

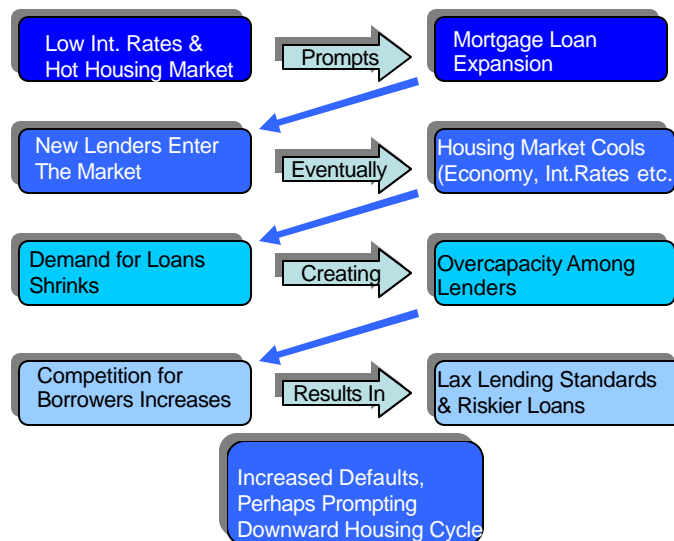
Cracks in the Foundation: Will Real Estate Sink the NH Economy?

Presentation to the
NH Assessors
May 13, 2008

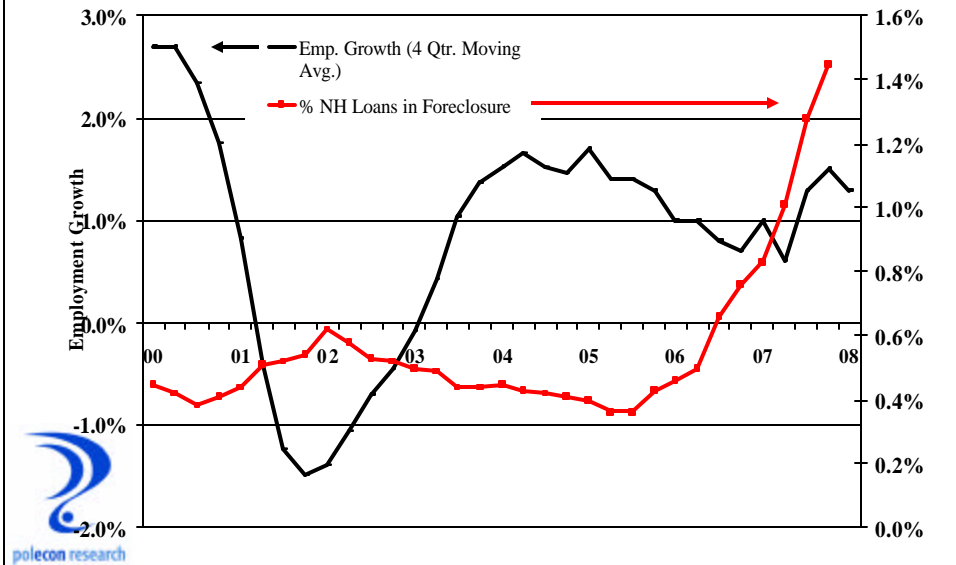
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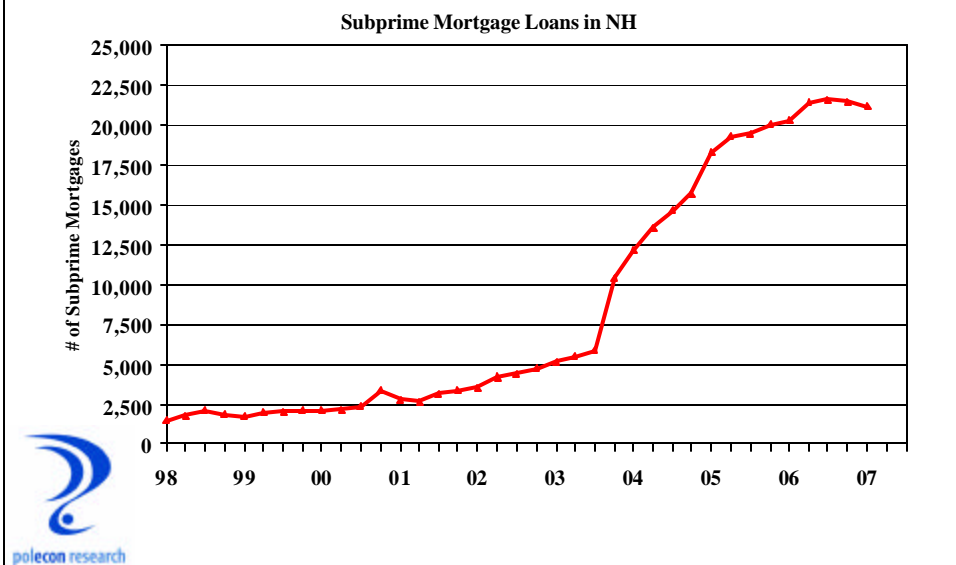
The Current Situation is Typical of Mortgage Credit Cycles (But With Some Unique Features)



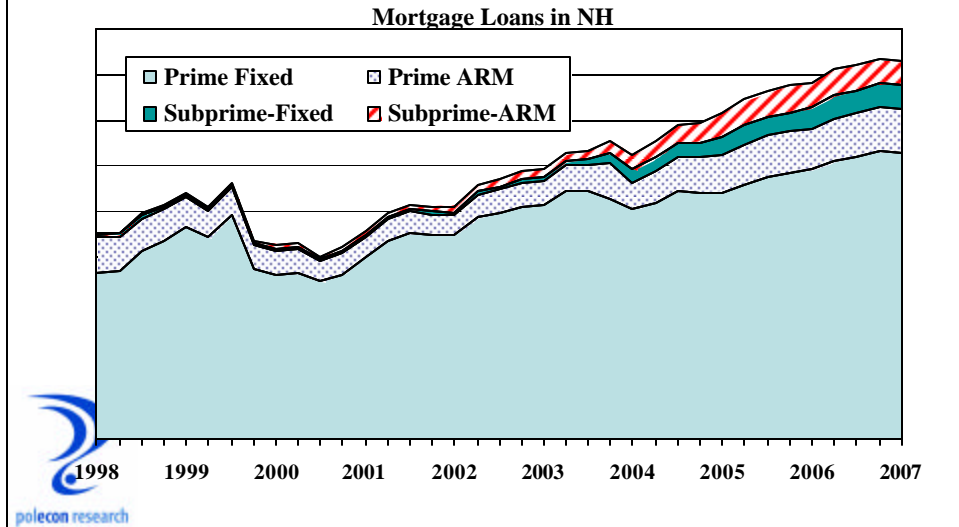
Foreclosures Typically Decline When Jobs Are Growing but Foreclosures Increased Despite Jobs Growth During This Mortgage Credit Cycle



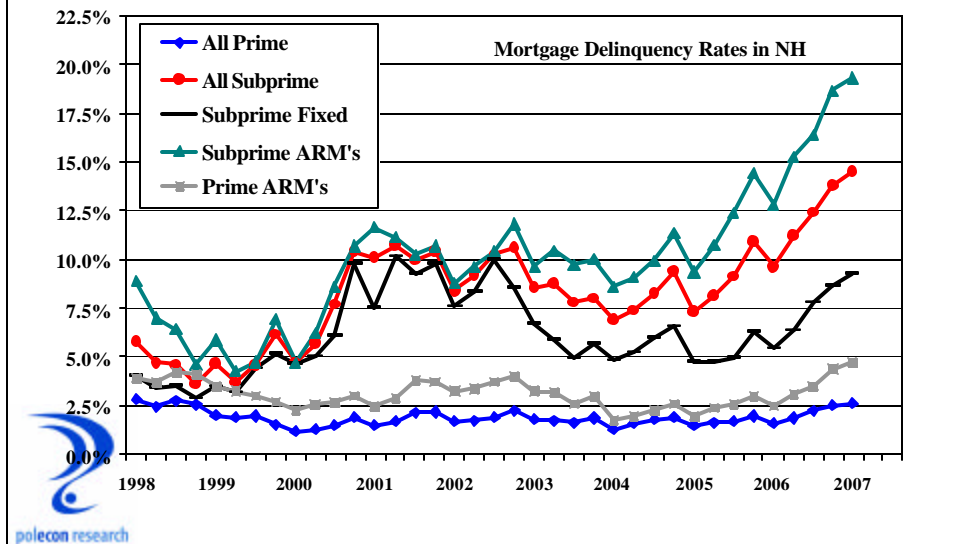
Subprime Loans Have Grown Dramatically and Accounted for 34% of Mortgage Loan Growth in NH Between 2003 and 2006



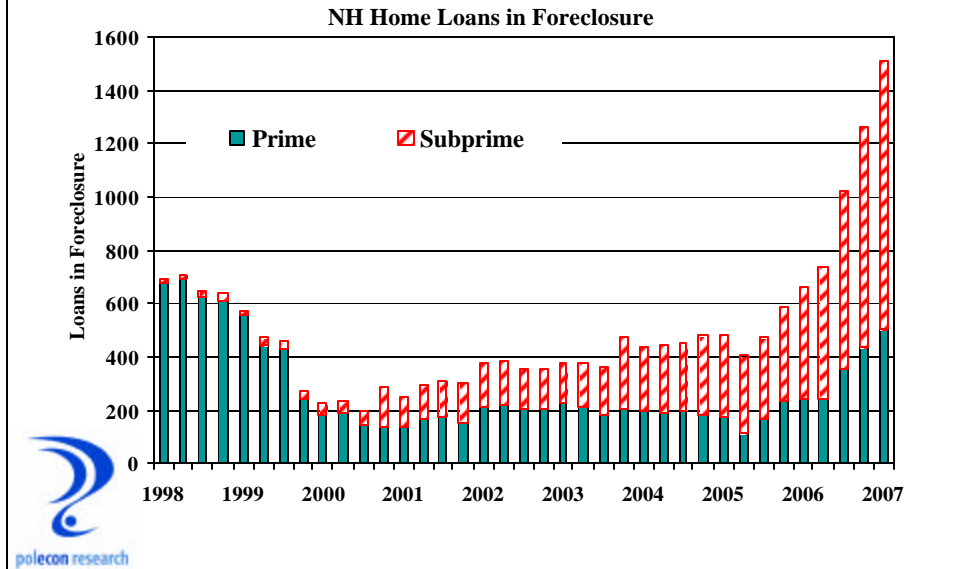
Despite the Growth of Subprime Loans, Fixed, Prime Rate Loans Remain the Dominant Mortgage in NH. Subprimes are 13% of all NH Mortgages



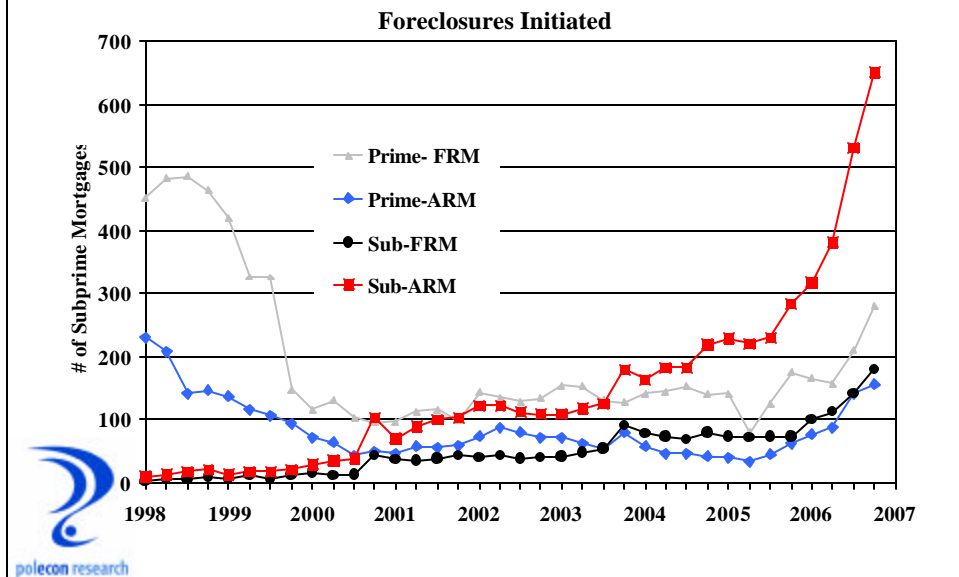
Mortgage Delinquencies Have Been Rising for 3 Years but Problems Have Been Concentrated Among Subprime, Especially Adjustable Rate Subprime Loans



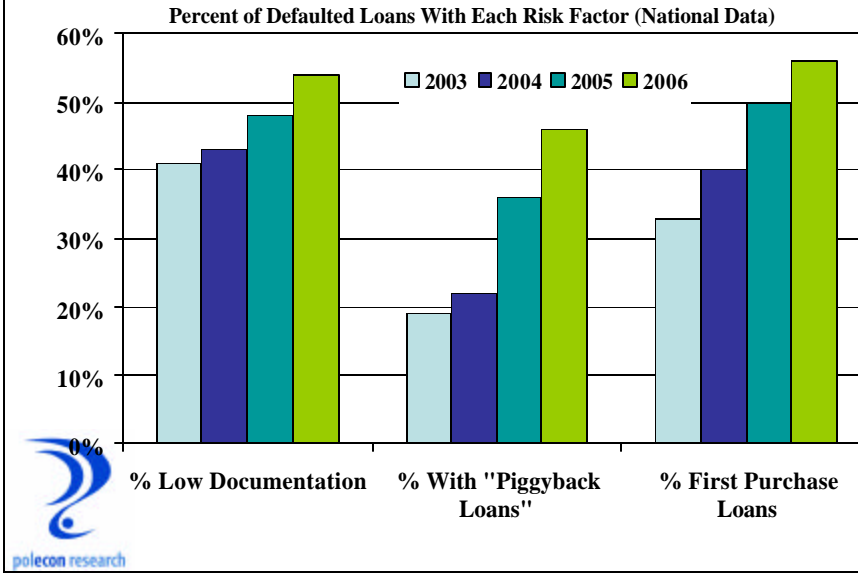
Prime Loan Foreclosures Have Risen but are Lower Now than in the Late 1990's. Subprimes Were Almost 70% of all Foreclosures in 2007



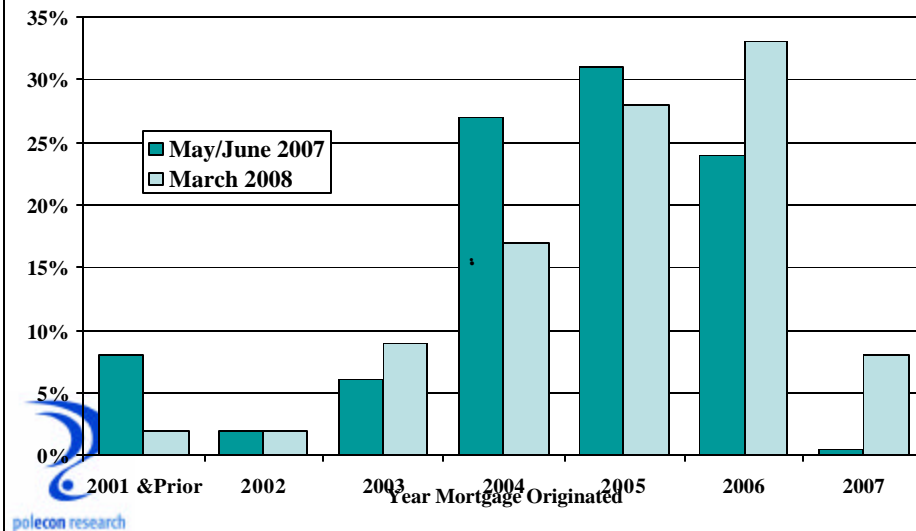
Subprime *Adjustable Rate Mortgages* are Still the Majority of the Foreclosure Problem – The “Bleed” Into Prime Loans is the Result Normal Rise During Weaker Economy, High Leverage and Falling Values, Not Bad Lending Practices



Subprime Loans Became Riskier as the Mortgage Credit Cycle Progressed and the Housing Market Peaked



The Majority of Mortgage Delinquencies are Concentrated in Subprime Loans - Subprime Loans are Working Their Way Through Credit Markets Like a Rat Through a Python



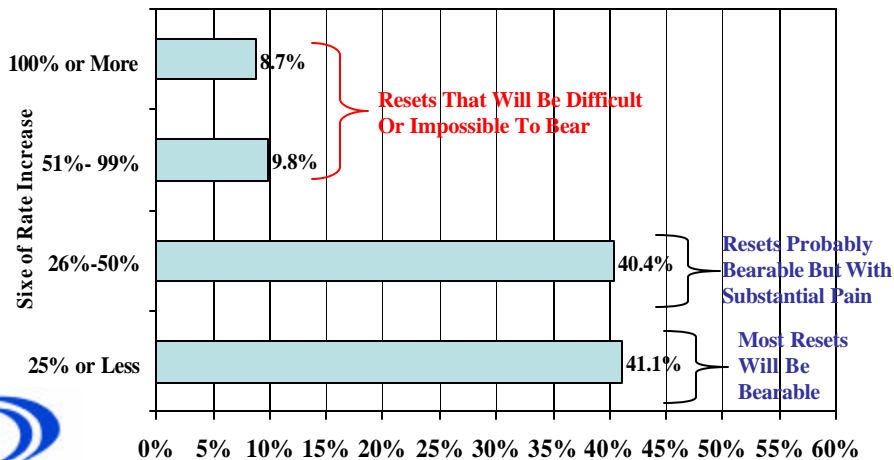
How High Will Foreclosures Go?

- Home price appreciation trends will have the greatest impact on the number of foreclosures
- Strength of the economy always plays a role in foreclosures
- House price declines make it harder for lenders to and work with borrowers with no equity
- Foreclosures will likely increase into mid-2008 as more subprime adjustable rate loans “reset” with higher payments
- Higher lending standards and lower home values mean fewer opportunities to refinance out of costly loan resets
- Loan workouts are still uncommon
- Lower interest rates saved some from “reset” related defaults but with so many homeowners “underwater”, no program will solve the problem.



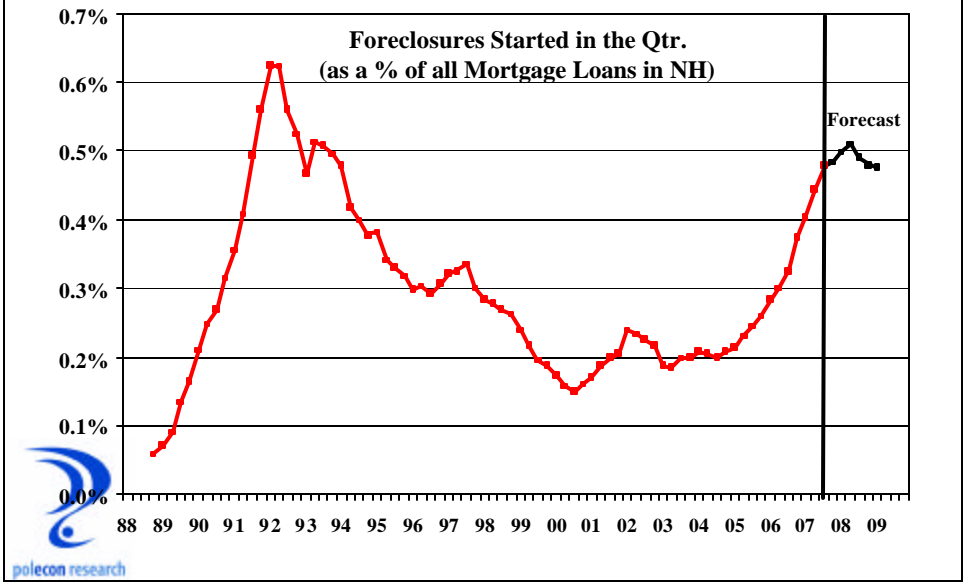
Rate Resets Will Peak Late in 2008 and Defaults are Likely in Almost 20% of The Loans

Est. % of 2004-2006 Subprime ARM's by Size of Rate Increase

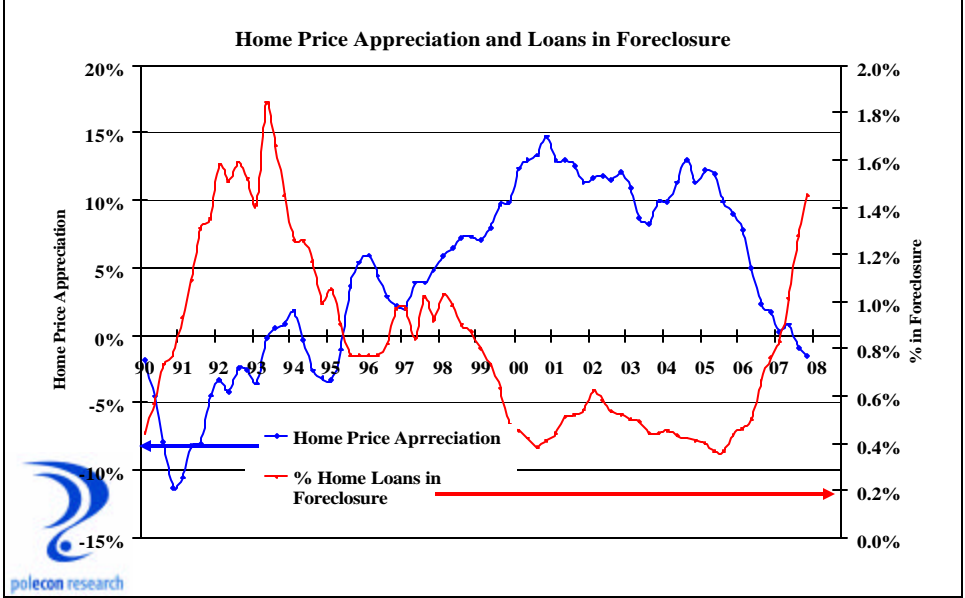


Source: First American CoreLogic, PolEcon Research

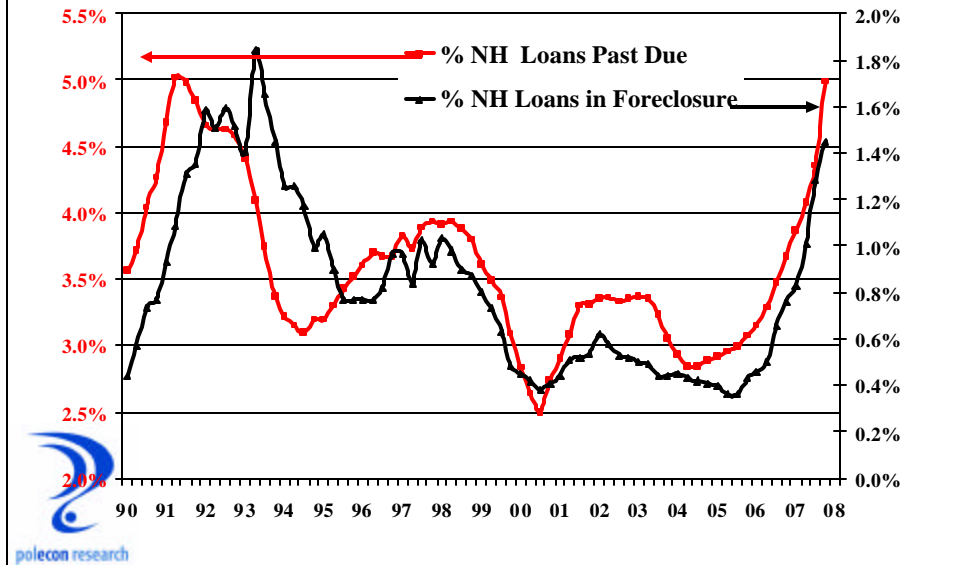
(My July 2007 Forecast)
 Based on the Volume of Subprime and Other Mortgages Between 2004 and 2007,
 Foreclosure Rates Should Peak in the First Half of 2008
 (Below 1990's Recession Levels)



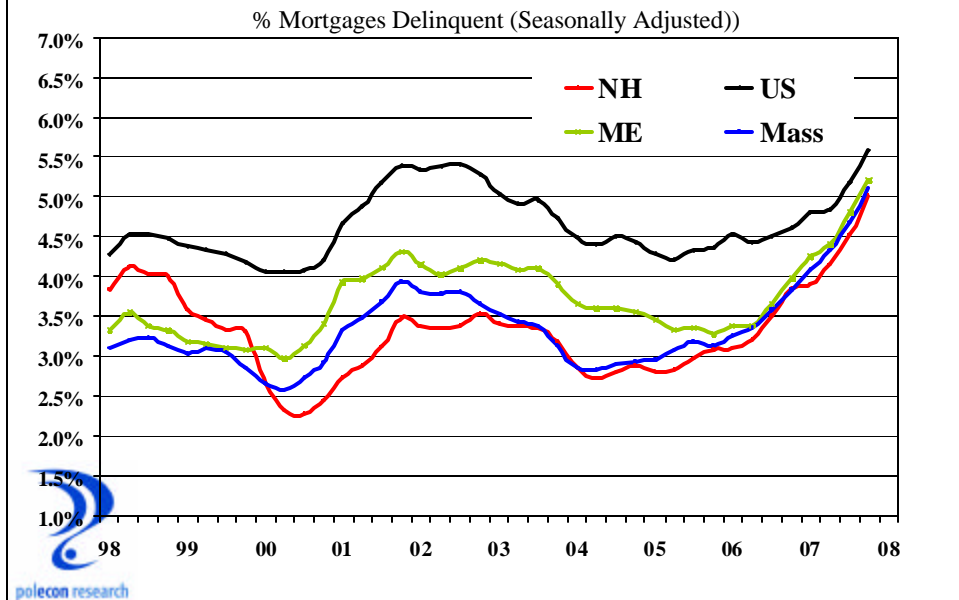
Home Price Trends Play A Big Role In Determining How Many
 Loans Eventually Fall Into Foreclosure.



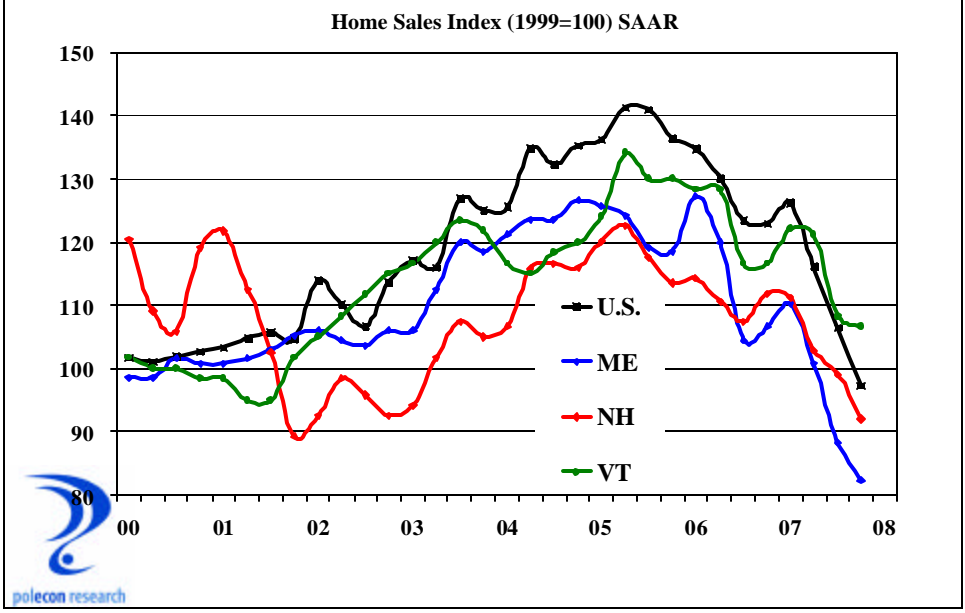
Delinquencies and Foreclosures in NH Showed No Signs of Slowing Through Q4 of 2007



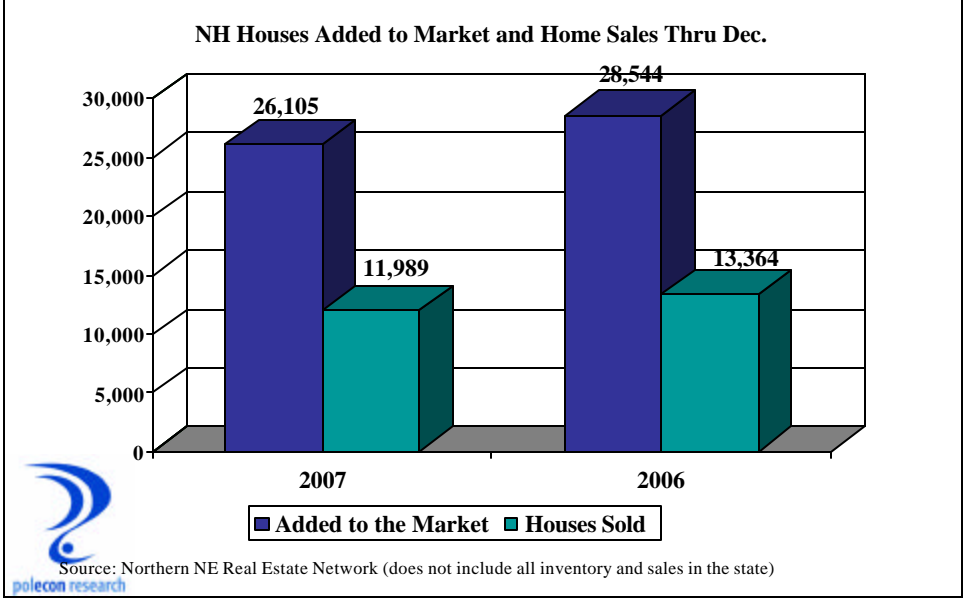
Mortgage Delinquencies in ME, Mass. and NH are Now Close to the U.S. Average But Since 2005 They Have Increased Faster in Mass and NH



Falling Sales and Rising Foreclosures Guarantee Further Price Declines... Which Pushes More Into Foreclosure.....

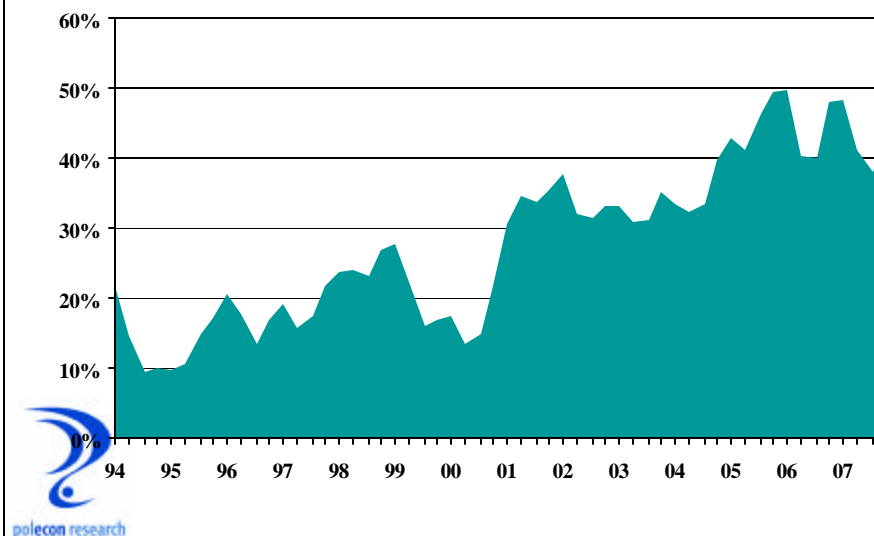


As Does Increased Inventory - The Housing Market Won't Stabilize Until The Supply of Unsold Homes Declines



Recent Year's Cash-Out Refinancings Put More Homes at Risk of No or Negative Equity and Have Added to Debt Burdens
(A 15% Decline in Home Prices Will Mean More Than 20% of Homeowners Will Have No Equity)

Est. % of New Loans That Were "Cash-Out Refi's"



Real Estate Markets Driven by Fundamentals

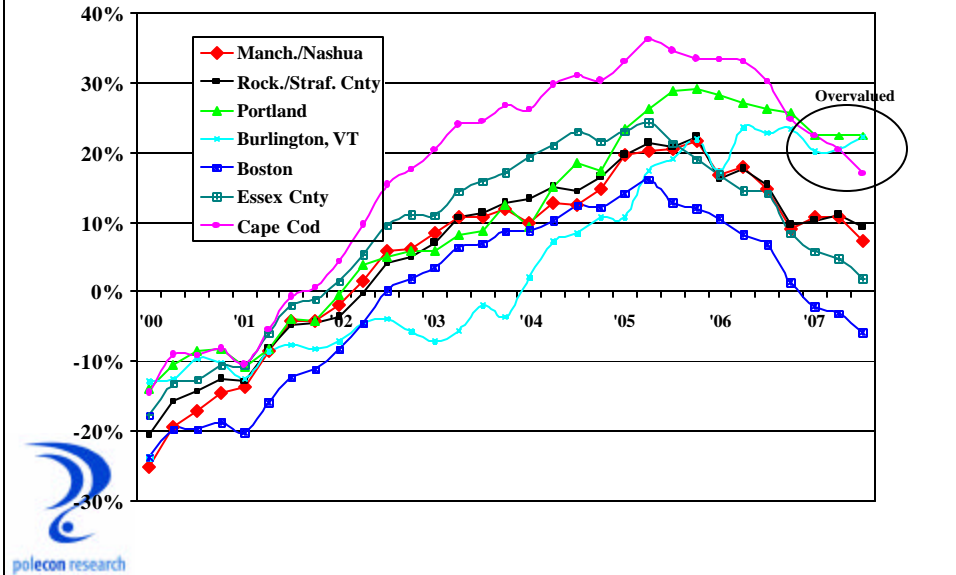
- Employment growth
- Population growth and especially net-migration
- Income growth
- Supply
- Affordability and "fair valuation" (includes much more than price)
- Increasingly by credit and its availability

And one major "non-fundamental":

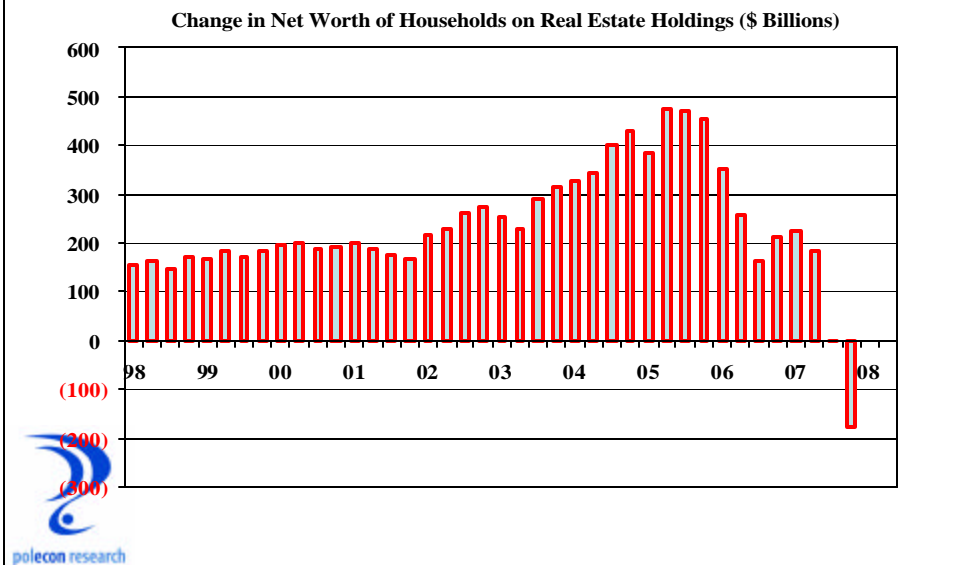
- Psychology



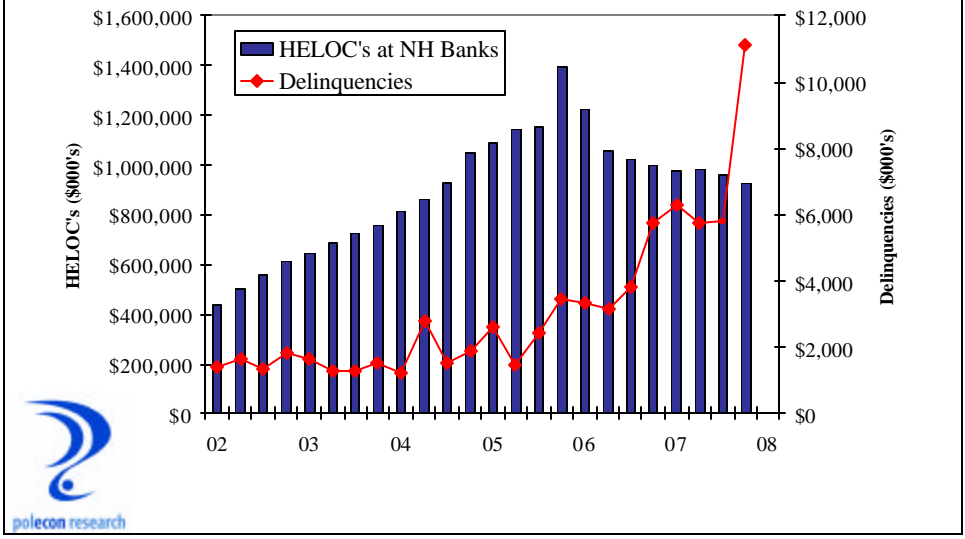
Estimated Over/Under Valuation of Large Real Estate Markets in New England (+/- 10% is "Fairly" Valued) 3rd Qr 2007



By The End of 2007, \$176 Billion in U.S. Household Net Worth Had Evaporated From Housing Market Decline But The Final Number Will Be Much Larger (Times 3 or More)



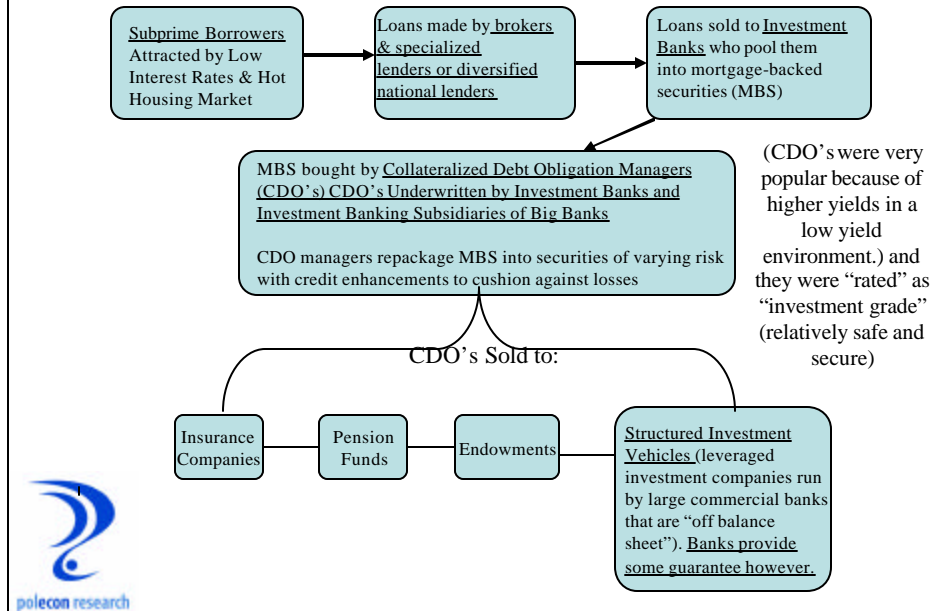
The “Wealth Effect” of Reduced Home Values.
 Home Equity Lines of Credit (and Cash-Outs Refi’s) Have Helped Fuel Expenditures. In NH, HELOC’s are Trending Downward While Delinquencies Increasing



Housing Market Summary

- Minimal Signs of a bottom even though valuations are becoming “fairer” in many areas
- To stabilize the market, inventories must decline
- Prices must fall further and mortgage credit must be available (biggest problem)
- We are nearing the end of the worst of the mortgage credit problems (lower int. rates likely saved 40% of impending reset problems – but significant further price erosion will force more problems)
- The broader impacts of housing market have been minimal thus far but will escalate:
 - Job cuts (financial, real estate, construction etc.) have yet to fully hit most NE metros but NH overall is further into correction
 - Wealth effect and slower mortgage equity withdrawals slow consumer expenditures
 - If availability of credit for businesses is constrained, the impacts become more pervasive and problematic
- Although most banks were not subprime lenders, many are affected – generating a credit crisis.

How The Subprime Mortgage “Contagion” Spread



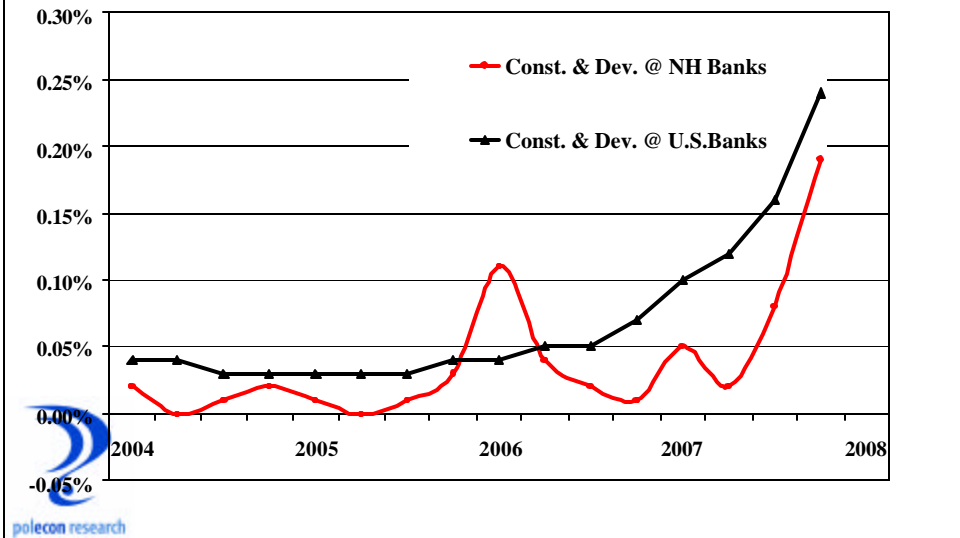
How the Subprime Contagion Becomes “Viral”

- Mortgage loan delinquencies and defaults rise
- MBS(Mortgage Backed Securities) pools exercise “put-back rights”
- With revenues drying up with cooling housing market mortgage originators unable to “buyback” loans and go bankrupt
- Defaults rise to overwhelm credit enhancements embedded in MBS and CDO's
- Hedge funds fail when unable to provide guarantees or value of CDO's collapse
- The whole class of MBS and CDO securities “shunned”
- Banks called on to make good on guarantees to SIV's (Structure Investment Vehicles)– “off balance sheet” becomes “on balance sheet” – affecting capital ratios and ability to lend.
- Banks also unable to sell loans made to some private equity firms for LBO's (“leveraged buyouts”) which followed the same pattern as mortgage securities – further reducing the ability of banks to make other loans.
- Banks reluctant to lend to one another because of fears of “hidden problems”
- Lending and credit markets freeze-up



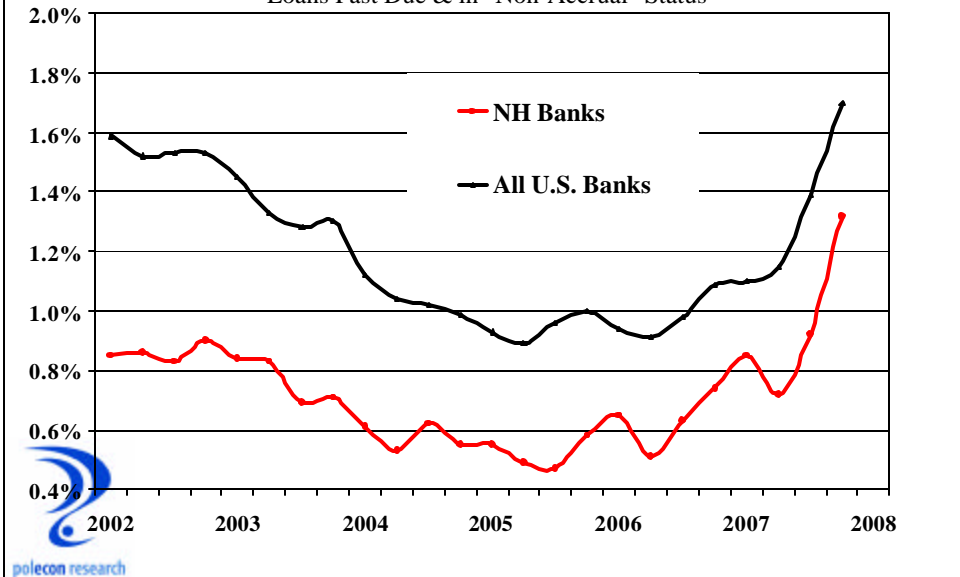
Construction and Development Loan Delinquencies May Become a Bigger Problem for Banks Than Residential Mortgages

Loan Delinquencies as a % of Dollar Value of Loans

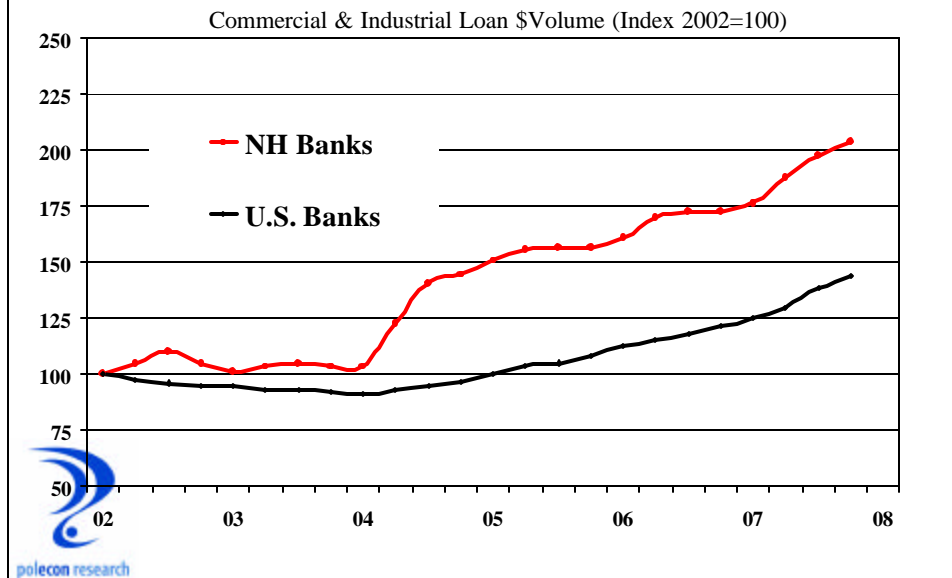


Delinquencies and Charge-Offs Have Accelerated at Banks Everywhere But are Lower in NH

Loans Past Due & in "Non-Accrual" Status



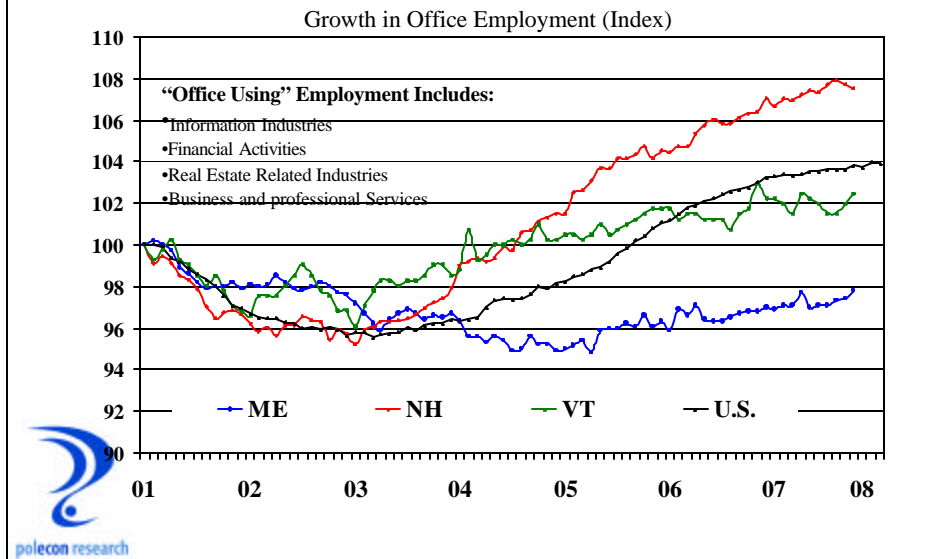
There is No Sign Yet That “Main St.” Business Access to Bank Credit Has Been Hampered



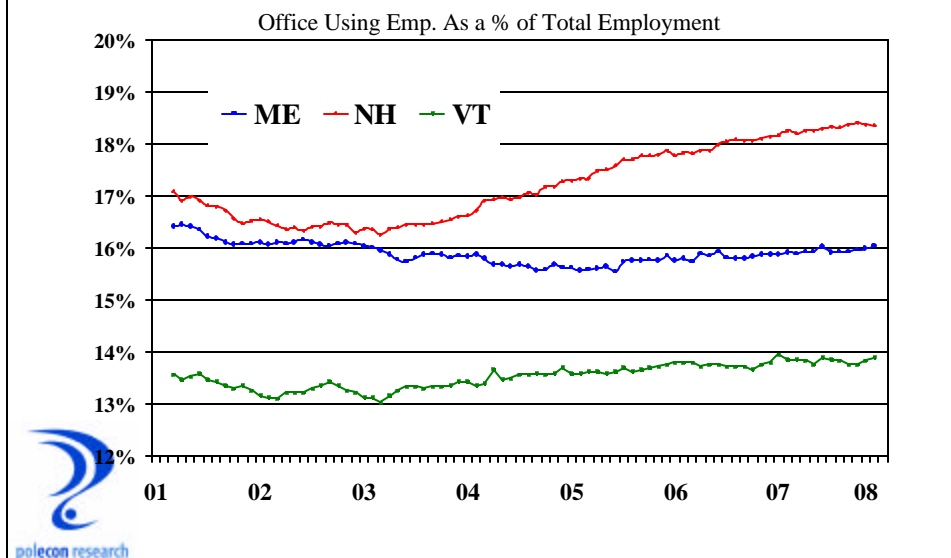
Commercial Real Estate Markets Often Follow The Same Patterns as Residential – Will Commercial Real Estate in NH Be The Next To Fall?



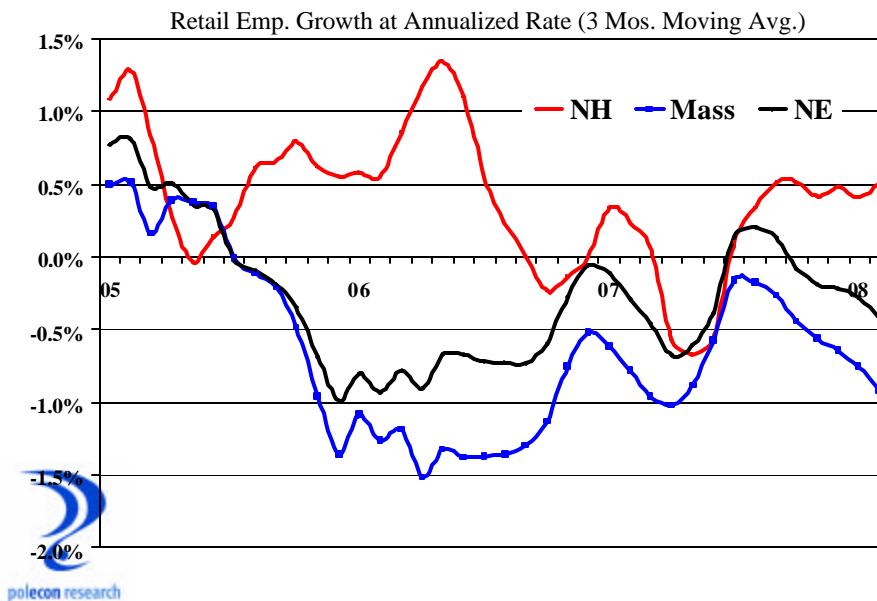
“Office Using” Employment Growth is a Good Indicator of the Demand for Office Space



Only NH’s Economy Has Been Shifting Toward More “Office Using” Industries and Occupations



NH's Ability to Maintain Retail Employment Will Also Help Prevent a Serious Slide in Commercial Real Estate

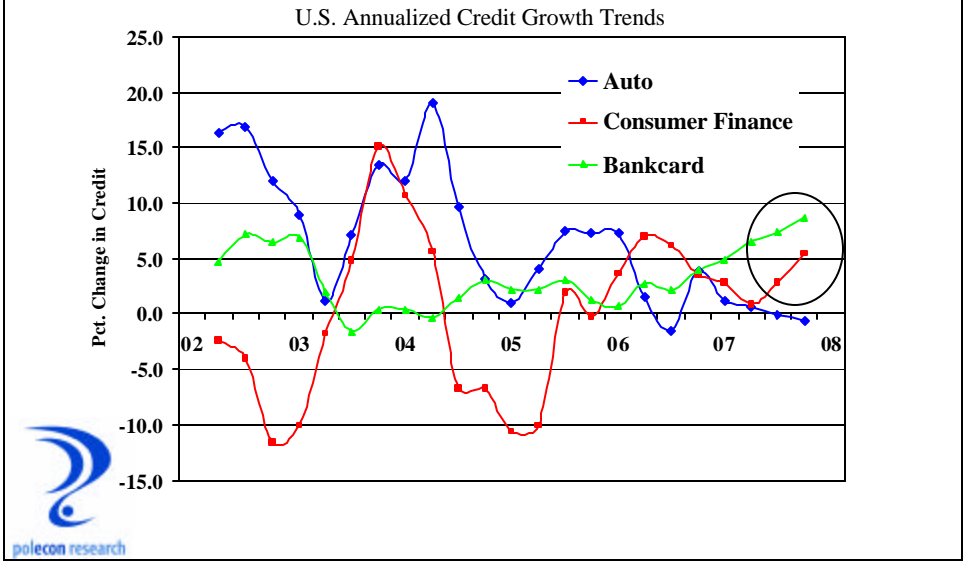


Consumers are Leading the Recession

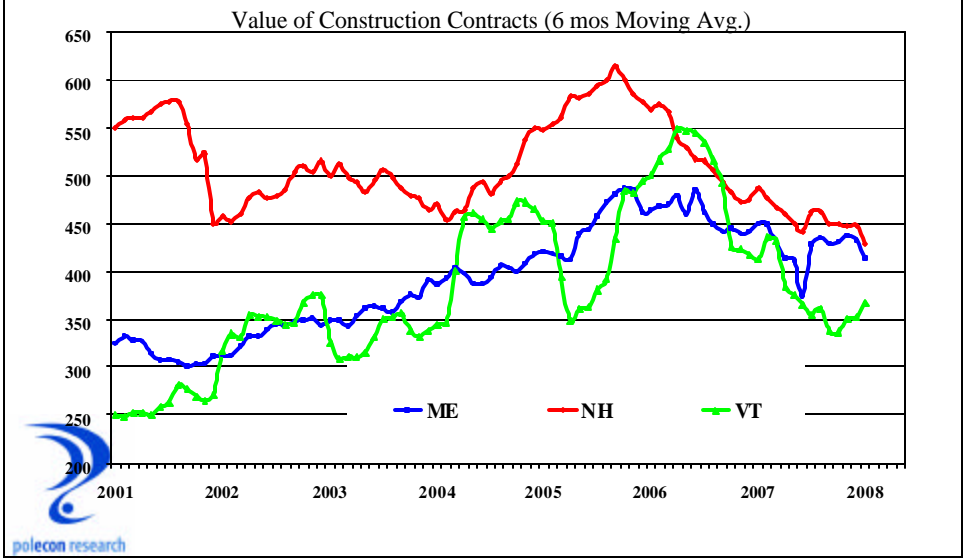
- Consumer confidence has little impact in a growing economy but the difference between a slowing economy and a recession is usually confidence
 - Rising prices
 - Falling home values
 - Petroleum price shocks
- Oil prices negate tax rebate effects. “If price trends continue \$4.00/gal by Memorial Day” Brian Gottlob 3/13/08
- Banks – nationally
 - Credit problems beyond mortgages
 - Consumer, construction, and commercial loan delinquencies rising



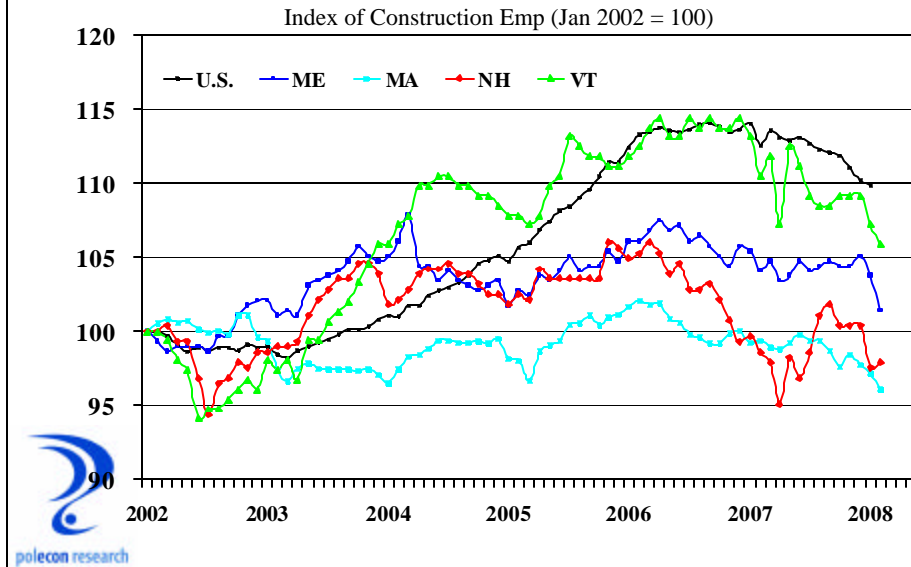
With the “Housing ATM” Largely Turned-Off, U.S. Consumers are Turning More To Credit Cards and Consumer Loans to Finance Expenditures



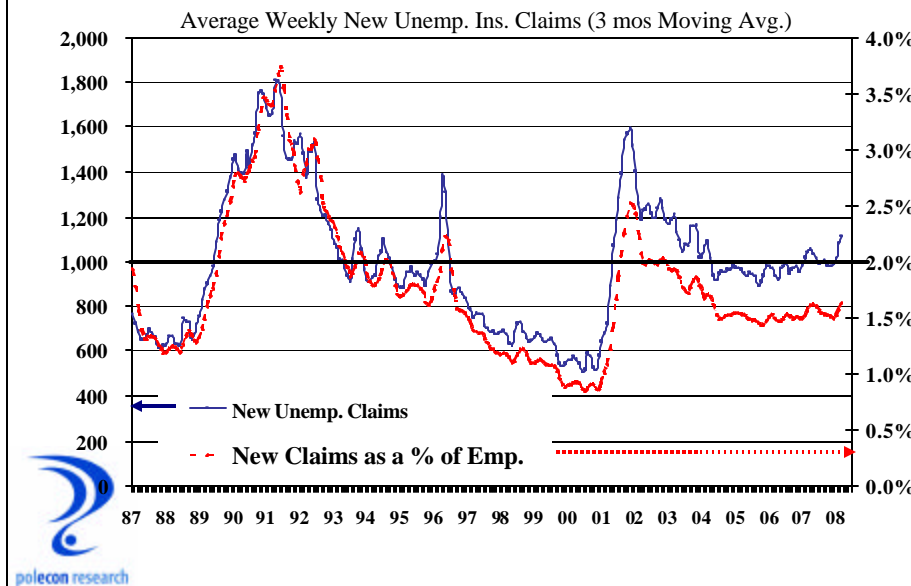
Going Forward - Construction Contracts Slowed Sooner in NH and Will Fall Less From Here



... and Much of NH's Construction Emp. Decline Has Already Occurred



New Unemp. Claims Are Still Well Below Recession Levels (But Have Surged a Bit)



Conclusions

- NH will not suffer more than most states from real estate and financial market troubles
- We have yet to feel the full effects of housing related layoffs, but we are closer than other NE states
- Many housing markets are at or near “fair valuation” but low consumer confidence, inability to sell current home and/or lack of credit keep buyers away
- Slow growth and likely recession “pile on” to housing markets woes brought on by subprime lending
- Banks ability and willingness to lend (all types) is key to containing impacts of housing crash (great opportunity if able to reinforce critical role of banks in local economies)
- Home price declines usually ‘clear the market’ but with consumer sentiment this low and uncertain mortgage credit this (and lower interest rates) won’t work their usual magic
- The last big housing correction was followed by a period of strong growth
- Little evidence of commercial real estate excesses in supply or lending risk in Northern NE, concerns may be overblown but we were also surprised at our subprime vulnerability

