

THE HOUSING & MORTGAGE MARKET REVIEW



PMI'S MONTHLY ANALYSIS OF ECONOMIC, HOUSING, AND MORTGAGE MARKET CONDITIONS

ISSUE 8 | VOLUME 1 | Sep 2008

Inside this Issue

- The Outlook
- Special Topic: Effective Affordability has Been Less than Measured Affordability
- Housing Market Indicators
- Mortgage Market Indicators
- Regional Roundup
- Region in Focus: The Midwest
- The PMI Forecast

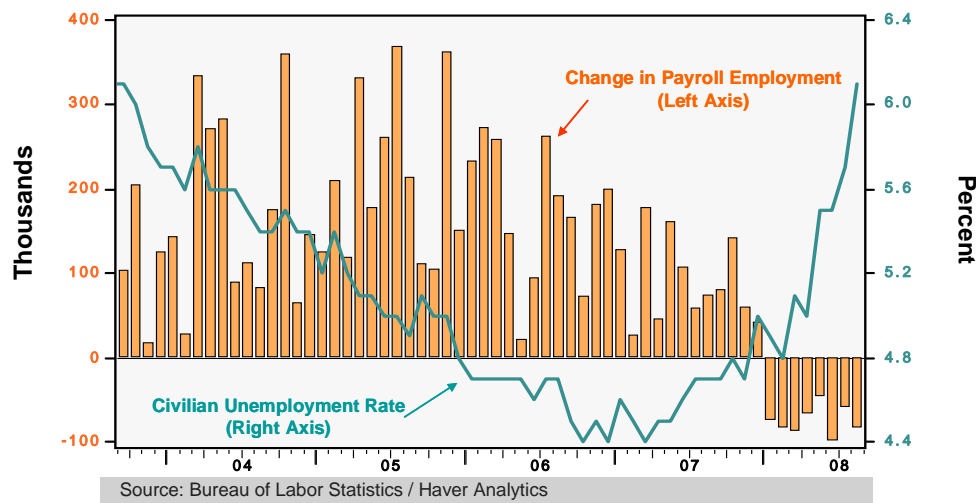
The Outlook

By David W. Berson, Ph.D., Chief Economist and Strategist

It's a brave new world in financial, housing, and mortgage markets in the U.S. in the wake of the government's move to put Fannie Mae and Freddie Mac (the GSEs) into conservatorship (plus breaking news on Lehman Brothers, Merrill Lynch, and AIG as this report was being finished). From our perspective, the most important element of this move is the impact it will have on the housing and mortgage markets.

In the near-term the effects will be positive, as the GSEs will be able to provide more liquidity to the mortgage market than they could prior to the government's move. Moreover, the combination of a more explicit guarantee of GSE debt and mortgage-backed securities (MBS), as well as the ability for the Treasury Department to purchase that MBS directly, has increased the overall demand for mortgage securities and pushed mortgage rates down. *(Continued on page 2)*

Figure 1: The Job Market is Weakening Still More



Special Topic: Effective Affordability has been Less than Measured Affordability

By LaVaughn M. Henry, Ph.D., Director, U.S. Economic Analysis

The National Association of Realtors (NAR) publishes a monthly Housing Affordability Index, which is an accurate reflection (at the time of home purchase) of the ability of a family earning the median income to afford a median-priced home. When the index is greater than 100, the family can afford a median-priced house. When it is less than 100, it can't. If, for example, the index were 120, then a family earning the median income would have 20 percent more income than necessary to qualify for the median-priced home. If, instead, the index were 90.0, then that same family would have only 90 percent of the income necessary to qualify for that median-priced home. *(Continued on page 12)*



The Outlook (continued from page 1)

Yields on conventional conforming 30-year fixed-rate mortgages (FRMs) have dropped by 30-50 basis points in the past few days. The net effect of all of this should be to strengthen housing demand, directly as a result of lower mortgage rates and perhaps indirectly by boosting homebuyer confidence.

We think, however, that the magnitude of this boost to the market will be modest, as the problems facing the housing market were not primarily interest rate related. To be sure, lower interest rates will make housing more affordable and will also allow more existing homeowners to refinance their current mortgage loans. But the run-up in house prices to unsustainably high levels still hasn't been completely reversed and unsold inventories remain at historically high levels.

As a result of this move, we have boosted our projection for home sales in our latest forecast, and reduced the future projected declines in house prices slightly. The impact could have been greater, but the weakening job market may offset much of the benefit of the moves surrounding the GSEs.

Nonfarm payroll employment fell for the eighth straight month in August, dropping by 84,000 (see Figure 1). Additionally, June's decline was revised upward to 100,000, the biggest drop since March 2003. A total of 605,000 jobs have been lost this year. Shockingly, the unemployment rate in August spiked to 6.1 percent, up from 5.7 percent a month earlier and only 4.7 percent a year ago. Sometimes there are unexpected movements in the unemployment rate that are mostly reversed in subsequent months, and that might be the case here since the jump was so big. But if most, or all, of the August increase in the unemployment rate remains, then it will be clear that the job market has weakened further. This would increase the chances that the economy is in recession.

Other economic news isn't nearly as bad, although in total it's certainly not good. Surveys of consumer and business confidence all improved last month, although they remain at levels consistent with economic downturns. The University of Michigan's index of consumer sentiment jumped to 73.1 in mid-September,

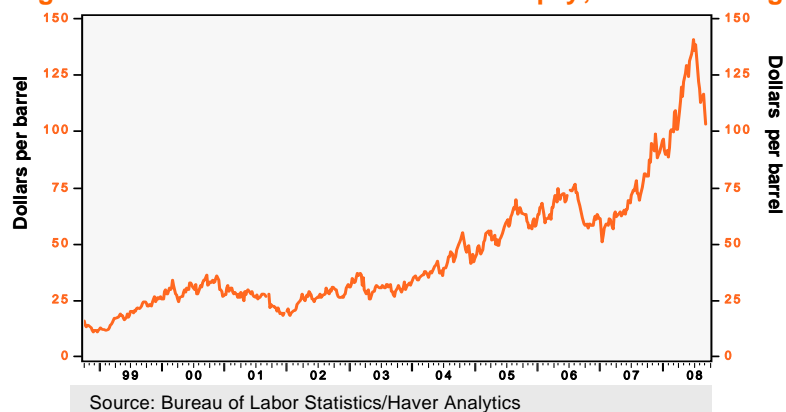
the highest reading in eight months, while the Conference Board's consumer confidence index rose to a three-month high of 56.9 in August. The National Federation of Independent Business (NFIB) small business confidence index edged up to 91.1 in August (its highest level since April.) While the increases in confidence are good news, they need to be sustained for a while in order for fears of an economic downturn to be reduced.

It's likely that the increase in consumer confidence is tied to the ongoing declines in energy prices. At their peak in early July, oil prices briefly rose to over \$150 per barrel. As this report was being written, they had fallen to around \$100 per barrel, a reduction of nearly one-third (see Figure 2). Of course, a year ago prices were around \$75 per barrel, so oil is far from cheap. We continue to expect oil prices to fall into a range of \$80-100 per barrel over the course of the next year, in the absence of a natural or man-made disaster. Unless the job picture gets much worse, this should be positive for consumer and business confidence. It will also be positive for inflation, as much of the jump in overall inflation that occurred in the first half of the year would be unwound. More importantly, the drop in energy prices, combined with strong productivity growth and a looser labor market, should allow core inflation to edge down. We anticipate core inflation to fall below the top of the Fed's target range of around 2.0 percent.

Another piece of positive economic news is that business capital spending continues to be strong. Orders for non-defense capital goods (excluding the volatile aircraft sector) were up by 2.5 percent in August and by 6.6 percent from a year earlier. Shipments of these goods also climbed strongly, up by 1.6 percent in August and by 5.6 percent from a year ago. These hefty figures show that businesses continue to spend on productivity and production enhancing capital goods. This will help boost the economy now and will also help U.S. firms compete in international markets. This has already had a significant impact on trade, with real net exports at their strongest levels in eight years. Real GDP growth would have been essentially flat were it not for the boost in net exports, which helped revised real GDP to grow at a 3.3 percent annualized rate in the second quarter.

(Continued on page 3)

Figure 2: Oil Prices are Down Sharply, but Still High





The Outlook *(continued from page 2)*

For the remainder of 2008, we expect very slow economic growth, as the job losses and past energy price hikes work their way fully into consumer spending. It is possible that with the impact of the fiscal stimulus ebbing, there could be a quarter – maybe two – of negative real GDP growth. We project a modest pickup in the economy in 2009, as lower energy prices, the end of the housing downturn, and a probable second fiscal stimulus bill combine to boost growth, especially in the second half of next year.

Housing: New home sales rose by 2.4 percent in July to 515 thousand units (seasonally adjusted annual rate, or SAAR), taking into account some substantial downward revisions to recent data. Over the past four months, new sales have been relatively stable at a little above June's level. Existing sales climbed by 3.1 percent to 5.00 million units (SAAR) in July, little changed over the past 10 months.

Despite the leveling-out of home sales, leading indicators of sales are mixed. The National Association of Realtors' pending home sales index fell by 3.2 percent in July, suggesting a downward move in August's actual sales when they are reported later this month. On the other hand, purchase activity in the Mortgage Bankers Association's (MBA) weekly applications survey has risen sharply over the past two weeks, and is at the highest level in three months. If the purchase applications remain at these levels, it would suggest that the stable home sales over the past several months are not illusory. Moreover, if purchase applications continue to increase, then the bottom in home sales may have been reached and modest increases could occur. Because this is a weekly survey with significant volatility, a longer-term trend in the survey results is necessary to determine whether movements are real or are just statistical noise.

The inventory situation for new homes continues to improve, with the actual level of inventories at the lowest level in nearly four years. The inventory-sales ratio fell to 10.1 months in July, which is still high, but is at least moving in the right direction. Existing home inventories, on the other hand, continue to rise, perhaps as more foreclosed units are put back on the market for resale. Both the number of units on the market and the inventory-sales ratio climbed to new all-time highs in July. This remains a significant negative for house prices.

For the remainder of 2008, we expect little change in home sales as the lower mortgage rates from the GSE situation encourage a bit more buying. In addition, foreclosure sales should continue to increase. Both of these things should roughly offset the negative impact of a worsening job market. Housing starts are expected to fall further over the rest of this year, as new home inventories are still too high. We project a modest pickup in sales for 2009, with starts finally bottoming next year. National home prices are forecast to fall further this year and next, but the worst national price drops are probably behind us as home price declines appear to be flattening out.

Interest Rates and Financial Markets: The biggest

news here is the activity surrounding the GSEs, which has caused mortgage rates to drop sharply. This should be a one-time event, however, so further declines are unlikely unless the economy worsens appreciably. The Federal Reserve continues to find itself in a very difficult position as it attempts to combat financial market disarray, rising inflation, and slower economic growth simultaneously. Fortunately, the decline in energy prices and continued strong productivity gains should allow both total and core inflation to decline in coming months. The Fed has kept monetary policy unchanged for more than four months, after bringing the federal funds rate down by 325 basis points from September 2007. A year ago the federal funds rate was 5.25 percent.

For the rest of 2008, the Fed will keep its actions centered on smoothing financial market disarray and on the potential for an economic downturn. In response to the most recent turmoil surrounding Lehman, Merrill, and AIG the Fed has expanded its special lending facilities and the odds of additional Fed easing have climbed to more than 50 percent. Once the Fed is more certain that economic growth is accelerating and the financial problems weighing on the economy have passed, we expect that it will begin a long process of tightening monetary policy to bring it back to neutral (with an ultimate federal funds rate of 4-5 percent). This tightening is projected to begin in the first half of 2009, although it might not be until later next year. Long-term interest rates should move upward in 2009 as well, although continued low core inflation should make that increase modest.

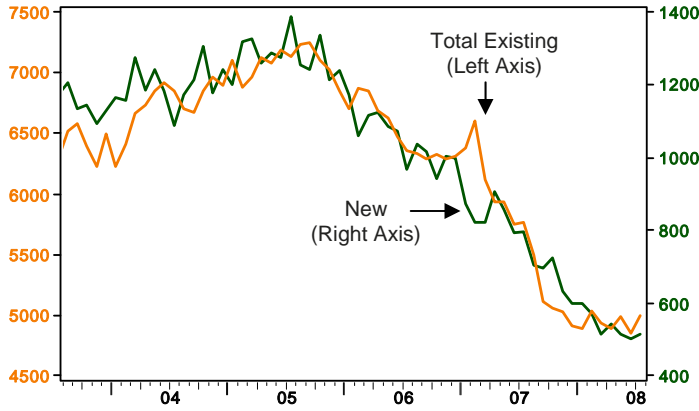
Mortgage Markets: Over the course of 2008, the share of originations going to the FHA/VA, Fannie Mae, and Freddie Mac has climbed sharply, perhaps to 90 percent of the total market. The increase in loan limits for high-cost regions is one of the reasons for this increase, as higher cost areas of the country were usually out of bounds for these organizations. In addition, the jump in jumbo mortgage rates compared with conforming rates (even the new jumbo-conforming rates), which has been a by-product of the financial disarray of the past year, has greatly reduced jumbo mortgage lending. Finally, the subprime market has shrunk significantly and the Alt-A market has almost disappeared. Interestingly, over the past couple of months, the FHA/VA share has soared, in part in response to the troubles of the GSEs. Reports from large mortgage lenders suggest the government-insured share rose to around 50 percent of the total market in August. This will likely fall in coming months, as the GSEs will be better able to participate in the market with their new Treasury backstops. Still, the combined government and GSE share of the market is likely to stay historically high for a while.

For 2008, we expect that total mortgage originations will fall to around \$1.94 trillion, with the refinance share at approximately 48 percent. The ARM share should average only around 8 percent in 2008. For 2009, originations are projected to slip a bit more to around \$1.85 trillion, but there should be a further shift away from refinancings toward purchase activity while the ARM share edges up a tad.



Housing Market Indicators

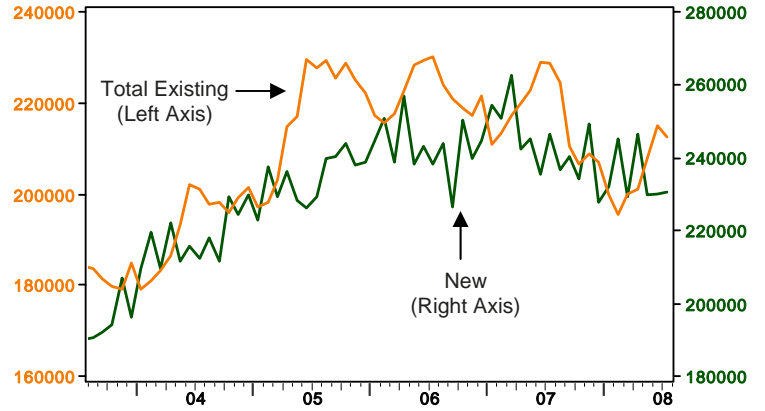
HOME SALES (THOUSANDS OF UNITS)



Source: National Association of Realtors, Census Bureau/Haver Analytics

% Change	Existing	New
Jul-07 to Jul-08	-13.19	-35.30
Jun-08 to Jul-08	3.09	2.39

MEDIAN HOME PRICES (\$)



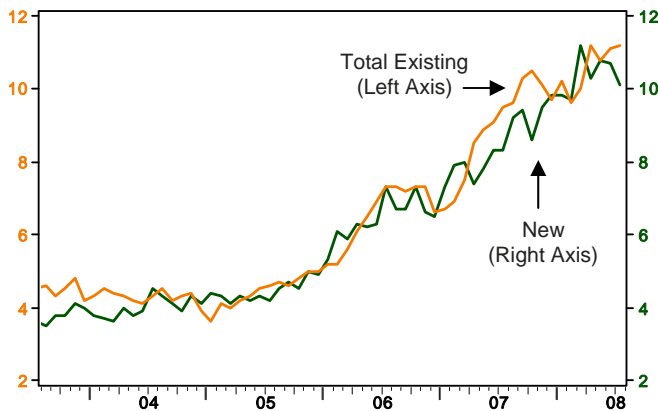
Source: National Association of Realtors/Haver Analytics

% Change	Existing	New
Jul-07 to Jul-08	-7.09	-6.30
Jun-08 to Jul-08	-1.26	0.26

NOTES:

- Total home sales have been fairly flat for most of 2008.
- The sharp second quarter rise in median existing home prices was mostly seasonal in nature – these prices should fall again over the remainder of the year.
- The inventory of unsold homes remains excessive, putting continued downward pressure on house prices.

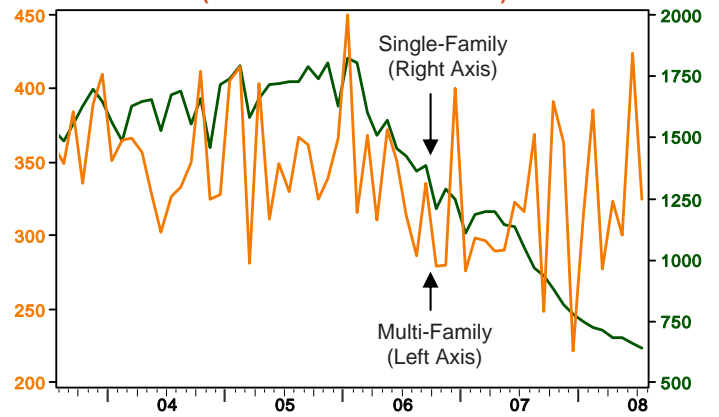
MONTHS' SUPPLY OF HOMES



Source: National Association of Realtors, Census Bureau/Haver Analytics

	Existing	New
July 2007	9.5	8.3
July 2008	11.2	10.1

HOUSING STARTS (THOUSANDS OF UNITS)



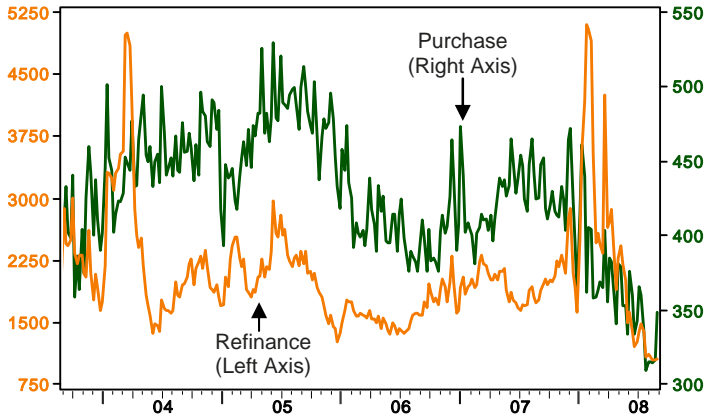
Source: U.S. Census Bureau/Haver Analytics

% Change	Single Family	Multi Family
Jul-07 to Jul-08	-39.24	2.53
Jun-08 to Jul-08	-2.88	-23.58



Mortgage Market Indicators

MORTGAGE APPLICATIONS (INDEX: MARCH 16, 1990 = 100)



Source: Mortgage Bankers Association/Haver Analytics

% Change	Purchase	Refinance
Aug-07 to Aug-08	-27.0	-41.6
Jul-08 to Aug-08	-6.1	-19.9

MORTGAGE RATES (%)



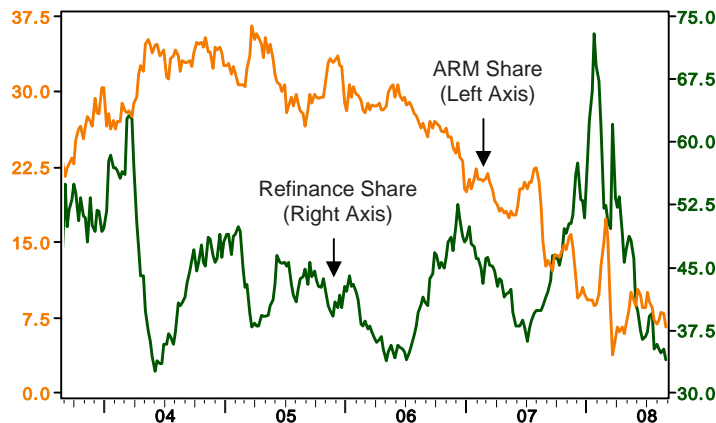
Source: Federal Home Loan Mortgage Corporation/Haver Analytics

	30-Year Fixed	1-Year Adjustable
August 2007	6.57	5.67
August 2008	6.49	5.26

NOTES:

- Purchase applications have jumped over the past couple of weeks, but it is uncertain if that will be sustained.
- Yields on 30-year fixed-rate mortgages (FRMs) have plummeted to under 6.0 percent in just the past few days.
- The drop in FRM rates should boost refinance activity, while keeping the ARM share depressed.

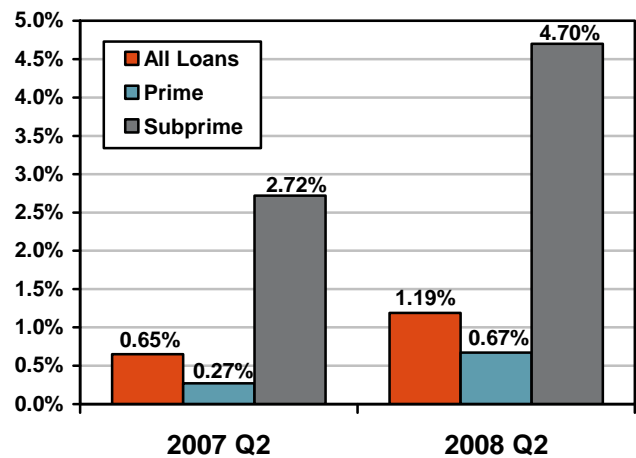
REFI/ARM SHARES (%)



Source: Mortgage Bankers Association/Haver Analytics

	Refinance	ARM
August 2007	40.3	17.9
August 2008	35.0	7.3

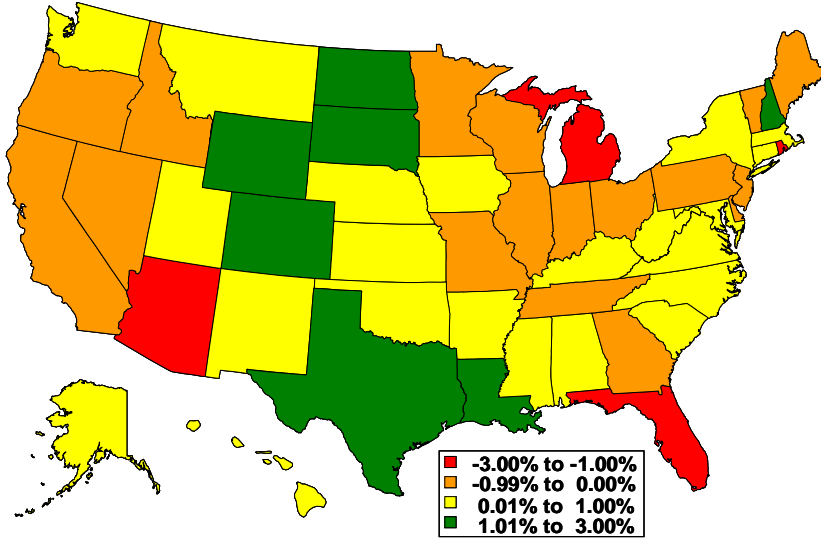
PERCENT OF MORTGAGES: FORECLOSURES STARTED



Source: Mortgage Bankers Association/Haver Analytics



12-MONTH CHANGE IN PAYROLL EMPLOYMENT JULY 2008



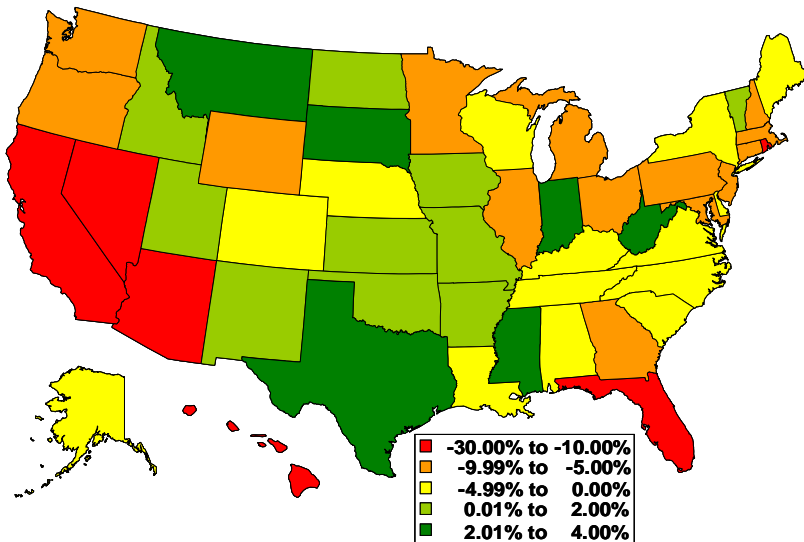
Rhode Island	-2.63%	Kansas	0.31%
Arizona	-1.55%	Connecticut	0.33%
Florida	-1.21%	Massachusetts	0.36%
Michigan	-1.14%	Utah	0.42%
Nevada	-0.63%	Arkansas	0.44%
Idaho	-0.58%	Iowa	0.45%
Indiana	-0.55%	West Virginia	0.46%
Missouri	-0.53%	Alabama	0.47%
California	-0.50%	Virginia	0.49%
Tennessee	-0.48%	Montana	0.51%
Wisconsin	-0.36%	New Mexico	0.72%
Georgia	-0.34%	Washington	0.80%
Ohio	-0.25%	Alaska	0.92%
Vermont	-0.23%	North Carolina	0.93%
Minnesota	-0.18%	Nebraska	0.93%
Oregon	-0.16%	Oklahoma	0.94%
New Jersey	-0.15%	Kentucky	0.95%
Delaware	-0.14%	Maryland	0.99%
Maine	-0.13%	North Dakota	1.09%
Pennsylvania	-0.01%	New Hampshire	1.16%
Illinois	0.00%	Colorado	1.32%
Hawaii	0.03%	South Dakota	1.52%
Mississippi	0.07%	Louisiana	1.56%
United States	0.14%	Wyoming	2.22%
New York	0.17%	District of Columbia	2.27%
South Carolina	0.21%	Texas	2.40%

Source: Bureau of Labor Statistics / Haver Analytics

NOTES:

- The number of jobs has fallen in 20 states over the past year, and it is barely up nationally.
- There is a strong correlation between weak job markets and house price declines, with some notable exceptions (New Hampshire, Maryland).
- There is no national house price decline (with 16 states up from last year), but some sharp declines in a number of specific states pulling the national average down.

12-MONTH GROWTH IN HOUSE PRICES JULY 2008



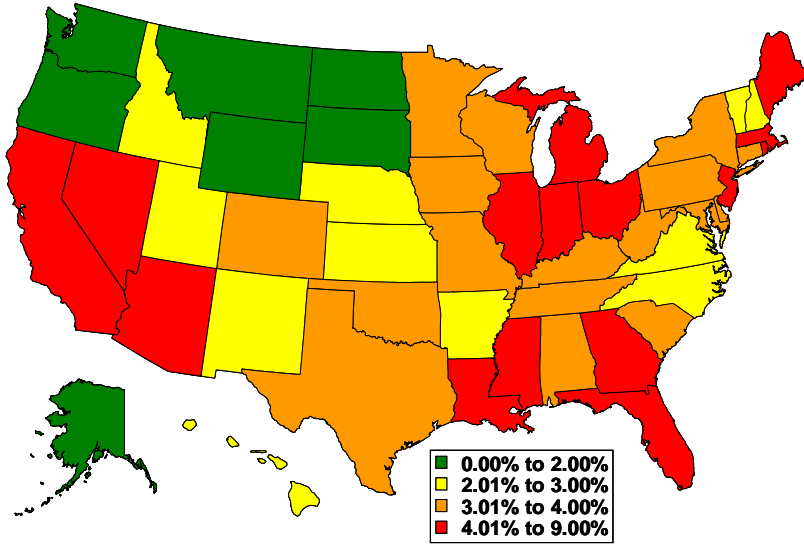
California	-29.00%	Colorado	-2.42%
Nevada	-23.96%	Tennessee	-2.21%
Arizona	-20.15%	Nebraska	-2.13%
Florida	-17.57%	Maine	-1.98%
Hawaii	-15.83%	Delaware	-1.54%
Rhode Island	-12.50%	Alaska	-0.80%
United States	-10.93%	South Carolina	-0.65%
Maryland	-9.21%	Kentucky	-0.32%
Minnesota	-9.17%	Louisiana	-0.13%
New Hampshire	-8.59%	North Carolina	-0.12%
Wyoming	-8.40%	North Dakota	0.16%
Michigan	-8.36%	Idaho	0.57%
Massachusetts	-7.38%	Arkansas	0.90%
Washington	-7.33%	Missouri	0.95%
New Jersey	-7.04%	Kansas	1.02%
Ohio	-6.65%	Iowa	1.04%
Georgia	-6.28%	Utah	1.18%
Pennsylvania	-5.78%	New Mexico	1.26%
Connecticut	-5.69%	Vermont	1.27%
District of Columbia	-5.55%	Oklahoma	1.89%
Illinois	-5.53%	Indiana	2.03%
Oregon	-5.30%	Montana	2.66%
Virginia	-4.54%	Mississippi	2.74%
Wisconsin	-4.15%	South Dakota	3.00%
New York	-3.65%	Texas	3.21%
Alabama	-3.36%	West Virginia	3.31%

Source: First American CoreLogic, LoanPerformance HPI



Regional Roundup

SERIOUSLY DELINQUENT MORTGAGE LOANS 2ND QUARTER 2008



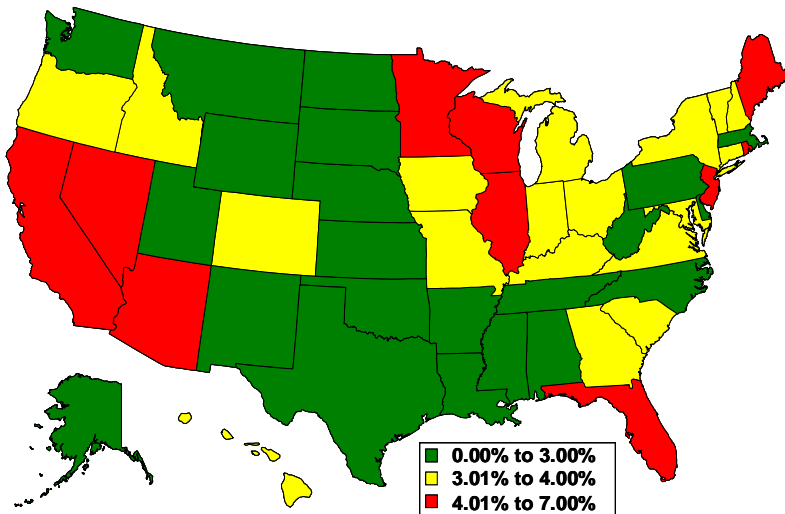
Wyoming	1.10%	Oklahoma	3.43%
North Dakota	1.33%	Colorado	3.45%
Montana	1.47%	South Carolina	3.47%
Alaska	1.68%	Maryland	3.49%
South Dakota	1.84%	Pennsylvania	3.50%
Washington	1.84%	New York	3.63%
Oregon	1.92%	Tennessee	3.65%
Utah	2.15%	Wisconsin	3.73%
Idaho	2.22%	Minnesota	3.94%
Hawaii	2.28%	Kentucky	3.99%
Vermont	2.30%	Massachusetts	4.00%
New Mexico	2.36%	Louisiana	4.05%
Nebraska	2.64%	New Jersey	4.08%
North Carolina	2.69%	Maine	4.19%
Arkansas	2.74%	Georgia	4.35%
District of Columbia	2.76%	United States	4.50%
Virginia	2.79%	Illinois	4.66%
Kansas	2.81%	Rhode Island	4.73%
New Hampshire	2.83%	Mississippi	4.96%
Iowa	3.06%	Arizona	5.03%
West Virginia	3.07%	Indiana	5.74%
Connecticut	3.08%	California	5.95%
Missouri	3.09%	Ohio	5.98%
Texas	3.11%	Michigan	6.15%
Alabama	3.23%	Nevada	7.61%
Delaware	3.31%	Florida	8.43%

Source: Mortgage Bankers Association / Haver Analytics

NOTES:

- Serious delinquency rates for all mortgage loans have climbed significantly over the past year.
- Delinquency rates tend to be highest in states with the weakest job growth and/or largest house price declines.
- Seven states account for the lion's share of subprime foreclosures started.

SUBPRIME MORTGAGE FORECLOSURES STARTED 2ND QUARTER 2008



Alaska	1.46%	Hawaii	3.17%
Wyoming	1.69%	Colorado	3.36%
Louisiana	2.40%	Kentucky	3.37%
West Virginia	2.49%	Idaho	3.39%
Texas	2.50%	Georgia	3.46%
Arkansas	2.53%	Maryland	3.50%
Pennsylvania	2.58%	New Hampshire	3.53%
Montana	2.59%	Iowa	3.59%
Tennessee	2.60%	Vermont	3.66%
Alabama	2.63%	Connecticut	3.72%
North Carolina	2.63%	Virginia	3.77%
Oklahoma	2.66%	Indiana	3.79%
South Dakota	2.74%	Ohio	3.86%
Massachusetts	2.76%	Michigan	3.96%
New Mexico	2.78%	Maine	4.19%
Delaware	2.89%	New Jersey	4.21%
Kansas	2.89%	Wisconsin	4.22%
Nebraska	2.90%	District of Columbia	4.24%
North Dakota	2.91%	United States	4.26%
Mississippi	2.93%	Illinois	4.36%
Washington	2.94%	Minnesota	4.54%
Utah	2.97%	Rhode Island	5.59%
New York	3.02%	Arizona	5.92%
Oregon	3.02%	Nevada	6.59%
South Carolina	3.03%	Florida	6.64%
Missouri	3.08%	California	6.72%

Source: Mortgage Bankers Association / Haver Analytics



REGION IN FOCUS

*The Midwest region includes IL, IN, IA, KS, MI, MN, MO, NE, ND, OH, SD, and WI

**All Region in Focus graphs contain data gathered from BLS, OFHEO, and MBA.

Region in Focus: The Midwest

The economic conditions in the Midwest region continue to weaken with two of the region's states, Michigan and Ohio, mired in recession. In general, the economic fortune of the region differs between the two broad sub-regions: the Great Lakes and the Great Plains.

The economy in the Great Lakes region has a very large industrial sector that is in decline. That decline has resulted in continuing job losses and weakness in the housing market. The economy in the Great Plains region is highly dependent on agricultural production and service provision and those areas remain strong, relative to the rest of the Midwest.

In July, the unemployment rate in the Midwest region was significantly higher than the national average. The region's unemployment rate jumped to 6.5 percent, up from 5.2 percent a year earlier. The national average increased from 4.7 to 5.7 percent over the same period.

The declines in home sales and new construction have been consistent in both sub-regions. According to Moody's Economy.com, existing and new home sales in the Midwest declined by 18 percent and 41 percent, respectively, between June 2007 and June 2008. House prices, however, have been more resistant to decline, mostly because the Midwest did not fully participate in the national home price boom and, therefore, has less to correct. Prices have fallen significantly over a long period in the heavily industrialized states of Michigan and Ohio, which has made them two of the weakest housing and credit markets in the country. In contrast, price growth is marginally positive in many MSAs in the Great Plains sub-region, and credit conditions there remain superior to the national average.

Kansas

The prospects for Kansas' long-term economic growth remain positive but growth has slowed substantially in recent months. Growth in employment, output, and retail sales has stalled as the national economy has slowed. The retrenchment in house price growth, as personal incomes have continued to increase, has helped to improve affordability across the state and made it a more attractive destination for in-migration.

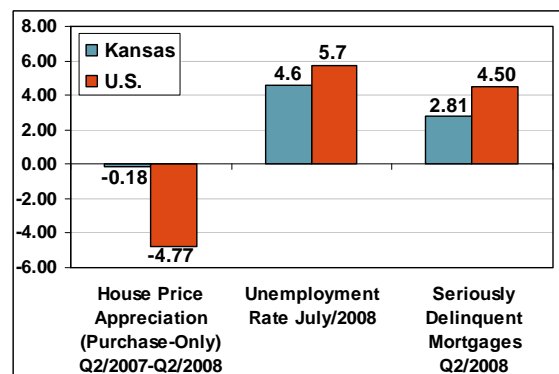
The state's unemployment rate continues to outperform the rest of the nation. In July the unemployment rate averaged 4.6 percent in Kansas, 1.1 percentage points below the national average. In the state's largest MSA, Wichita, the unemployment rate remained low at 4.9 percent, only slightly above its July 2007 showing of 4.4 percent.

In spite of the state's relatively strong general economy, however, the housing market continues to see declines in home sales and prices. According to Moody's Economy.com, home sales in the state declined by 14.9 percent between the second quarter of 2007 and 2008. This compares with a national decline for the same period of 15.1 percent. In the Wichita MSA, home sales declined by 2.8 percent. According to the Office of Federal Housing Enterprise Oversight's (OFHEO) purchase-only Home Price Index (HPI), seasonal factors helped the state's house prices grow by a strong 8.9 percent compound annualized rate during the second quarter. Prices did decline by 0.2 percent between the second quarters of 2007 and 2008. In the Wichita MSA, according to OFHEO's all-transactions price index, seasonal factors

helped prices rise at an annual rate of 4.1 percent in the second quarter and by 2.1 percent between the second quarter of 2007 and 2008.

Credit quality in Kansas is well above the national average. According to the Mortgage Bankers Association (MBA), 0.63 percent of all mortgage loans in the Kansas entered the foreclosure process during the second quarter of 2008; below the national average of 1.08. Loans rated as seriously delinquent (those that are delinquent 90 days or more, plus the foreclosure inventory) totaled 2.81 percent in the second quarter, which was also below the national average of 4.50 percent. The state's subprime market is also outperforming the national average. At the end of the second quarter of 2008, 16.45 percent of all subprime loans were past due while 12.09 percent were seriously delinquent. This compares with national averages of 18.21 and 17.85 percent, respectively.

(Continued on page 9)





Region in Focus: The Midwest

Ohio

Ohio's economy is contracting faster than the regional average. The majority of job losses have been in the manufacturing, construction, and housing sectors. The only source of payroll growth has been in the healthcare industry. The major source of decline in the relatively higher-paying manufacturing sector has been the prolonged contraction in the state's auto manufacturing industry. Over the past ten years, more than 40 percent of all manufacturing jobs in the state have disappeared. This is most apparent in the heavily industrialized cities of Toledo and Cleveland, but the effects have permeated throughout the state and across a broad array of related industries. The near-term outlook is for more of the same. The state's labor market remains weak, with the July unemployment rate at 7.2 percent, significantly above the national average of 5.7 percent.

Unemployment has risen across the state. The unemployment rate in the state's largest MSA, Cleveland-Elyria-Mentor, rose to 7.2 percent in July, up from 6.1 percent a year earlier. This is far from the worst employment performance in the state, however. Toledo had an 8.9 percent unemployment rate in July, up from 7.2 percent a year earlier. Lima (8.6 percent), Mansfield (8.2 percent), Sandusky (7.9 percent) and Youngstown-Warren (7.8 percent) followed closely. The lowest unemployment rate among the state's large MSAs was 6.1 percent in the state capital of Columbus. This is still 1.3 percentage points above Columbus' levels one year earlier and 0.4 percentage points above the current national average.

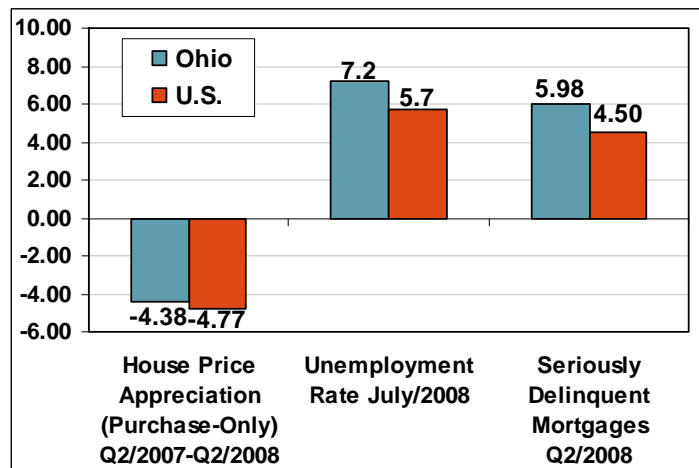
According to Moody's Economy.com, existing home sales in the state declined by 8.9 percent between the second quarters of 2007

and 2008. This was better than the Midwest region as a whole, which had a 16.4 percent decline. The Cleveland-Elyria-Mentor MSA had a 13.2 percent decline over this period. The growing credit crunch has also had a significant impact on this housing market. Tightened lending standards have made it more difficult for potential homeowners to qualify for loans, reducing the likelihood of renewed growth in the short-run.

According to data from OFHEO's purchase-only HPI's, home prices in the state declined by 4.4 percent between the second quarter of 2007 and the second quarter of 2008. The national decline in the same period was 4.8 percent. The state's 5.3 percent compound annualized HPI growth rate during the second quarter came primarily from seasonal factors.

As with most areas of the nation, credit quality in Ohio continues to be a concern. The rate of foreclosures started in the state was 1.19 percent (non-seasonally adjusted) during the second quarter; slightly higher than the national average of 1.08 percent. The delinquency rate on all loans in Ohio was 7.17 percent, which is also higher than the national average of 6.22 percent. According to the MBA, loans rated as seriously delinquent totaled 5.98 percent in the second quarter. For the nation, this measured 4.50 percent. At the end of the second quarter of 2008, 18.28 percent of all subprime loans were past due, while 20.29 percent were seriously delinquent. The national averages were 18.67 and 17.85 percent, respectively.

(Continued on page 10)





Region in Focus: The Midwest

Illinois

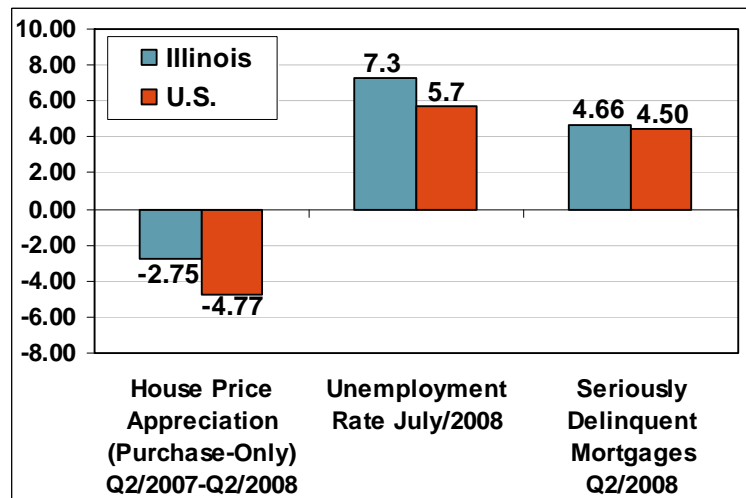
Illinois' economy is declining along with the nation. Unemployment in Illinois had been relatively low over the past nine months, but the state's weakening economy has caused unemployment to rise significantly during the summer months. In July, the unemployment rate averaged 7.3 percent on a seasonally adjusted basis compared with the national average of 5.7 percent. In the states' largest MSA, Chicago-Naperville-Joliet, the unemployment rate rose to 7.5 percent from 5.4 percent a year earlier. Unemployment rates remain highest in the smaller manufacturing MSAs in the state with Rockford leading at 9.0 percent, followed closely by Danville and Kankakee at 8.6 percent. The more rural, service-based MSAs in the state such as Bloomington-Normal (5.6 percent) and Davenport-Moline-Rock Island (5.1 percent) had significantly lower unemployment rates.

According to Moody's Economy.com, existing home sales in the state have fallen much faster than both the national and regional average. Home sales declined by 24.1 percent in the state between the second quarters of 2007 and 2008 compared with a regional decline of 16.4 percent and a national decline of 15.1 percent over the same period.

House prices in the state rose by much less than the national average during the housing boom and, as a result, home price deceleration has been less severe during the decline. According to data from OFHEO's

purchase-only HPI, home prices in the state declined by 2.8 percent between the second quarter of 2007 and the second quarter of 2008. As was the case in Ohio, seasonal factors largely explain the second quarter HPI compound annualized increase of 3.6 percent. Prices accelerated in all but two of the state's 10 MSAs during the second quarter, also probably because of seasonal factors. Prices in the Chicago-Naperville-Joliet MSA, declined at a 4.8 percent annualized rate during the second quarter despite seasonal factors.

Credit conditions in Illinois are generally similar to the national average. According to the MBA, 5.97 percent of all mortgage loans were past due in the second quarter compared with a national average of 6.41 percent. Conversely, 1.04 percent of all mortgage loans in the state entered the foreclosure process during the second quarter of 2008. This compares with a national average of 1.08 percent. Loans rated as seriously delinquent totaled 4.66 percent in the second quarter. For the nation, this measured 4.50 percent. The subprime market in the state is performing a bit worse than the national average. At the end of the second quarter of 2008, 18.86 percent of all subprime loans were past due while 20.14 were seriously delinquent. Nationally these figures were 18.21 and 17.85, respectively.





Region in Focus: The Midwest – Selected Housing / Economic Indicators

State	MSA	Unemployment Rate*		House Price Appreciation		Housing Vacancy Rate	
		Jul-08	Jun-08	2nd Qtr 08	1st Qtr 08	1st Qtr 08	4th Qtr 07
Illinois	Chicago-Naperville-Joliet	7.3	6.8	3.58	-7.65	8.97	9.04
	Lake County-Kenosha County	7.5	7.3	-4.78	-1.21	7.90	7.99
	Peoria	6.6	6.4	-5.76	-2.20	5.31	5.55
Indiana	Evansville	6.0	5.8	1.53	1.03	10.40	10.35
	Fort Wayne	6.3	5.9	1.74	-0.91	11.98	12.10
	Gary	5.4	5.5	1.45	3.32	12.21	12.32
Iowa	Indianapolis-Carmel	6.5	5.6	-6.40	8.94	10.06	10.29
	Des Moines-West Des Moines	5.7	5.8	0.10	1.81	11.21	11.22
	Wichita	5.1	5.2	-0.74	3.76	11.30	11.47
Kansas	Ann Arbor	4.3	4.0	4.28	-5.33	11.40	11.49
	Detroit-Livornia-Dearborn	3.5	3.7	-4.60	0.49	8.52	8.58
	Flint	4.6	4.3	8.93	-5.43	11.53	11.65
Michigan	Grand Rapids-Wyoming	4.9	4.3	4.15	1.60	9.87	10.03
	Lansing-East Lansing	8.5	8.5	-3.91	-8.39	15.23	15.30
	Warren-Troy-Farmington Hills	6.9	6.3	-16.21	3.14	6.86	7.03
Minnesota	Ann Arbor	10.9	11.1	-22.45	-4.54	12.65	12.58
	Minneapolis-St. Paul-Bloomington	12.3	9.7	-9.60	-1.38	14.08	14.16
	St. Louis	8.0	7.1	-9.89	4.37	9.89	10.01
Missouri	Springfield	7.7	7.2	-10.47	2.93	10.45	10.49
	Omaha-Council Bluffs	8.3	8.8	-17.02	-1.29	8.71	8.82
	St. Louis	5.8	5.3	-0.30	-8.81	12.46	12.66
Nebraska	Omaha-Council Bluffs	5.4	5.1	-9.78	1.07	6.29	6.59
	Omaha-Council Bluffs	6.4	5.7	12.90	-10.14	12.44	12.52
	Springfield	6.1	5.9	-1.33	1.44	9.09	9.22
North Dakota	Omaha-Council Bluffs	7.2	6.4	-1.75	0.46	10.65	10.72
	Omaha-Council Bluffs	5.3	4.9	0.93	1.64	10.22	10.02
	Springfield	3.4	3.4	8.40	-5.81	11.05	11.18
Ohio	Omaha-Council Bluffs	3.8	3.3	-0.96	3.50	8.02	7.73
	Akron	3.5	3.2	1.35	4.93	17.35	17.39
	Cincinnati-Middletown	7.2	6.6	5.25	-7.87	11.18	11.23
South Dakota	Cincinnati-Middletown	6.7	6.2	-1.72	4.50	10.07	10.12
	Cleveland-Elyria-Mentor	6.0	5.2	-3.26	2.65	9.30	9.31
	Columbus	7.2	7.7	-2.87	2.37	12.18	12.11
Wisconsin	Dayton	6.1	5.7	-2.78	3.40	9.93	10.06
	Toledo	7.7	6.9	-0.73	0.85	11.94	12.03
	Youngstown-Warren-Boardman	8.9	7.5	-15.88	4.73	14.19	14.23
United States	Madison	7.8	7.4	-6.21	12.32	14.01	14.02
	Madison	3.0	2.8	4.54	1.82	16.67	16.70
	Madison	4.9	4.6	2.74	-1.32	14.45	14.54
United States	Madison	3.6	3.9	-2.00	0.97	8.04	8.19
	Madison	5.2	5.3	-3.38	1.93	6.96	7.07
	Madison	7.1	6.7	-3.61	1.91	12.04	12.11
United States	Madison	5.2	4.7	-2.13	1.79	12.28	12.40
	Madison	6.1	5.7	-0.96	-7.64	11.24	11.35
	Madison	6.1	5.7	-0.96	-7.64	11.24	11.35

Source: Bureau of Labor Statistics/Office of Federal Housing Enterprise/U.S. Census Bureau/Moody's Economy.com/Haver Analytics

*State, Regions, and U.S. unemployment rates are seasonally adjusted. MSA unemployment rates are not seasonally adjusted

**State and national house price appreciation from Purchase-Only Index (NSA); MSA and Census Division house price appreciation from Total Index (NSA)



Special Topic (Continued from cover page)

This article shows that, while the NAR index provides an accurate reading of affordability at the time of home purchase, effective affordability was overstated by the index during the period of the housing boom; an environment with rising interest rates and with increasing use of adjustable-rate mortgages (ARMs). More recently, effective affordability has again been overstated as a result of credit tightening on the part of mortgage lenders.

The affordability index is composed of median house prices, median family income, and mortgage rates. The calculation assumes a down payment of 20 percent of the house price and a qualifying ratio of 25 percent, which means the monthly principal and interest payments on the mortgage for the property can't exceed 25 percent of the family's monthly income. (Note, however, that NAR also publishes a "first-time buyer" affordability index that assumes a larger 90 percent loan-to-value ratio and the resulting payment of private mortgage insurance). Lower house prices, lower mortgage rates, and higher family incomes all increase affordability, while higher house prices, higher mortgage rates, and lower family incomes all reduce it.

When home prices were increasing to record levels in the 2003-6 period, housing affordability fell significantly. Given that the economy was growing at-or-above trend rates, income growth helped to offset some of the decline in affordability. Additionally, mortgage rates stayed low for an extended period, although they generally rose over this time frame. Despite these offsets, affordability declined from a peak level of 137.1 in February 2003 to a low of 99.6 in July 2006 (see Figure 1). Surprisingly, this period of sharp decline in affordability was also a period of significant increases in home sales. Moreover, while the affordability index accurately measured

affordability at the time of purchase, in many cases it overstated longer-term affordability, which suggests that effective affordability fell more sharply than measured affordability.

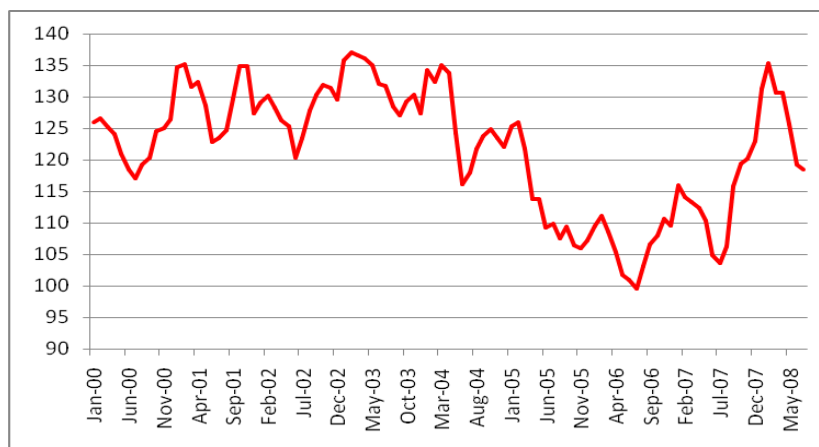
This overstatement of effective affordability can occur when rates on adjustable-rate mortgages (ARMs) adjust upward, as they typically do unless offset by a decline in the general level of interest rates. This happens because the starting interest rates on most ARMs are less than their fully-indexed rates (the sum of their underlying index rate and whatever spread is required by the mortgage contract). These lower ARM start rates are often called teaser rates. Since this was a period of generally rising interest rates, there were widespread and significant upward ARM adjustments. Concurrently, the share of borrowers using ARMs rose. The Mortgage Bankers Association's applications survey showed the ARM share increased from about 13 percent in the first half of 2003 to nearly 37 percent in 2005 (and the ARM share stayed close to 30 percent into the middle of 2006).

As a result of the combination of upwardly adjusting ARM rates and an increasing share of ARM borrowers, a larger share of homeowners found their mortgage payments rising. This future increase in rates was not reflected in the affordability index that those borrowers faced at purchase, since that was based on the then-current (and lower) level of mortgage rates.

The increasing use of ARMs to boost initial affordability in a rising home price environment resulted in the expansion of a number of mortgage products that allowed more households to purchase homes, especially in high cost areas and especially when lenders underwrote the loans at the starting interest rate, not the fully indexed rate.

(Continued on pg. 13)

Figure 1 - NAR Composite Housing Affordability Index



Source: National Association of Realtors

Special Topic (Continued from page 12)



Figure 2 shows some of the widely used ARM products in recent years, how much more house a family could afford to buy using them, and the difference between the initial and fully-indexed monthly payments. The measured affordability index would have used the initial interest rate and monthly payment, while an effective index would have used the fully indexed rate and payment. It is clear that an index that measured the effective affordability of the mortgage would have been substantially less than the measured index in all of these cases.

While this is an obvious limitation of the standard measure of affordability, it is not the only one. The measure assumes that access to mortgage capital is the same for all potential borrowers. This is generally not the case. While it is true that affordability is improving as a result of the decline in house prices, it is also the case that fewer borrowers can get loan approvals because of stricter lending standards that borrowers must now meet.

As shown in Figure 3, lending standards have tightened significantly for all borrower classes. According to the Federal Reserve Board's Survey of Senior Loan Officers, 15.1 percent of respondents said that lending standards had tightened for prime mortgage loans in the second quarter of 2007. By the third quarter of 2008, that number had grown five-fold to 74 percent. This is only modestly less than the share stating that nontraditional and subprime lending standards had tightened, which had also increased sharply over the past year.

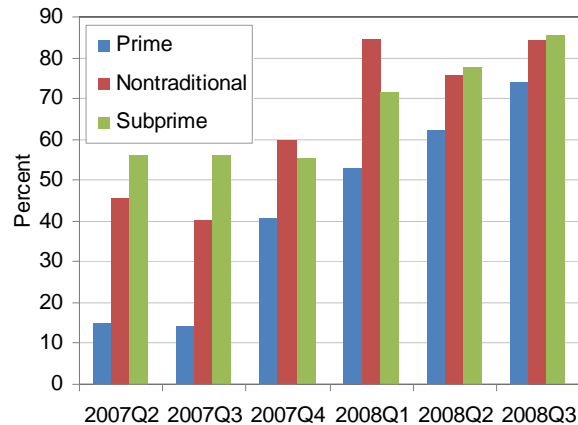
The impact on the housing market of tighter lending standards is similar to a drop in affordability, without an explicit drop in the affordability index. This implicit decline in affordability through tightened lending standards can occur in a variety of ways such as requiring larger downpayments, restricting lending to households with higher credit scores, or requiring lower payment ratios. These changes are more likely to impact lower-income borrowers, who would have fewer assets for a downpayment and less income to meet tighter payment ratios. Subprime borrowers, or any borrowers without top-tier credit, would also be affected by tighter lending requirements to a greater

extent than those with excellent credit may feel little or no impact from the tighter standards.

In summary, measured housing affordability was overstated during the period of sharply rising home prices (2003-6) as a result of upward ARM adjustments and a rising ARM share. The general increase in measured affordability over the past couple of years compared with the lows at the peak of the housing boom, stemming mostly from the sharp declines in house prices, is also likely overstated. The drop in affordability over the past few months has occurred primarily because of a seasonal hike in NAR's measure of median existing home prices, as well as higher mortgage rates. Both of these things are already reversing, which should push affordability higher in coming months.

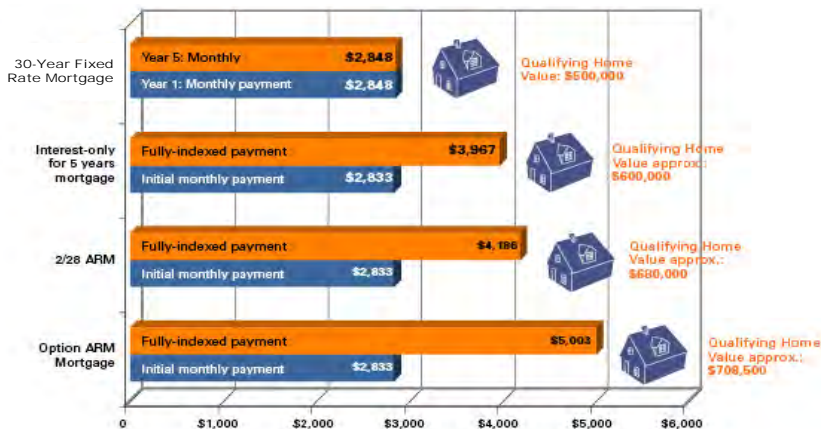
Effective affordability today is likely lower than the NAR index indicates because of significantly tighter lending standards. We expect credit conditions to remain tight for some time, but this may be offset to some extent by the recent drop in mortgage rates related to both lower inflation expectations and the placement of the GSEs into conservatorship, as well as ongoing house price declines.

Figure 3 - Survey of Loan Activity: Net % of banks tightening standards for mortgage loans



Source: Federal Reserve Board/Haver Analytics

Figure 2 – Increased use of ARMs overstates long-term affordability



Source: The PMI Group, Inc.



The PMI Forecast

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 our expectation with respect to the economy and the housing and mortgage markets. Readers are cautioned that forward-looking statements by their nature involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. Many factors could cause actual results and developments to differ materially from those expressed or implied by forward-looking statements. Such factors include, among others, national or regional recessions, credit market disruptions, changes in interest rates, housing prices and employment rates, and regulatory and legislative developments. Other risks and uncertainties are discussed in our SEC filings, including our Annual Report Form 10-K for the year ended December 31, 2007 (in Item 1A) and Form 10-Q for the quarter ended June 30, 2008. We undertake no obligation to update forward-looking statements.

		Housing Market		
Year	Quarter	Existing Sales (Thousands of Units)	New Sales (Thousands of Units)	Median Existing Home Price Change (%) ¹
2008	1st Quarter	4953	561	-4.4
	2nd Quarter	4910	520	4.8
	3rd Quarter	4920	515	-2.0
	4th Quarter	4950	530	-2.5
	Annual	4933	532	-6.6
2009	1st Quarter	4990	550	-1.7
	2nd Quarter	5100	580	5.0
	3rd Quarter	5400	610	0.3
	4th Quarter	5450	640	-1.0
	Annual	5235	595	0.1

		Mortgage Market		
Year	Quarter	Single Family Originations (Billions of \$)	Refinancing Share	ARM Share
2008	1st Quarter	470	59.7	10.6
	2nd Quarter	530	50.1	7.7
	3rd Quarter	480	36.8	8.4
	4th Quarter	460	44.0	6.1
	Annual	1940	47.7	8.2
2009	1st Quarter	420	45.0	6.5
	2nd Quarter	500	42.0	7.5
	3rd Quarter	520	40.0	8.0
	4th Quarter	410	38.0	9.5
	Annual	1850	41.3	7.9

		Interest Rates		
Year	Quarter	30-year Fixed Rate Mortgage (%)	10-year Treasury Note (%)	1-year Adjustable Rate Mortgage (%)
2008	1st Quarter	5.87	3.67	5.14
	2nd Quarter	6.09	3.88	5.19
	3rd Quarter	6.30	3.85	5.23
	4th Quarter	5.90	3.90	5.20
	Annual	6.04	3.83	5.19
2009	1st Quarter	5.90	4.05	5.25
	2nd Quarter	5.95	4.15	5.30
	3rd Quarter	6.00	4.25	5.60
	4th Quarter	6.05	4.35	5.80
	Annual	5.98	4.20	5.49

		Economic Outlook		
Year	Quarter	Real GDP Growth ²	Consumer Price Inflation ³	Civilian Unemployment Rate
2008	1st Quarter	0.9	4.3	4.9
	2nd Quarter	3.3	5.0	5.3
	3rd Quarter	1.0	3.0	5.9
	4th Quarter	0.2	1.0	6.2
	Annual	1.3	4.0	5.6
2009	1st Quarter	1.3	1.2	6.3
	2nd Quarter	2.2	2.0	6.2
	3rd Quarter	2.7	2.3	6.0
	4th Quarter	2.9	2.3	5.9
	Annual	2.3	2.0	6.1

1 Quarterly = percent change ; Annual = Year Avg. / Year Avg.

2 Quarterly = annualized percent change ; Annual = Q4 / Q4

3 Quarterly = annualized percent change ; Annual = Year Avg. / Year Avg.