Market Insight Snapshot



Strategic defaults off from peak but still high

Problem won't really vanish until home prices climb (and stay there)

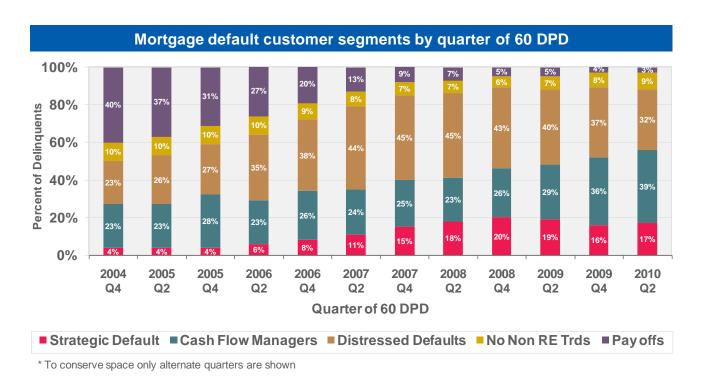
June 23, 2011

Terry Stockman (not his real name) earns a handsome income, maintains a high credit score and owns several residential properties. They include the Southern California home where he has lived since 2007. Terry is now angling to buy the foreclosed home across the street. What's so unusual about this? Terry hasn't made a mortgage payment on his own home for more than six months. With prices now at 2003 levels, his house is worth only about one-half of what he paid for it. Although he isn't paying his mortgage loan, Terry is current with his other debt payments.

Terry is a strategic defaulter — and he isn't alone. By the end of 2008, a record one-in-five mortgage delinquencies (mortgages 60 days past due or greater) was a strategic default, according to Experian data. Since 2008, strategic defaults have fallen below that percentage in every quarter through the second quarter of 2010, the most recent quarter for which figures are available. However, the percentages are still high: 16 percent in the last quarter of 2009 and 17 percent in the second quarter of last year. (See the chart on the following page.)

Indeed, these percentages aren't likely to decline much unless residential housing prices increase and remain at higher levels. Homeowners have to see for themselves that their neighbors' houses are selling for higher prices. So far, home prices nationwide continue to decline in most regions. Strategic default in mortgage continues to be an ongoing issue for many lenders, with no relief in sight. With home prices hitting another new low in the first quarter of 2011 (down 5.1 percent from a year ago to levels not reached since 2002), ¹ prices are now 32.7 percent lower than they were at their peak in the first quarter of 2006. In addition, Standard & Poor's, the debt-rating agency, and other real-estate forecasters expect a 5 percent drop in home prices in the last nine months of 2011 in addition to the 4.1 percent drop recorded in the first quarter, according to the S&P/Case-Shiller housing price index.

¹S&P/Case-Shiller National House Price Index



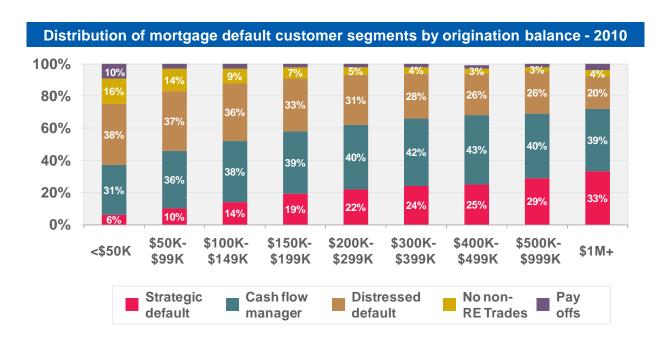
For mortgage lenders, the latest strategic default figures suggest the issue will continue to be a problem for the next few years given their account management queues. So what should lenders do?

For one thing, lenders need to differentiate strategic default behavior from cash flow managers. A strategic defaulter — someone who seemingly has the capacity to pay his or her mortgage but walks away because it's underwater — doesn't fit the profile of a borrower unable to pay. Indeed, a strategic defaulter isn't the type of mortgage borrower who is motivated to pay on a loan modification. A strategic defaulter is likely to redefault on a loan if conditions deteriorate. On the other hand, a cash flow manager — someone who is making an occasional mortgage payment — may be more likely to take advantage of a loan modification program.

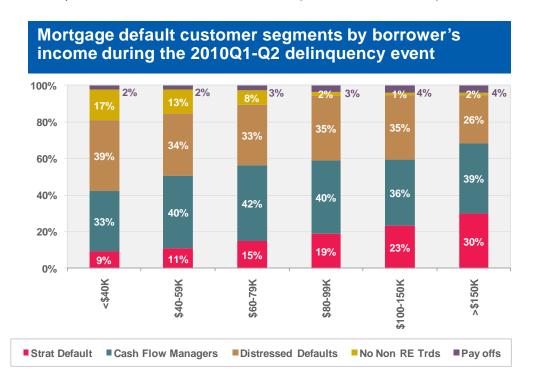
As strategic default has remained high, we have seen the incidence of distressed default actually come down and conversely cash flow managers go up. This is evidence that many of distressed consumers are again having the ability to begin to make periodic payments on their mortgage loan. This trend has repeated itself over the last two time periods and may hold some optimism for future quarters.

Experian® and Oliver Wyman, pioneers of strategic default research, recently evaluated more information to develop a clearer profile of these defaulters — and the findings are interesting on several fronts:

Customers with higher origination balances are more likely to strategically default. Of loan-default customers with loan origination balances of less than \$50,000, only 6 percent were strategic defaulters while 38 percent were distressed defaulters. However, for those with loan origination balances of more than \$1 million, one-third had strategically defaulted while only 20 percent had defaulted under distress. The percentage of strategic defaulters steadily climbed as the loan origination amount increased. (See the chart below.)

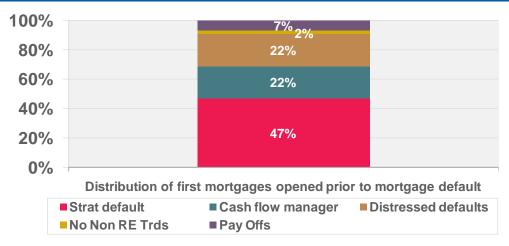


Borrowers with higher income showed a higher incidence of strategic default. At an annual income
of less than \$40,000, only 9 percent of mortgage default customers were strategic defaulters,
compared with 30 percent of those making more than \$150,000 annually. For those mortgage
delinquents with an annual salary of between \$100,000 and \$150,000, 23 percent were strategic
defaulters and 35 percent were distressed defaulters. (See the chart below.)



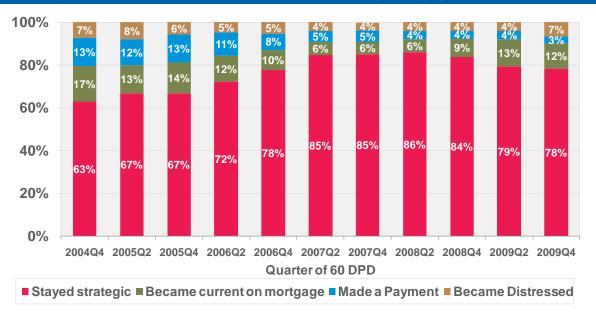
In the six months prior to mortgage default, strategic defaulters accounted for nearly half (47 percent)
of all new mortgages opened. This behavior further supports the evidence that these mortgage
defaulters were doing so strategically. (See the chart below.)





When payment behavior of strategic defaulters was evaluated another six months after the initial
performance window, nearly 80 percent remained strategic defaulters. This finding reaffirms that the
behavior is "strategic." (See the chart below.) Strategic defaulters also were half as likely to default
on their bankcard compared with distressed consumers.





What can lenders do?

Mortgage lenders need to be able to identify strategic defaulters in order to best employ their resources and set different strategies for consumers who have defaulted on their loans. To assist them, Experian has developed a suite of mortgage strategic default products and services that identify the behaviors of likely strategic defaulters and cash flow managers who are facing mortgage-delinquency issues because of temporary distress, but continue to make payments on all other mortgage credit obligations.

Experian's Strategic Default Indicators M helps lenders identify suspected strategic default behavior as early as possible. These indicators help to identify consumers who have exhibited strategic default and cash flow manager behavior. The indicators can be used to prioritize account management or collections queues for better treatment strategies. They also can be used in prospecting and account acquisition to better understand payment behavior prior to extending an offer.

Lenders also can replicate the Experian analysis on their individual portfolio and incorporate loan-to-value and other account-level details to augment the credit data. They can evaluate mortgage delinquency and its impact on other products in their portfolio, such as a bankcard. In addition, when possible, servicers should evaluate strategies to preempt strategic default behavior, including looking at equity-risk agreements and incentive plans.

Experian also has developed a new set of loan modification attributes to capture the number and type of loan modifications as well as to identify those that haven't been delinquent or derogatory. The new set is a subset of more than 800 Premier AttributesSM that are available and capture a variety of consumer behaviors. Strategic Default Indicators and Premier Attributes are now available for testing.

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