

ECONOMIC REAL ESTATE TRENDSSM



WINTER 2007

PMI MORTGAGE INSURANCE CO.

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Welcome to 2007

By Mark F. Milner, Chief Risk Officer, PMI Mortgage Insurance Co.

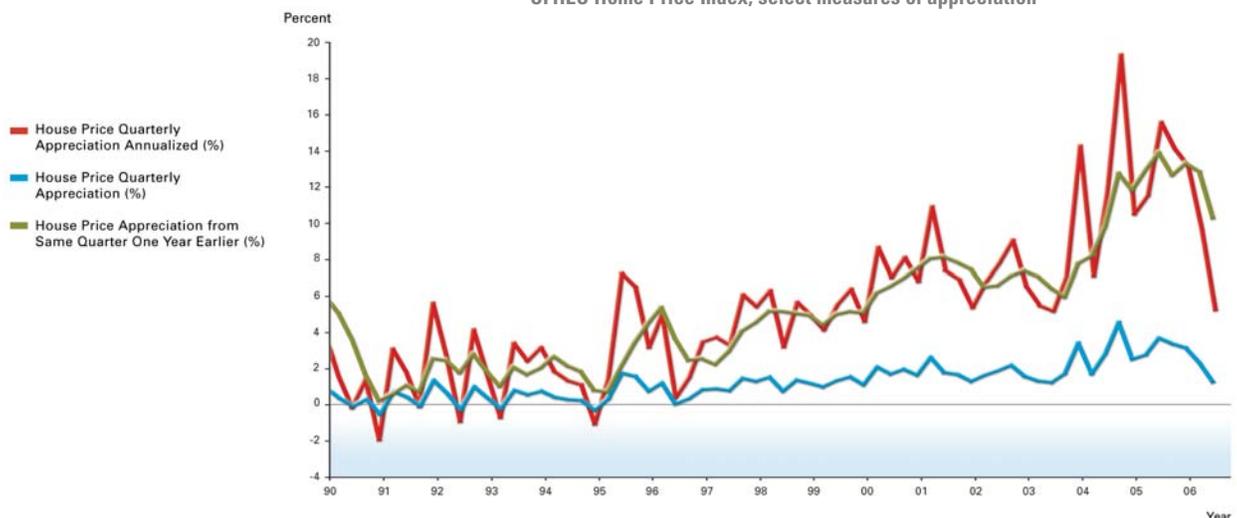
For many people, the beginning of a new year is a time to take stock—of ambitions achieved and dreams yet to be fulfilled. In that spirit, I want to offer some thoughts on where we've been and where we may be headed in 2007.

We began 2006 in an unusual environment of historically low interest rates and record home price appreciation. With prices increasing much faster than incomes in many areas, consumers often turned to nontraditional mortgages, including piggy-back loans (*a first mortgage for 80 percent of the home price and a second mortgage*

that covers the difference between the borrower's down payment and the first mortgage), interest-only loans, and payment option ARMs. These products offered low initial monthly payments in exchange for higher payments down the road, when interest only periods ended, option ARMs reset, or interest rates on seconds increased.

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U.S. Home Price Appreciation
OFHEO Home Price Index, select measures of appreciation





Changing Market *(continued from page 1)*

Today things look quite different. Rates of home price appreciation are slowing, in many cases approaching the historical norm of 4 to 6 percent a year, and in a few cases, slipping into negative territory. Job growth, on the other hand, remains strong, signaling the continued vibrancy of the national economy. In September, federal regulators issued new guidance advising lenders to consider more carefully consumers' ability to repay loans, particularly after resets or increases in monthly payments. Regulatory pressures directed toward exotic mortgages mounted as many state regulators followed suit. Media reports of higher delinquencies, especially among subprime borrowers, combined with uncertainty about just how many borrowers face rate resets in the coming year, are fueling concerns that increases in homeownership rates in recent years may not be sustainable. The year ended with the passage of federal legislation making the cost of mortgage insurance tax deductible for low- and moderate-income borrowers—recognition of the important role mortgage insurance plays in expanding sustainable homeownership.

What does all this mean for 2007? Economist John Kenneth Galbraith once said, *"The only function of economic forecasting is to make astrology look respectable,"* but as I look ahead I do think three things are clear:

- Affordability will continue to be a challenge, at least for the near term. Price appreciation has slowed in many areas and incomes continue to rise. As a result we saw slight improvements in many areas' Affordability IndexSM scores this quarter, the first improvements we've seen for some time. Still, after years of record increases prices are still far ahead of incomes in many areas, and affordability has a ways to go to catch up. We expect appreciation rates to continue to moderate, allowing prices to move back into better alignment with incomes over time.
- Using the traditional model of a 20 percent down payment, buying the national median-priced home, at \$218,000, means saving more than \$40,000—a challenge for many low- and moderate-income borrowers. In high cost areas such as California, where the median home price is more than \$550,000, saving a 20 percent down payment is even more of a challenge. Because the American dream of homeownership is alive and well but home prices remain high, low down payment mortgages will continue to be a significant factor in the marketplace.
- Sustainability will become a greater concern, as the industry focuses not just on getting people into homes, but keeping them there. Finding ways of providing products that offer affordable payments without transferring undue risk to borrowers will ensure that we continue to enjoy a stable, thriving mortgage finance market.

Although most markets are slowing and our Risk Index shows an increase in the risk of declining home prices, housing markets in many areas remain underpinned by strong economic fundamentals, including strong job growth and local unemployment rates that are low by historical standards. At the same time, the U.S. population is at 300 million and growing, and the American dream of homeownership remains a powerful one, attracting diverse believers including new immigrants, minorities, and singles, including increasing numbers of single women. These trends suggest that the U.S. housing market will continue to be active and growing, and that homeownership will continue to be the cornerstone of a long-term, wealth-building strategy. ♦

Local Economic Patterns and MSA Indicators

The U.S. Market Risk IndexSM on pages 4 and 5 ranks the likelihood of home price declines in two years for the nation's 50 largest metropolitan statistical areas (MSAs). The scores use third quarter 2006 house price data from the Office of Federal Housing Enterprise Oversight (OFHEO), employment data from the Bureau of Labor Statistics (BLS), and PMI's proprietary Affordability IndexSM.

The average risk score is 342, indicating a 34.2 percent chance of home price declines in two years. This is a 14-point increase from last quarter, and an 81-point increase from the same quarter a year earlier. This quarter, 19 MSAs have a greater than 50 percent chance of home price declines, up from 18 last quarter and 11 a year ago.

Several trends emerge:

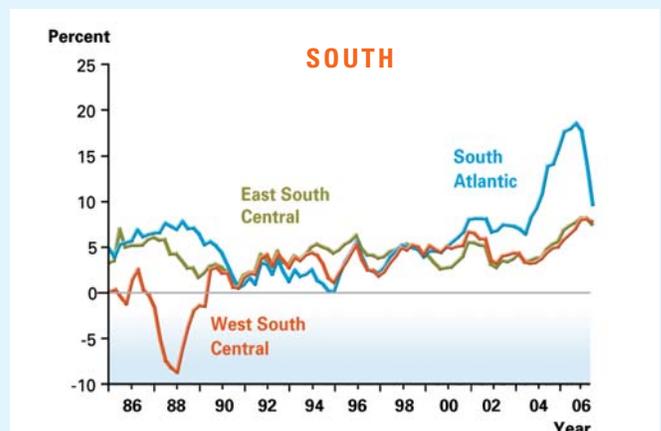
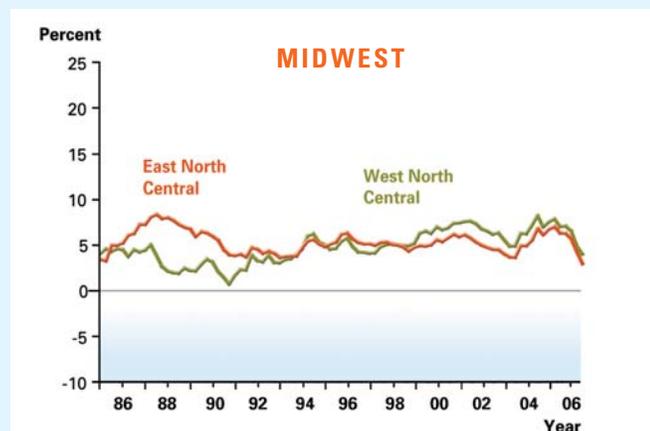
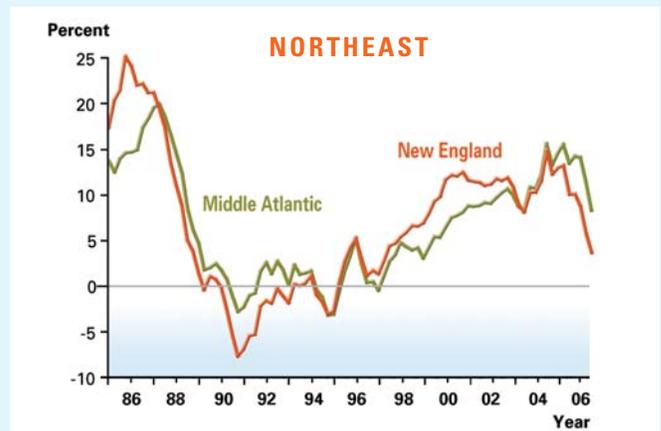
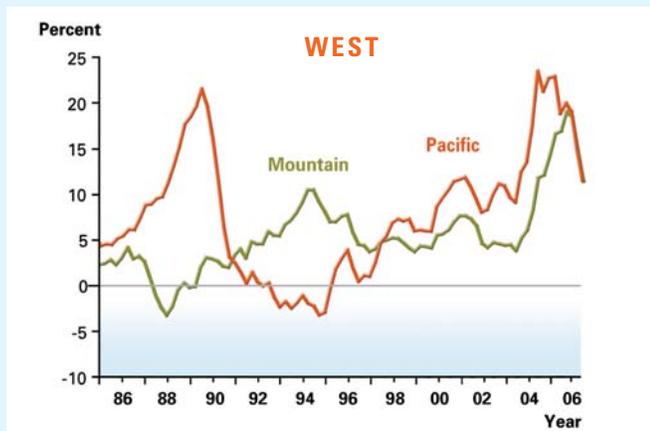
- **Appreciation** – Price appreciation has decelerated in all but seven MSAs; however, 14 MSAs still experienced double-digit appreciation year over year.
- **Affordability** – Affordability Index scores increased in 34 of the 50 largest MSAs, signaling improved affordability.
- **Employment** – Job growth continued to be strong in most MSAs, declining in only four of the top 50.

Years of rapid appreciation have made homes less affordable in many areas. Although home price appreciation in many areas has slowed to a more sustainable pace, affordability has yet to catch up. However, over time moderating appreciation should bring prices back into line with economic fundamentals, particularly incomes.

(continued on page 6)

Regional Home Price Appreciation

by Census Division, percent change over previous four quarters earlier as of third quarter 2006





MSA

MSA	RISK MEASURES		HOME PRICES		
	Risk Index ¹	Appreciation ²		Acceleration ³	
		2004Q3:2005Q3	2005Q3:2006Q3		
Sacramento-Arden-Arcade-Roseville, CA	604	18.45%	1.36%	-17.09%	
San Diego-Carlsbad-San Marcos, CA	603	11.41%	3.16%	-8.25%	
Oakland-Fremont-Hayward, CA (MSAD)	603	19.60%	6.27%	-13.33%	
Santa Ana-Anaheim-Irvine, CA (MSAD)	602	15.51%	10.71%	-4.79%	
Nassau-Suffolk, NY (MSAD)	601	12.33%	6.59%	-5.74%	
Riverside-San Bernardino-Ontario, CA	600	19.01%	13.28%	-5.73%	
Los Angeles-Long Beach-Glendale, CA (MSAD)	597	18.37%	14.83%	-3.54%	
Boston-Quincy, MA (MSAD)	595	7.34%	0.98%	-6.36%	
Providence-New Bedford-Fall River, RI-MA	595	10.56%	3.86%	-6.70%	
San Jose-Sunnyvale-Santa Clara, CA	592	17.72%	8.30%	-9.42%	
San Francisco-San Mateo-Redwood City, CA (MSAD)	588	15.76%	6.54%	-9.22%	
Edison, NJ (MSAD)	586	13.59%	7.86%	-5.73%	
Fort Lauderdale-Pompano Beach-Deerfield Beach, FL (M	579	24.29%	14.88%	-9.41%	
Washington-Arlington-Alexandria, DC-VA-MD-WV (MSAD)	568	20.36%	10.53%	-9.83%	
New York-White Plains-Wayne, NY-NJ (MSAD)	566	13.44%	9.01%	-4.43%	
Cambridge-Newton-Framingham, MA (MSAD)	563	7.44%	-0.26%	-7.70%	
Las Vegas-Paradise, NV	550	13.42%	9.35%	-4.07%	
Newark-Union, NJ-PA (MSAD)	549	12.50%	8.61%	-3.90%	
Miami-Miami Beach-Kendall, FL (MSAD)	535	22.54%	20.00%	-2.54%	
Baltimore-Towson, MD	498	18.52%	12.16%	-6.36%	
Tampa-St. Petersburg-Clearwater, FL	494	20.95%	15.35%	-5.60%	
Virginia Beach-Norfolk-Newport News, VA-NC	491	20.83%	12.82%	-8.01%	
Phoenix-Mesa-Scottsdale, AZ	448	30.58%	15.62%	-14.96%	
Orlando-Kissimmee, FL	447	25.98%	16.87%	-9.11%	
Minneapolis-St. Paul-Bloomington, MN-WI	402	7.42%	2.79%	-4.64%	
Detroit-Livonia-Dearborn, MI (MSAD)	389	2.56%	-2.00%	-4.56%	
Warren-Troy-Farmington Hills, MI (MSAD)	247	3.40%	-1.48%	-4.88%	
Philadelphia, PA (MSAD)	206	12.67%	8.38%	-4.29%	
Portland-Vancouver-Beaverton, OR-WA	197	16.69%	15.78%	-0.92%	
Atlanta-Sandy Springs-Marietta, GA	190	5.70%	3.73%	-1.96%	
Denver-Aurora, CO	188	4.37%	2.27%	-2.11%	
Seattle-Bellevue-Everett, WA (MSAD)	167	14.25%	15.84%	1.58%	
Milwaukee-Waukesha-West Allis, WI	143	8.41%	4.48%	-3.93%	
Chicago-Naperville-Joliet, IL (MSAD)	140	9.24%	7.74%	-1.50%	
St. Louis, MO-IL	137	7.24%	5.35%	-1.89%	
Kansas City, MO-KS	114	5.13%	3.10%	-2.03%	
Austin-Round Rock, TX	107	6.44%	8.41%	1.97%	
New Orleans-Metairie-Kenner, LA	106	7.79%	14.65%	6.86%	
Charlotte-Gastonia-Concord, NC-SC	97	5.17%	7.58%	2.42%	
Nashville-Davidson-Murfreesboro, TN	83	7.46%	8.90%	1.43%	
Houston-Sugar Land-Baytown, TX	82	5.05%	6.01%	0.97%	
Dallas-Plano-Irving, TX (MSAD)	82	4.19%	3.73%	-0.46%	
Cleveland-Elyria-Mentor, OH	78	3.93%	0.01%	-3.92%	
San Antonio, TX	75	6.99%	8.41%	1.42%	
Columbus, OH	74	4.64%	1.96%	-2.68%	
Fort Worth-Arlington, TX (MSAD)	73	4.22%	3.48%	-0.74%	
Cincinnati-Middletown, OH-KY-IN	71	4.56%	2.62%	-1.94%	
Memphis, TN-MS-AR	68	5.63%	2.58%	-3.05%	
Indianapolis-Carmel, IN	64	4.77%	1.63%	-3.14%	
Pittsburgh, PA	62	5.59%	2.57%	-3.01%	

INDICATORS *As of December 2006*

LABOR MARKETS

Employment Growth ⁴	Unemployment Rate 2006Q3	
2005M09:2006M09	Local ⁵	Local De-meaned ⁶
1.81%	4.43%	-0.53%
1.33%	4.10%	-0.41%
2.15%	4.47%	-0.71%
0.97%	3.60%	-0.60%
0.22%	4.07%	-0.09%
2.35%	4.93%	-0.73%
0.97%	5.00%	-1.23%
0.78%	4.94%	0.61%
0.49%	5.48%	0.50%
0.87%	4.73%	-1.42%
1.51%	4.07%	-0.77%
1.68%	4.70%	0.28%
2.98%	3.20%	-1.58%
2.35%	3.30%	-0.25%
1.05%	5.07%	-1.29%
0.78%	4.17%	0.25%
5.38%	4.23%	-0.97%
0.02%	5.30%	0.38%
1.08%	4.23%	-1.61%
0.84%	4.47%	0.06%
2.13%	3.33%	-1.16%
1.51%	3.70%	0.08%
4.97%	3.50%	-0.99%
3.64%	3.17%	-1.24%
2.17%	3.47%	-0.30%
-1.99%	8.90%	2.28%
-1.49%	6.30%	1.37%
0.75%	4.77%	-0.20%
2.75%	5.10%	-1.46%
2.07%	4.60%	0.54%
1.56%	4.67%	-0.01%
4.17%	4.13%	-1.26%
0.95%	5.00%	0.04%
1.25%	4.37%	-1.55%
0.19%	5.07%	0.27%
0.70%	5.10%	0.27%
2.68%	4.13%	-0.47%
8.37%	4.43%	-0.66%
1.56%	4.73%	-0.32%
2.40%	4.30%	0.34%
2.70%	5.10%	-0.43%
2.54%	4.97%	-0.41%
-0.07%	5.30%	0.31%
1.86%	4.83%	-0.17%
0.36%	4.73%	0.47%
2.10%	4.90%	-0.09%
1.05%	5.13%	0.58%
1.14%	6.07%	1.15%
-0.08%	4.57%	0.81%
0.83%	4.73%	-0.43%

AFFORDABILITY

Index ⁷ (1995Q1=100)
68.62
68.82
64.83
61.15
67.16
57.96
57.86
80.52
77.44
67.61
72.70
74.93
56.08
76.52
72.03
89.34
74.21
82.40
58.21
83.91
68.64
84.15
69.77
70.20
86.30
98.58
105.42
93.72
80.91
99.82
102.96
87.76
103.62
94.08
104.15
109.85
114.95
95.43
117.36
111.50
124.65
126.15
121.54
124.43
123.40
131.58
124.87
128.52
131.48
128.00

- The **Market Risk Index score** translates to a percentage that predicts the probability of a house price decline in two years. For example, a Risk Index score of 100 means there is a 10% chance that house prices in that MSA will be lower in two years.
- Appreciation** measures increases in home prices for the previous and current year (*based on quarterly OFHEO HPI*). Research indicates that house price growth is very persistent in the short run: a year of low appreciation is likely followed by another year of low appreciation. Consequently, low or negative appreciation in the past year is a sign of impending trouble. The Risk Index score will thus vary inversely with last year's appreciation.
- Using previous and current year appreciation, **acceleration** measures the change in home price appreciation. For example, consider a metropolitan area where the property value of a typical house was \$100,000 at the end of 2000, \$110,000 in 2001, and \$111,100 in 2002. Home price appreciation for this area is 10% for the year 2001 and 1% for the year 2002. Because the appreciation rate dropped by 9% points from the year 2000 to the year 2001, home price acceleration is minus 9% points at the end of 2002. The model interprets negative home price acceleration (*slowing growth*) as a warning sign that home prices may be close to their peak and likely to fall soon. Accordingly, the Risk Index score increases as home price acceleration declines, other things equal.
- The **employment growth rate** is calculated with Bureau of Labor Statistics total non-agricultural employment monthly observations, from the indicated months (*12-month growth rate*). Lower employment growth is a sign of weakness in the local economy; therefore, the Risk Index score increases as employment growth falls.
- The **local unemployment rate** is calculated with Bureau of Labor Statistics MSA-wide quarterly averages, not seasonally adjusted.
- The **de-meaned unemployment rate** indicates the current unemployment rate compared to its past rate. For example, a de-meaned unemployment rate of 1% for the calendar year 2005 means that the current unemployment rate is 1% higher than the five-year average from 1999 to 2003. The higher the de-meaned unemployment rate, the higher the Risk Index score.
- Using median household income, home price appreciation, and the cost of the 30-year fixed rate mortgage (FRM), PMI's **Affordability Index (AI)** measures the change in home purchasing power over time according to how affordable homes are today compared to 1995. An AI score above 100 means homes are more affordable; a score below 100 means they are less affordable. For example, an AI score of 110 means that if your monthly mortgage payment took 30% of your monthly income in 1995, today it takes only 27% (*a change of 10% based on the original ratio of 30%*). Conversely, an AI score of 90 means that the share of your monthly income taken by your monthly mortgage has increased to 33%. The higher the AI, the less vulnerable a housing market is to local economic shock (and hence the lower is the Risk Index score). The AI score is calculated as $AI_t = (I_t/QI_t)/(I_{95}/QI_{95})$ where subscript t denotes the current quarter, I_t measures household income, and QI_t represents qualifying income index defined as

$$QI_t = HPI \cdot 0.80 \cdot 4 \cdot 12 \cdot \left[\frac{r}{12} \frac{(1 + \frac{r}{12})^{360}}{(1 + \frac{r}{12})^{360} - 1} \right]$$

where r denotes the 30-year FRM, 0.80 is LTV, and $4 \cdot 12 \cdot []$ represents index of the annual mortgage payment under a 25% mortgage payment-to-income threshold.



Local Economic Patterns *(continued from page 3)*

Regional Risk

Of the 19 highest risk MSAs, eight are located in **California**, eight are in the **Northeast**, and two are in **Florida**. **Sacramento, CA** has replaced San Diego, CA as the highest risk MSA among the top 50, with a score of 604. **San Diego** and **Oakland, CA** follow, tied at 603, followed by **Santa Ana, CA** at 602, **Long Island, NY** (Nassau-Suffolk) at 601, and **Riverside, CA** at 600. **Orlando, FL** experienced the greatest increase in risk with a score of 447, up 134 points from last quarter and up 310 from a year ago. Declining affordability has led to increased risk of a price decline despite a very strong economy. The other MSAs with the greatest increases in risk scores were **Phoenix, AZ** and **Tampa, FL** with score increases of 95 and 90 points, respectively. Each of these MSAs faces affordability challenges because of continued high rates of price appreciation. Risk continued to be lowest in the central section of the nation. Of the 22 MSAs scoring below 200, eight are from the **Midwest** and five are from **Texas**.

Appreciation

According to OFHEO, the average home price nationwide appreciated by 7.73 percentage points from Q3'05 to Q3'06, compared to 12.02 percent the prior year. Quarterly appreciation from Q2'06 to Q3'06 was 0.86 percent, down from 2.86 percent the prior quarter. Although home prices did not appreciate as rapidly as in past quarters, 14 MSAs still experienced double-digit year-over-year price appreciation¹. The highest appreciation rate occurred in **Miami, FL** where home prices increased by 20 percent. Despite continuing appreciation in most areas, 21 of the top 50 MSAs experienced appreciation at or below the historic norm of 4 to 6 percent. Three MSAs—**Cambridge, MA**, and **Warren** and **Detroit, MI**—experienced year-over-year price declines.

Deceleration

While homes continued to appreciate across most areas, the rate of appreciation slowed in 43 markets, compared to 41 MSAs last quarter. Six of the 10 areas with the highest rates of deceleration were in the West, with five in California. **Sacramento** led the trend with a 17.1 percentage point drop in year-over-year appreciation, followed by **Phoenix** at 15 percent and **Oakland** at 13.3 percent. Of the 19 MSAs with a greater than 50 percent chance of price declines, 13 have seen appreciation drop into the single digits. The lowest rate of appreciation

among this group was in **Cambridge, MA**, with a year-over-year appreciation rate of -0.26 percent, down from 1.53 percent last quarter.

Economic Strength

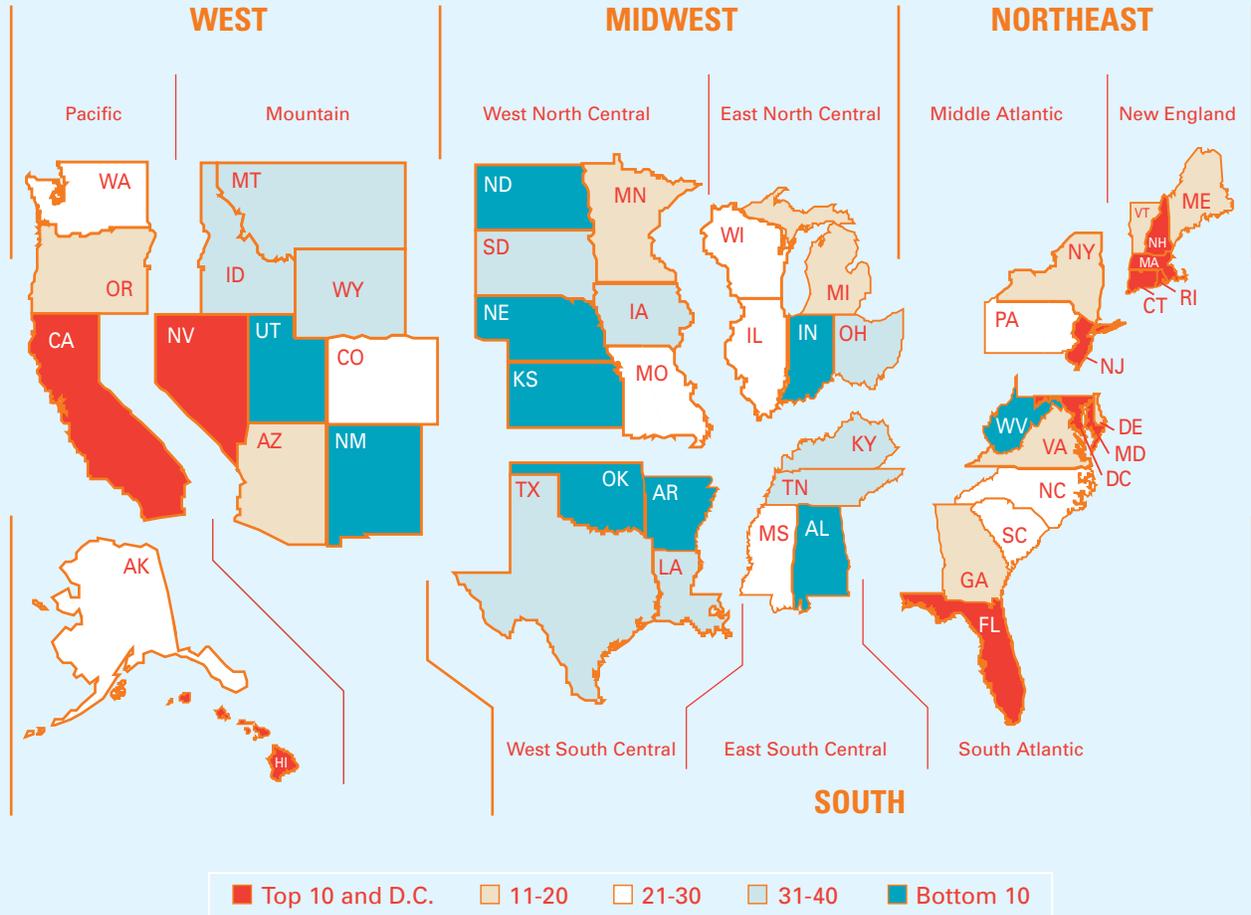
Unemployment remains historically low, with 31 areas experiencing unemployment rates below their long-term average. **Miami** leads this trend with unemployment 1.6 percentage points below its long-term average. Of the 19 areas with unemployment above historical norms, **Detroit** was No. 1 with an unemployment rate that is 2.28 percentage points above its long-term average, followed by **Warren, MI** at 1.37 percentage points and **Memphis, TN** at 1.15 percentage points. Of the top 50, **Orlando** had the lowest unemployment rate at 3.17 percent, which is 1.24 percentage points below the long-term average for that area. Unemployment remains high in the state of **Michigan** as it adjusts to the downsizing of the auto industry, and at 8.9 percent **Detroit** had the highest unemployment rate among the top 50 MSAs, with the neighboring city of **Warren** averaging 6.3 percent. **New Orleans, LA** now leads the nation in job growth, with a growth rate of 8.37 percent, followed by **Las Vegas, NV** at 5.38 percent and **Phoenix** at 4.97 percent.

Affordability

Although affordability remains a challenge, with homes in many MSAs less affordable than they were in the index's baseline year of 1995, slowing rates of appreciation have resulted in improved affordability in 34 MSAs. Twelve areas posted affordability ratings below 70, considered a threshold below which an area is particularly vulnerable to an economic shock, unchanged from last quarter. Of the 19 MSAs with a greater than 50 percent chance of price declines, more than half have affordability ratings below 70. Of this group, **Cambridge** had the best affordability rating at 89.34. The least affordable areas continue to be the same as those posted last quarter — **Fort Lauderdale, FL** (56.08), **Los Angeles, CA** (57.86), **Riverside** (57.96), and **Miami** (58.21). **Fort Lauderdale** has been the least affordable MSA among the top 50 for six consecutive quarters. Among the top 50 MSAs, **Fort Worth, TX** now ranks as the most affordable with a score of 131.58, followed closely by **Indianapolis, IN** (131.48), **Memphis, TN** (128.5), and **Pittsburgh, PA** (128). ♦

¹ OFHEO reports quarterly annualized appreciation while the PMI Risk Index is based on year-over-year appreciation.

Geographic Distribution of HOUSE PRICE RISK



The above U.S. map depicts in color the geographic distribution of house price risk for all 50 U.S. states and the District of Columbia. The color codes rank order the 10 riskiest states in red (11 including the District of Columbia), followed by the next 10 riskiest states in tan, white, light blue, and aqua. Again, the Northeastern states and California top our list, but Florida replaced New York in the top 10. (This presentation is based on the data for 379 MSAs available in the appendix to ERET posted on the publications page of the media center at <http://www.pmigroup.com>.)

TABLE 1: CENSUS REGION RISK INDEX

Division	Risk Index
New England	525
Pacific	508
Middle Atlantic	385
South Atlantic	357
Mountain	264
West North Central	173
East North Central	144
East South Central	78
West South Central	75
Division	Risk Index
West	444
Northeast	421
South	232
Midwest	152

Cautionary Statement: Statements in this document that are not historical facts or that relate to future plans, events or performance are 'forward-looking' statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, PMI's U.S. Market Risk Index and any related discussion, and statements relating to future economic and housing market conditions. Forward-looking statements are subject to a number of risks and uncertainties including, but not limited to, the following factors: changes in economic conditions, economic recession or slowdowns, adverse changes in consumer confidence, declining housing values, higher unemployment, deteriorating borrower credit, changes in interest rates, the effects of natural disasters, or a combination of these factors. Readers are cautioned that any statements with respect to future economic and housing market conditions are based upon current economic conditions and, therefore, are inherently uncertain and highly subject to changes in the factors enumerated above. Other risk and uncertainties are discussed in the Company's filings with the Securities and Exchange Commission, including our report on Form 10-K for the year ended December 31, 2005 and Form 10-Q for the quarter ended September 30, 2006.

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METROPOLITAN AREA ECONOMIC INDICATORS STATISTICAL MODEL OVERVIEW

The U.S. Market Risk Index is based on the results of applying a statistical model to data on local economic conditions, income, and interest rates, as well as judgmental adjustments in order to reflect information that goes beyond the Risk Index's quantitative scope. For each Metropolitan Statistical Area (MSA) or Metropolitan Statistical Area Division (MSAD), the statistical model estimates the probability that an index of metropolitan-area-wide home prices will decline in two years (eight quarters), with an index value of 100 implying a 10% probability of falling house prices.

The Risk Index uses information on past house price growth and variables measuring local employment and unemployment, as well as local income measures and interest rates. The Risk Index is determined by the following variables: (i) Home Price Appreciation, (ii) Home Price Acceleration, (iii) Employment Growth, (iv) the De-measured Unemployment Rate, which we define as the difference of the local Unemployment Rate from its average in recent years, and (v) PMI's proprietary Affordability Index.

Home prices are measured with a Repeat Sales Index provided by the Office of Federal Housing Enterprise Oversight (OFHEO). This method follows homes that are sold repeatedly over the observation period and uses the change in the purchase prices to construct a price index. The index is based on data from Fannie Mae and Freddie Mac and covers only homes financed with loans securitized by these two companies. Consequently, this index does not apply to high-end properties requiring jumbo loans.

Periodically, we may re-estimate our model to update the statistical parameters with the latest available data. We also may make adjustments from time to time to account for general macroeconomic developments that are not captured by our model.

Please contact your PMI representative for more information or printed versions.

The ERET report is produced quarterly.

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