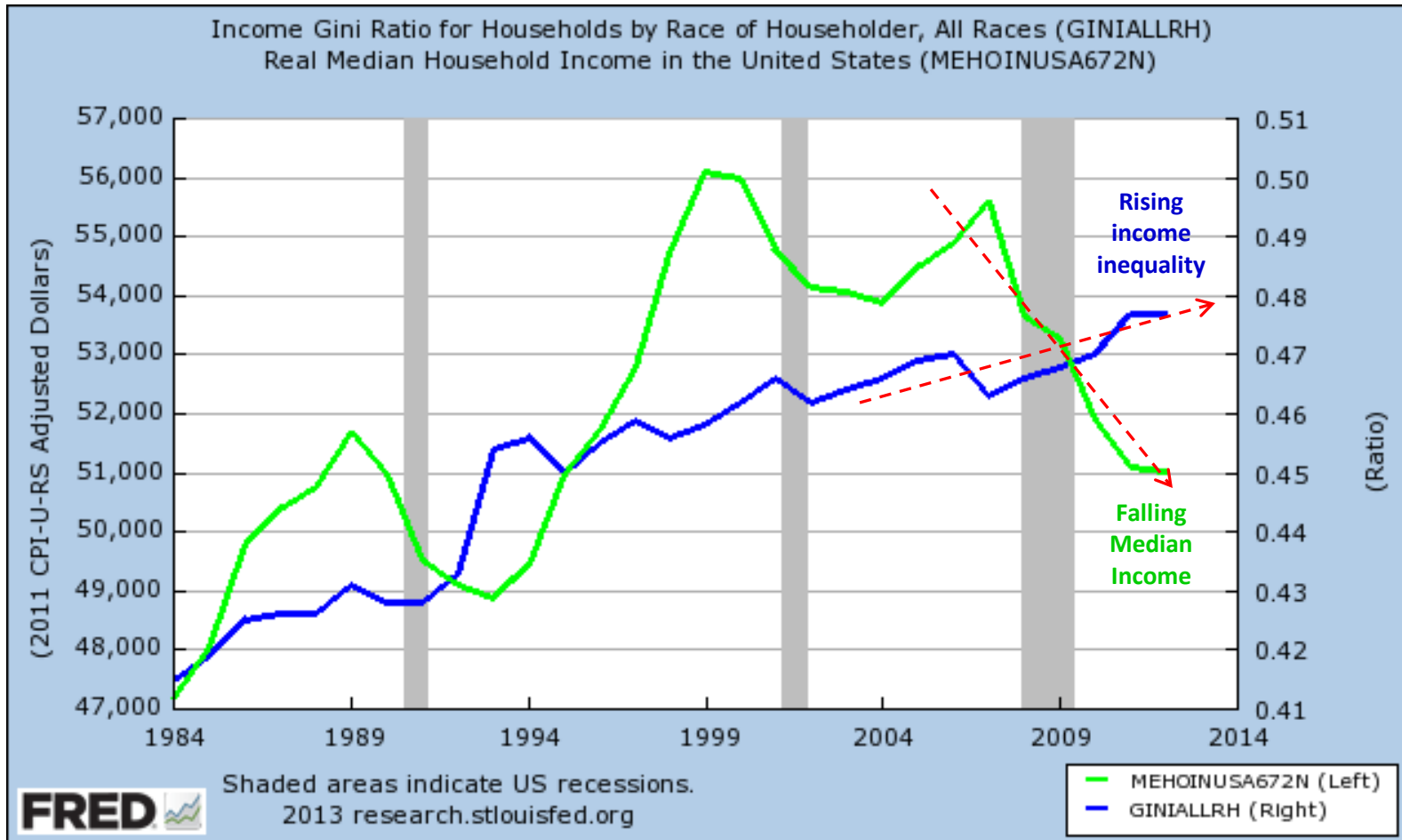


[Graph courtesy of Doug Short – Advisor Perspectives]

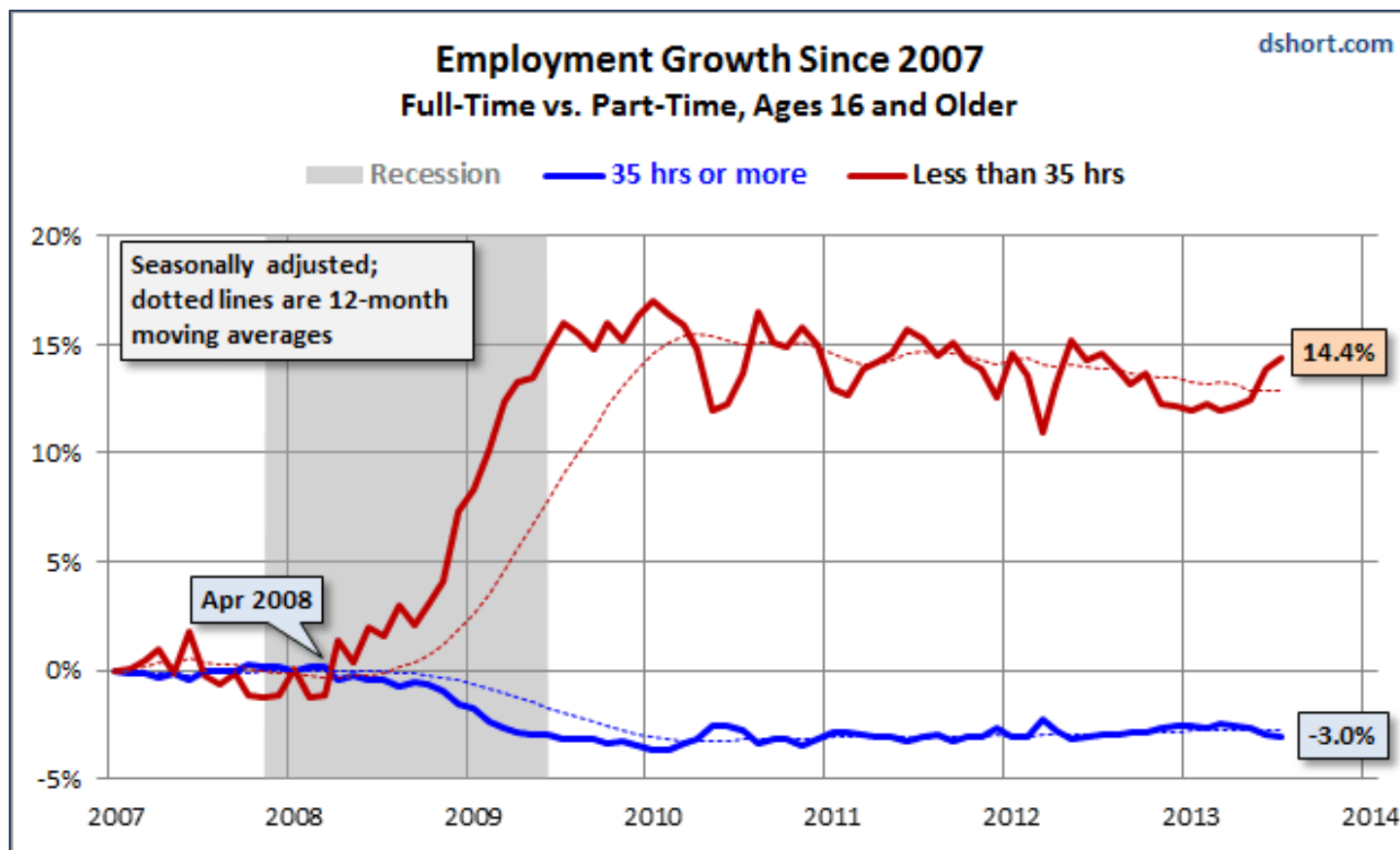
- Share of total household wealth shows the same growth problem as household income for the bottom 90%. The latest wealth data shows the trend is continuing at an increasingly faster pace. The widening gap in wealth accumulation is a serious financial impediment to 80% or more of all U.S. households who'd like to buy a home in 2014.



- Rising income inequality and falling median income are not independent phenomena. The more entrenched the gap between inequality and income trends becomes, the greater its negative impact on homeownership, home buying and purchase mortgage lending activities.

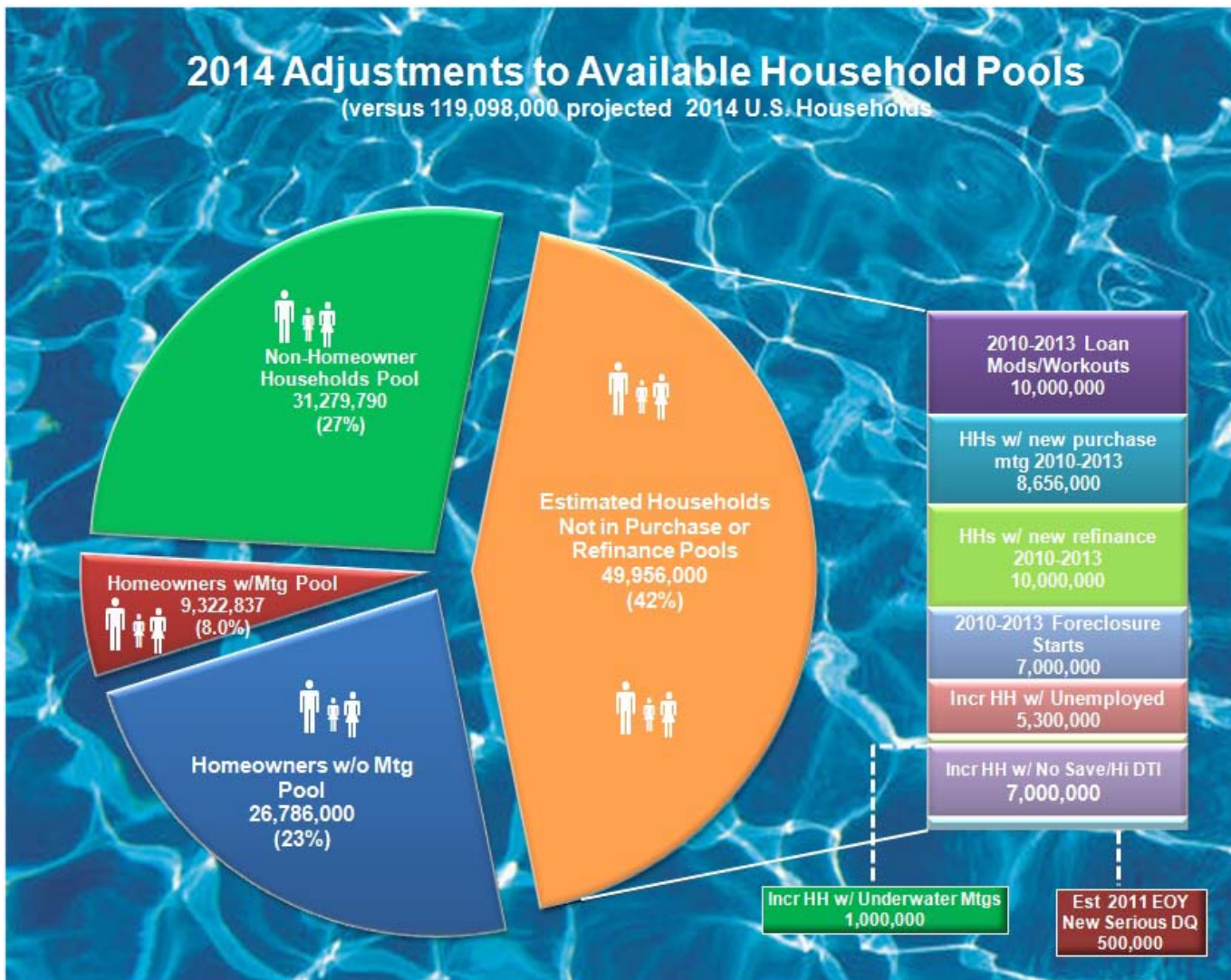


- Full-time job growth has been negative since the official end of the recession and during the “recovery,” while part-time job growth has been in positive territory. Growth in job-counts doesn’t mean the one-for-one replacement of jobs lost during and after the recession. Much of the growth in jobs is not only part-time positions, but they’re also lower paying jobs.



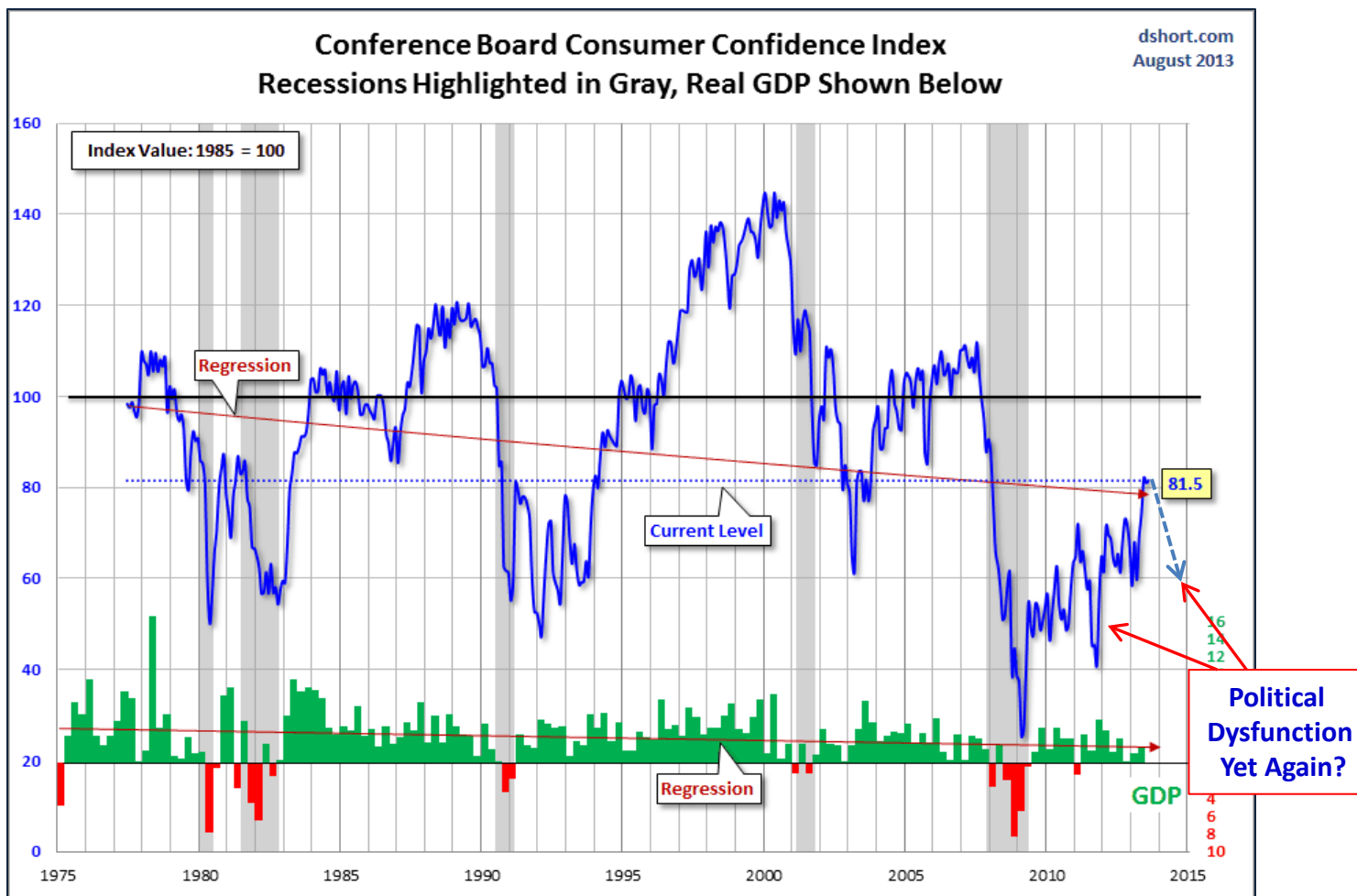
[Graph courtesy of Doug Short – *Advisor Perspectives*]

- **The Result: The available household pools of potential home buyers remains very low going into 2014.**

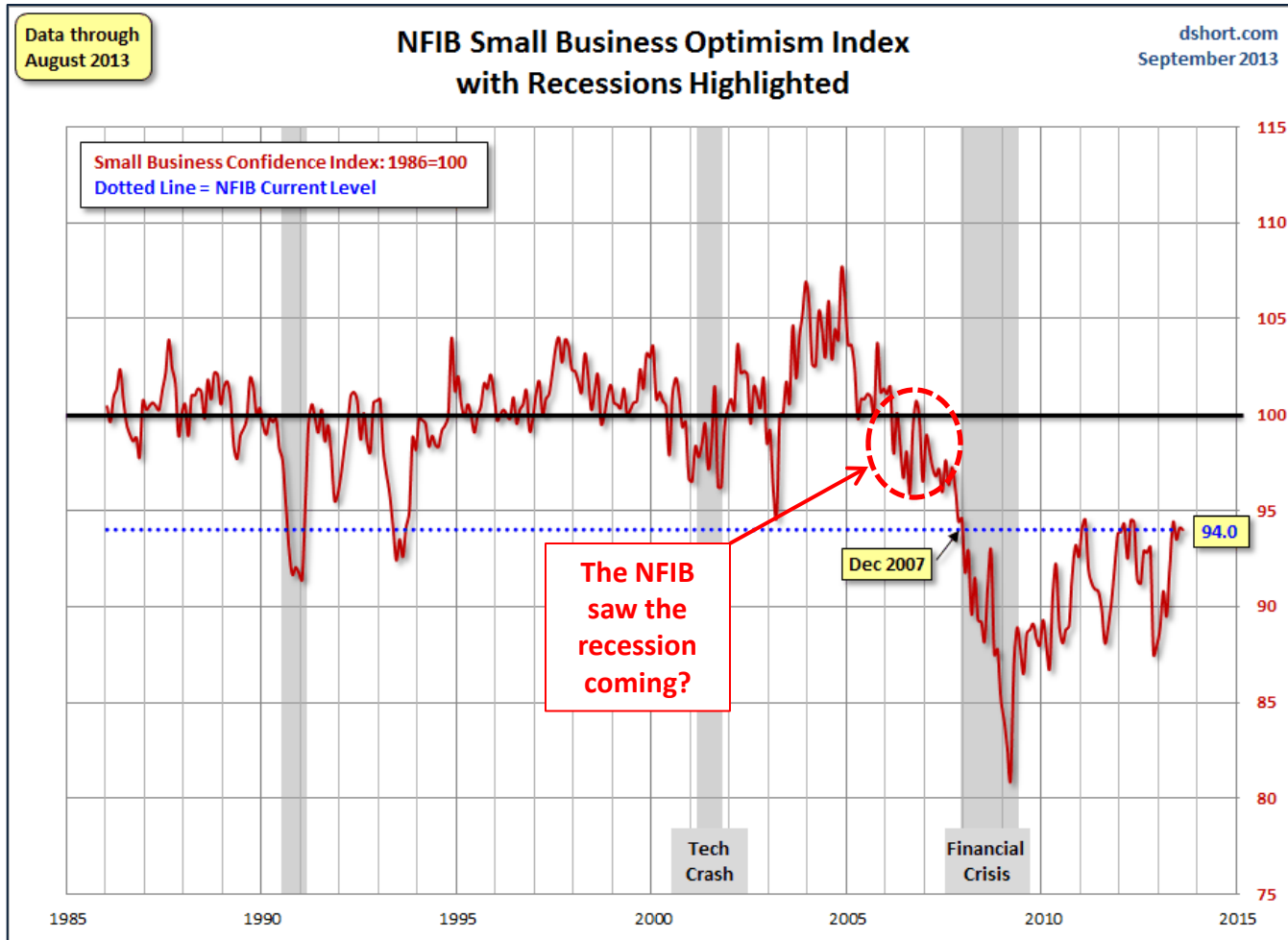


2014 Economic Confidence Trajectories

- The *secular trend* in Consumer Confidence has been moving in a positive direction up to now, but has never crossed the “100” threshold since the recession. It is highly likely that consumers’ outlook will turn sharply downward as a result of impending federal government shutdown and U.S. debt default upheavals. Another recession could be triggered and with it, a fall in home buying.



- The NFIB Small Business Optimism Index has been more positive than Consumer Confidence trends (small businesses are generally more confident than everyone else), yet it still remains below the positive “100” threshold that it left a year before the recession began.



[Base Graph courtesy of Doug Short – *Advisor Perspectives*]

- The weekly Gallup Economic Confident Index has shown negative confidence (below 0) since the recovery began and now the “current conditions” and the “economic outlook” indices have converged at the same low negative territory going into 2014. Consumers’ very low trust/confidence in the banking sector creates another long-lasting downward pressure on future mortgage finance demand.

Gallup Economic Confidence Index -- Weekly Averages for 2013

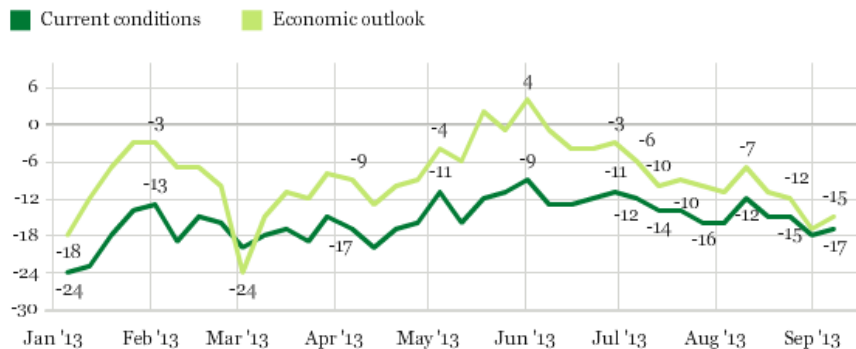
Latest results for week ending Sept. 8, 2013



Gallup Daily tracking

Gallup Economic Confidence Index Components -- Weekly Averages for 2013

Latest results for week ending Sept. 8, 2013



Gallup Daily tracking

Ratings of the Industries and Sectors

For each of the following business sectors in the United States, please say whether your overall view of it is very positive, somewhat positive, neutral, somewhat negative, or very negative.

	Total positive	Neutral	Total negative	Net positive
	%	%	%	
Computer industry	65	22	11	+54
Restaurant industry	61	26	13	+48
Farming and agriculture	60	21	18	+42
Internet industry	54	23	20	+34
Travel industry	49	33	16	+33
Retail industry	46	32	18	+28
Accounting	44	36	16	+28
Automobile industry	49	27	23	+26
Grocery industry	50	25	25	+25
Publishing industry	41	32	25	+16
Telephone industry	41	26	32	+9
Airline industry	38	29	30	+8
Sports industry	39	26	32	+7
Education	46	14	40	+6
Advertising and public relations industry	38	27	32	+6
Movie industry	38	26	34	+4
Television and radio industry	40	21	38	+2
Electric and gas utilities	38	23	39	-1
Real estate industry	35	27	36	-1
The legal field	34	22	41	-7
Pharmaceutical industry	35	18	45	-10
Banking	33	22	43	-10
Healthcare industry	36	14	49	-13
The federal government	27	17	56	-29
Oil and gas industry	26	17	57	-31

Net positive ratings are computed by subtracting the percentage rating each industry negatively