

Economic Summary

- Indications of economic activity in the United States have turned decidedly negative. US GDP declined 0.3% in the third quarter. IMF revised economic outlook now projects US leading global recession, forecasting US GDP growth to slow from 2.0% in 2007 to 1.4% in 2008 and -0.7% in 2009. In advanced economies, output is forecast to contract on a full-year basis in 2009, the first such fall in the post-war period.
- The employment situation has taken a turn for the worse. Unemployment and continued job losses will extend the delinquency trend, not just in mortgage but in other consumer loan portfolios.
- Layoff events reached their highest level since September 2001, a month that experienced substantial layoff activity due to the 9/11 attacks. The construction, professional and technical services, and finance and insurance sectors reported program highs for the month of September in terms of mass layoff initial unemployment claims (with data available back to 1995).
- Business spending on equipment and software fell at an annual rate of 2.75% percent in the first half of 2008, and the near-term outlook is not favorable. Many firms are facing dimmer sales prospects, higher funding costs, and more restrictive borrowing terms.
- Measures of price imbalance are improving. Homes are much more affordable. NAR's housing affordability index reached 135.2 in September, which is close to a four-year high.
- Price declines as evidenced by Case-Shiller Index forecasts suggest largest adjustments are behind us in some markets, but also that price declines are spreading farther across metro areas.

Economic Outlook

- Total mortgage originations are expected to decline until Q1 09. Originations will total \$1.8 trillion this year, down 29% from 2007 and 39% from the 2005 peak.
- Inventory is still overabundant, and foreclosures will keep trending high. Home prices may not turn around before mid-2009.
- From Peak to Trough forecasted single family home sales will decline by 35%, a downward revision from 20% last quarter. Forecasted housing starts will decline by 60%.

- **Outlook Risk1:** The intensification of financial and economic distress since mid-September may cause home price declines to reaccelerate toward the end of this year.
- **Outlook Risk2:** Employment situation may cause mortgage credit quality to deteriorate further, resulting in a credit crunch that will limit the ability of businesses to expand, leading to reduced hiring activity and more layoffs.
- **Outlook Risk3:** Self-reinforcing downturn, as business expectations and consumer confidence erode further, may result in limited economic activity.
- **Outlook Risk4:** Deflation, though unlikely, may slow production, suffocate fresh investment and worsen joblessness for months or even years. Central Banks' rate cuts and massive lending designed to support growth and fight off deflation.

Economic Summary - Virginia

- The Virginia economy is slowing in tandem with the nation, although it has yet to lose many jobs. Conditions are highly variable across the state. The weak income growth, combined with slower growth in borrowing and mortgage equity withdrawal, is taking a large toll on consumer industries.
- State budget problems are creating bigger threats to the state economy. The September state revenue report letter states that on a year-to-date basis, total revenues declined 4.2 percent in the first quarter of the 2008-2009 FY, below the annual forecast of 2.0 percent growth.
- September payrolls in Virginia flat lined for the second month in a row as job losses in construction, financial activities, professional and business services, and education and health services were offset by gains in other industry sectors. Virginia's unemployment rate (NSA) fell 0.4 percentage point to 4.2% in September. Although 1.2 percentage points above its year-ago mark, Virginia unemployment rate is the lowest out of the largest 13 states.
- Housing markets softened further in Virginia. Residential permits and housing starts have kept declining. Northern Virginia leads the state in home price percentage drops . Mortgage Delinquencies have trended up the first two quarters of 2008 in all major metro areas except Roanoke. Foreclosure inventory is rising and stood at 1.46% of all loans at the end of Q2 2008, however the rate is still well below the national average of 2.75%.

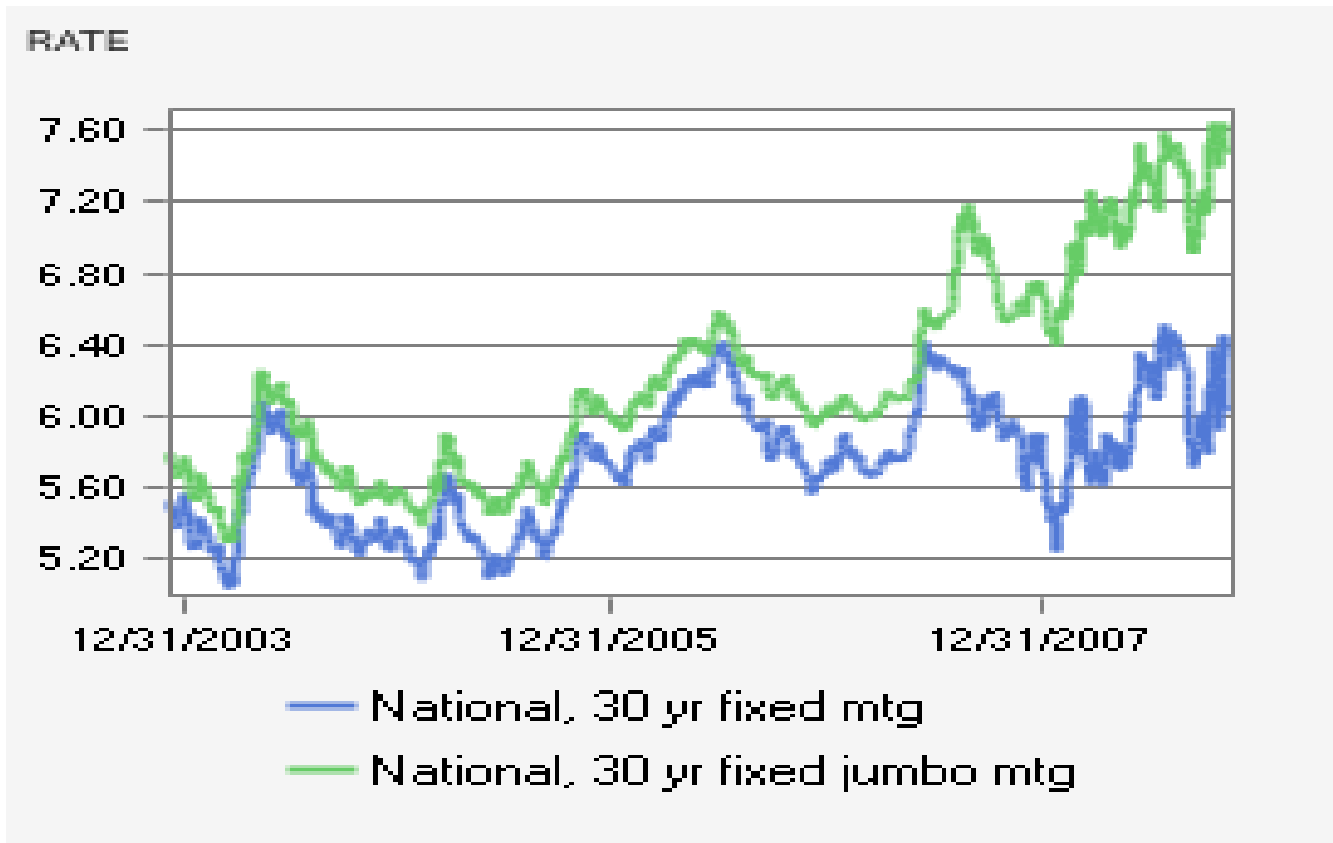


Source: Moody's Economy.com

HOW DID WE GET HERE?

Mortgage Rates Were At Very Low Levels in 2003

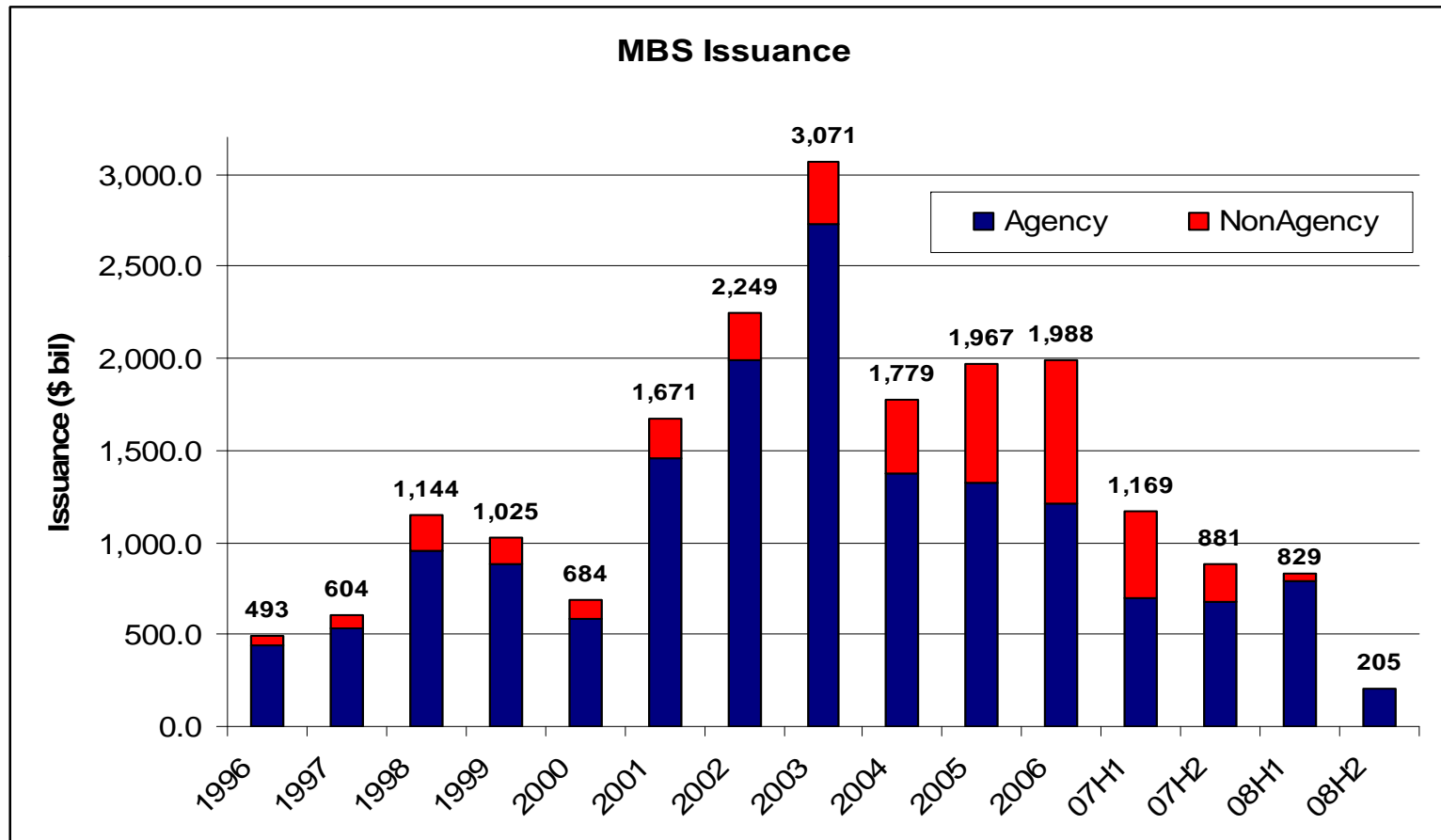
5 Year Comparison



Source: Bankrate.com

Which Fuled a Refinance Boom in 2003 But..

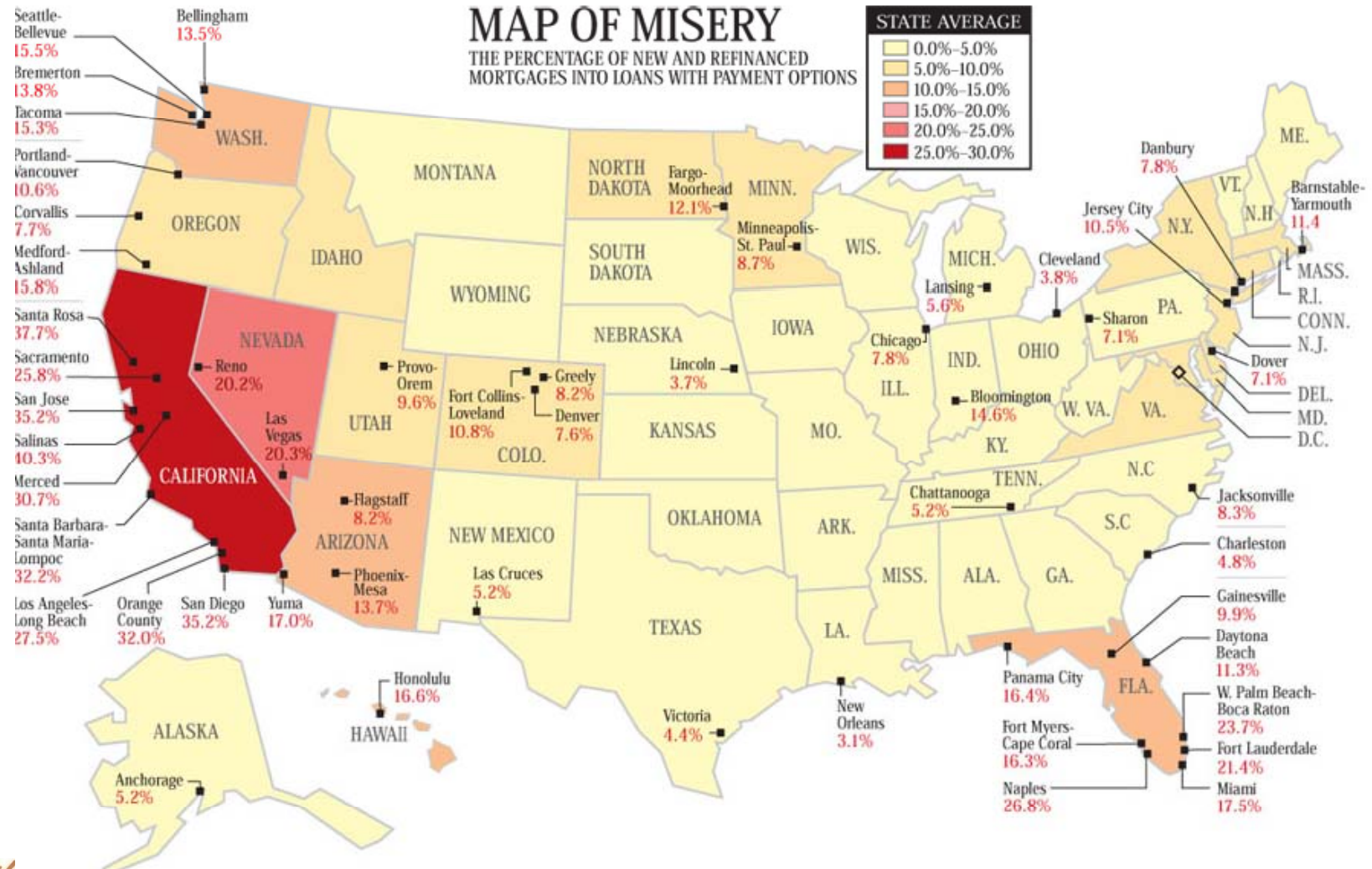
When Interest Rates Began Increasing In 2004, Non Agency Production Increased.



Source: Bond Market Association, 08H2 thru August 2008

Riskier Loans Production Increased

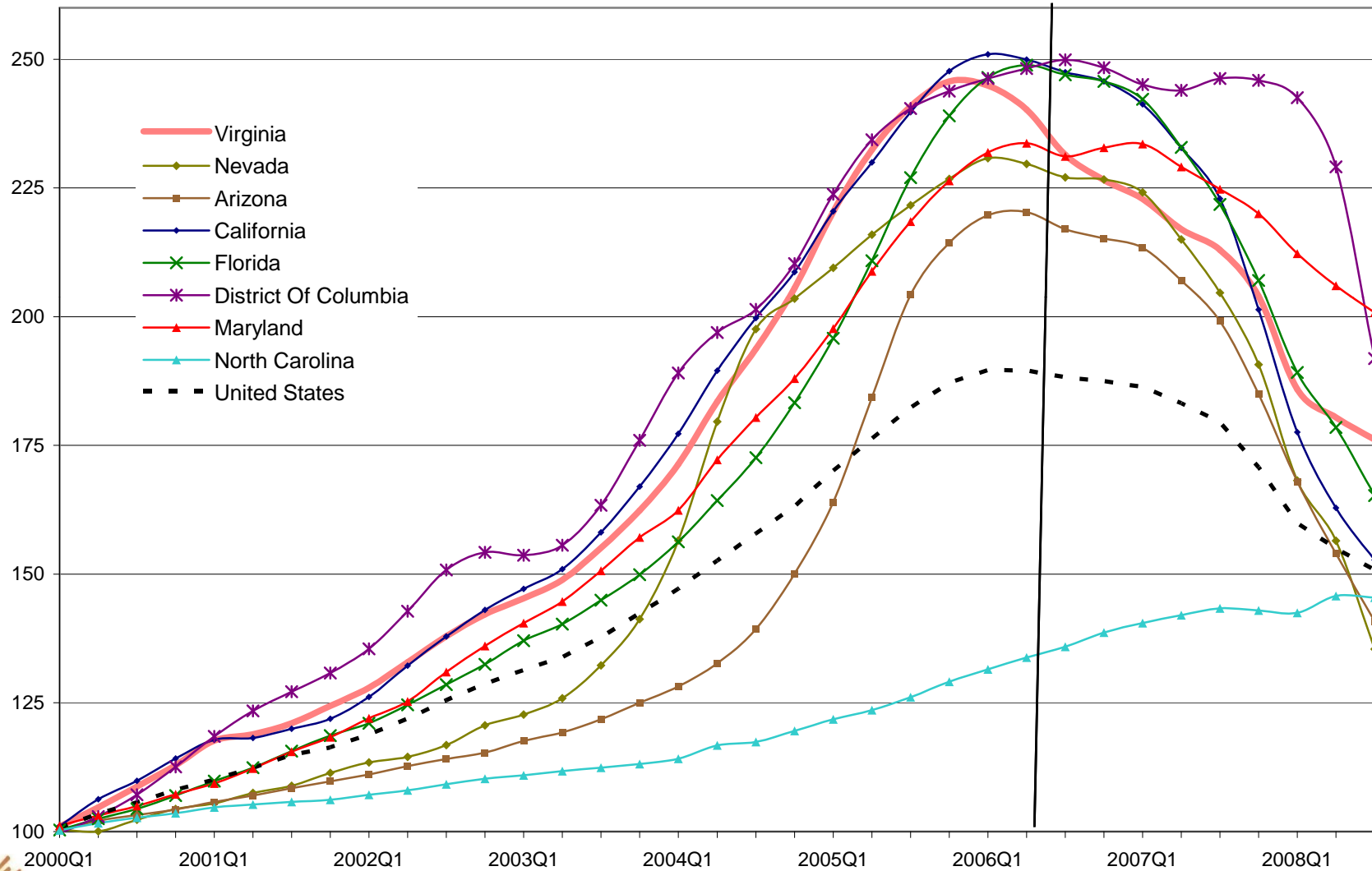
California, Nevada and S. Florida lead the nation in option ARM concentration (2006 vintage).



Source: Business Week, Nightmare Mortgages, September 2006

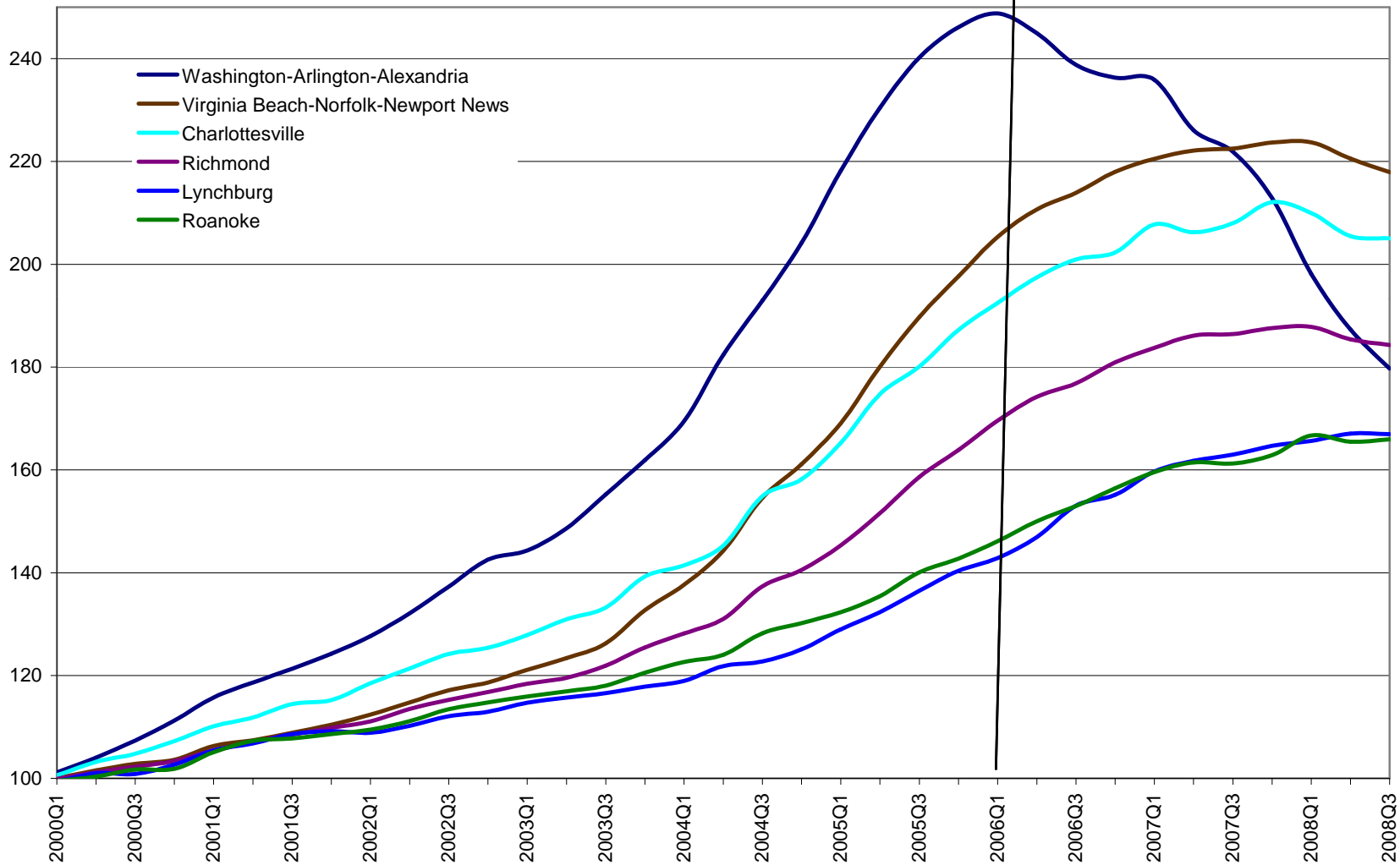
Home Prices Rose Through 2006

Historical Home Price Levels by State



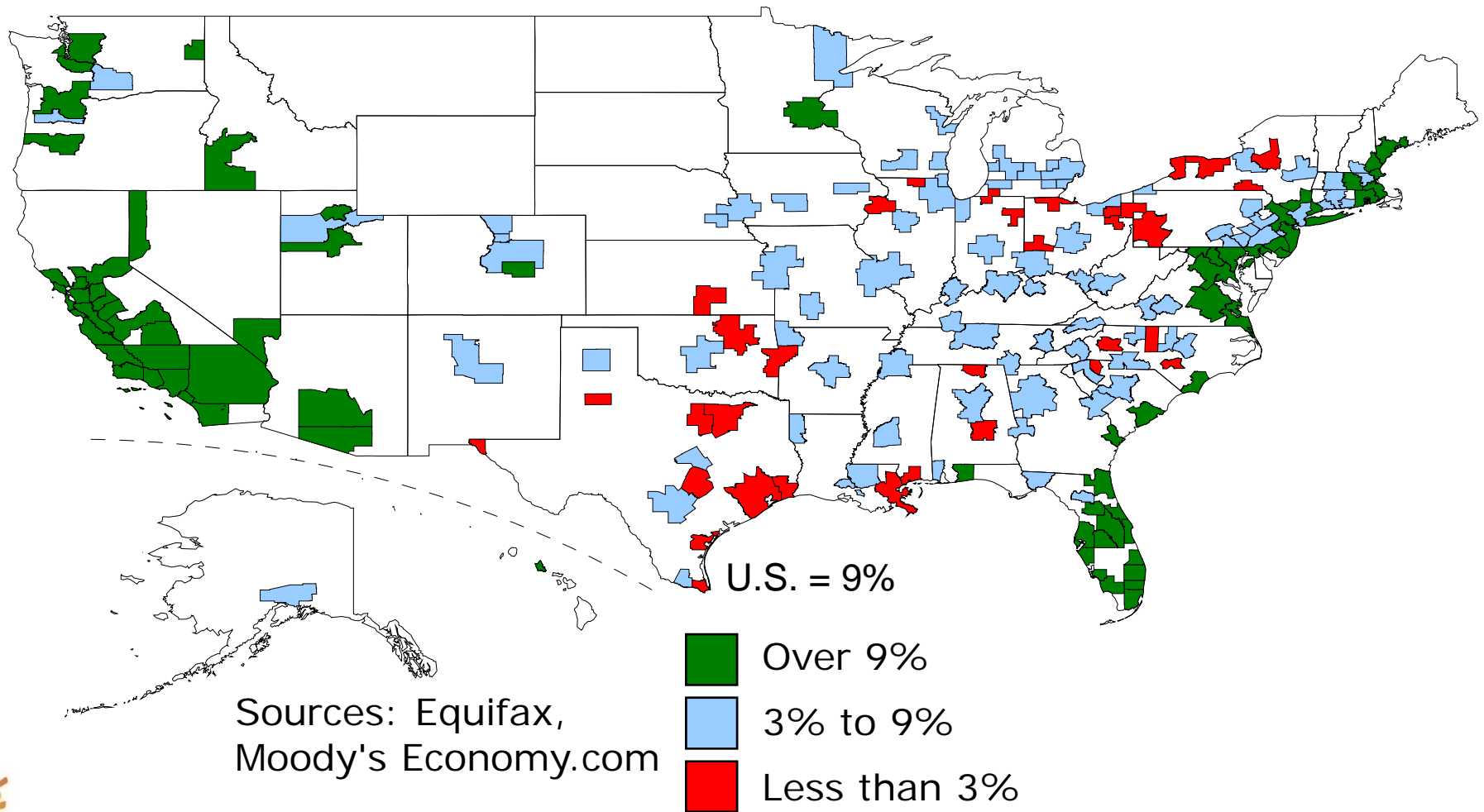
Northern Virginia Had the Fastest Rise In The State

Virginia MSAs Historical Home Price Level
Based on Case Shiller Index



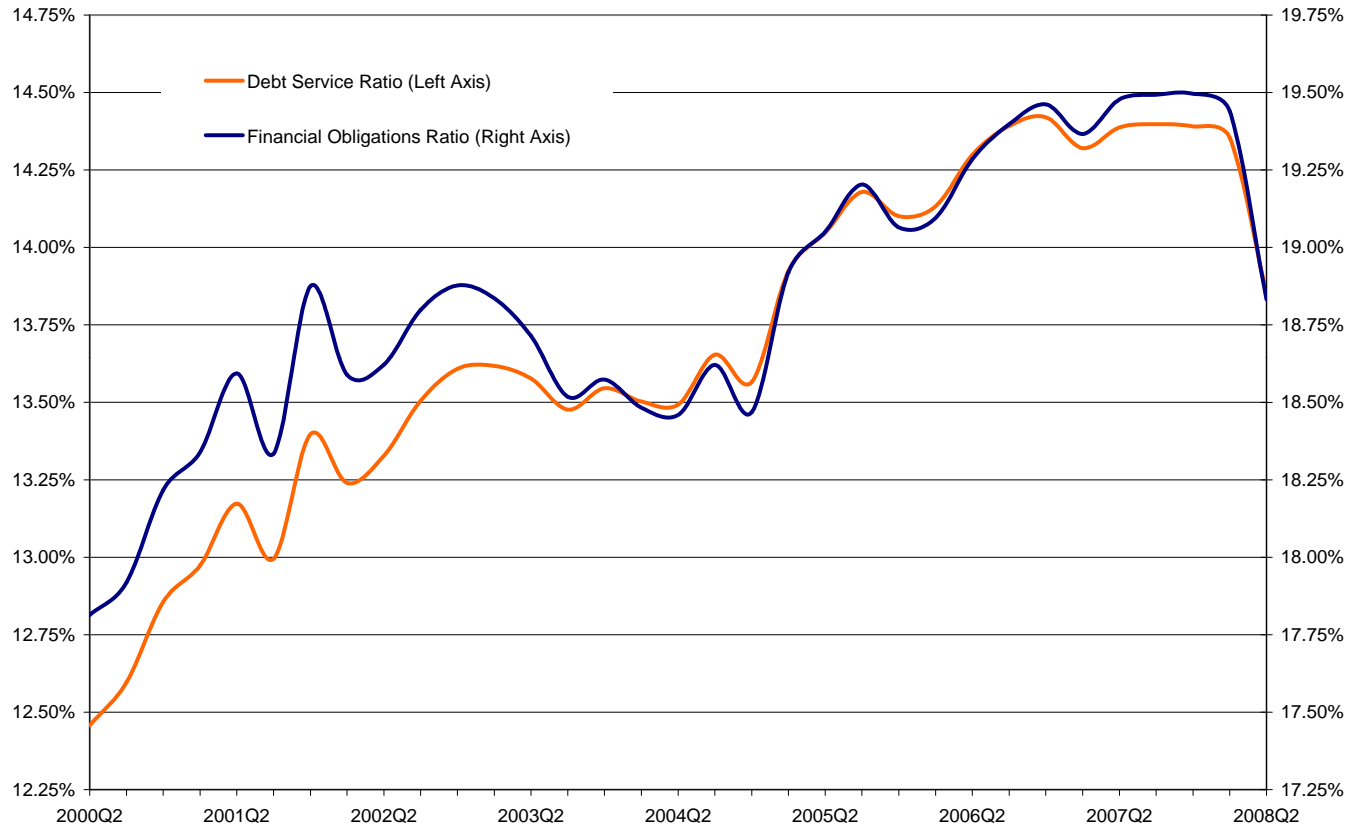
Homeowners Withdrew Newly Created Wealth

Equity extraction as a share of household income, 2006



Household Debt Service and Financial Obligations Ratios Increased Through 2007

Household Debt Service and Financial Obligations Ratio



Source: Federal Reserve

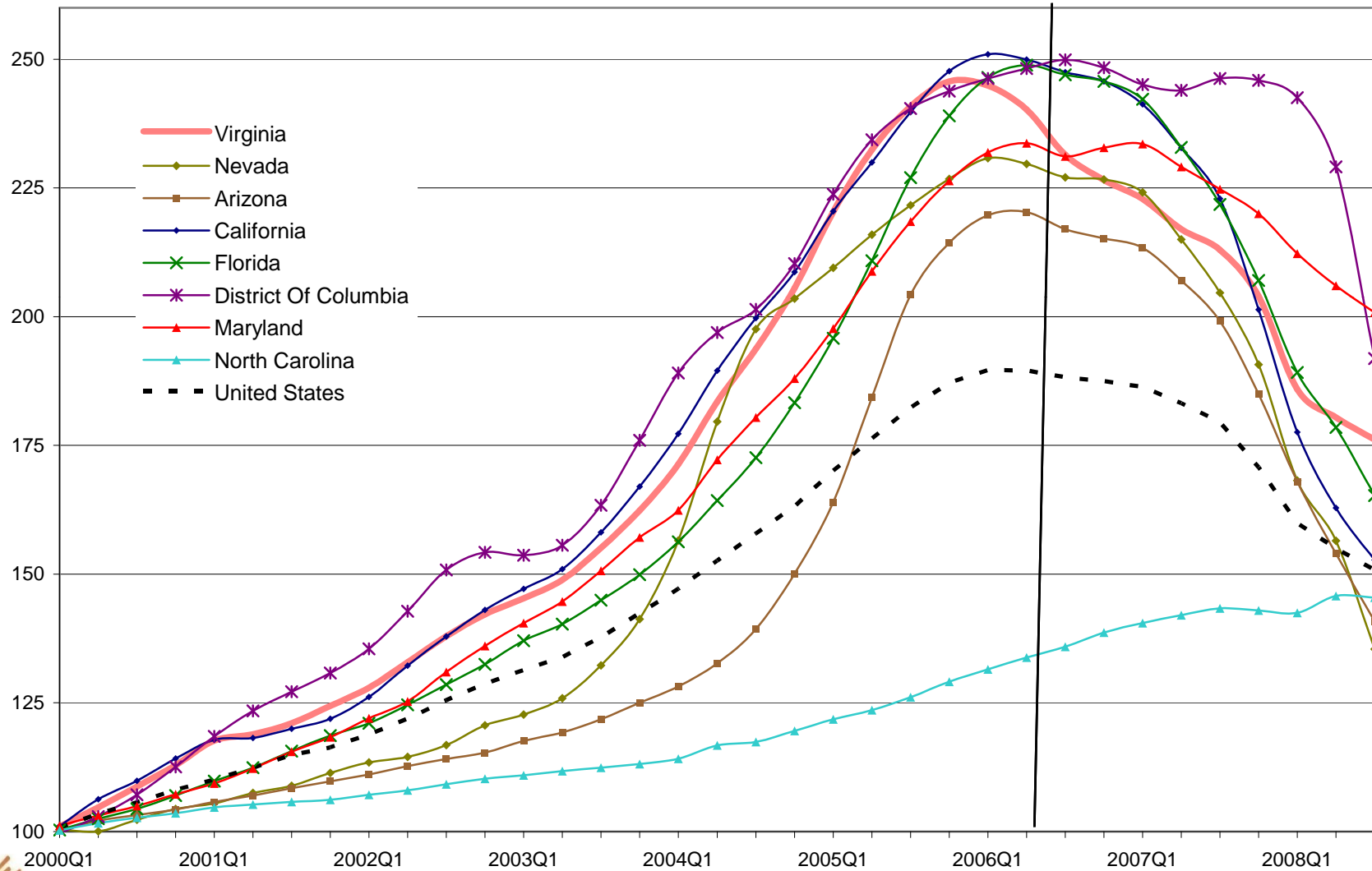
Both ratios = debt payments / disposable personal income

DSR debt payments = required payments on outstanding mortgage and consumer debt

FOR debt payments = DSR debt payments + car lease payments, homeowners' insurance, property tax, and rental payments on tenant-occupied property.

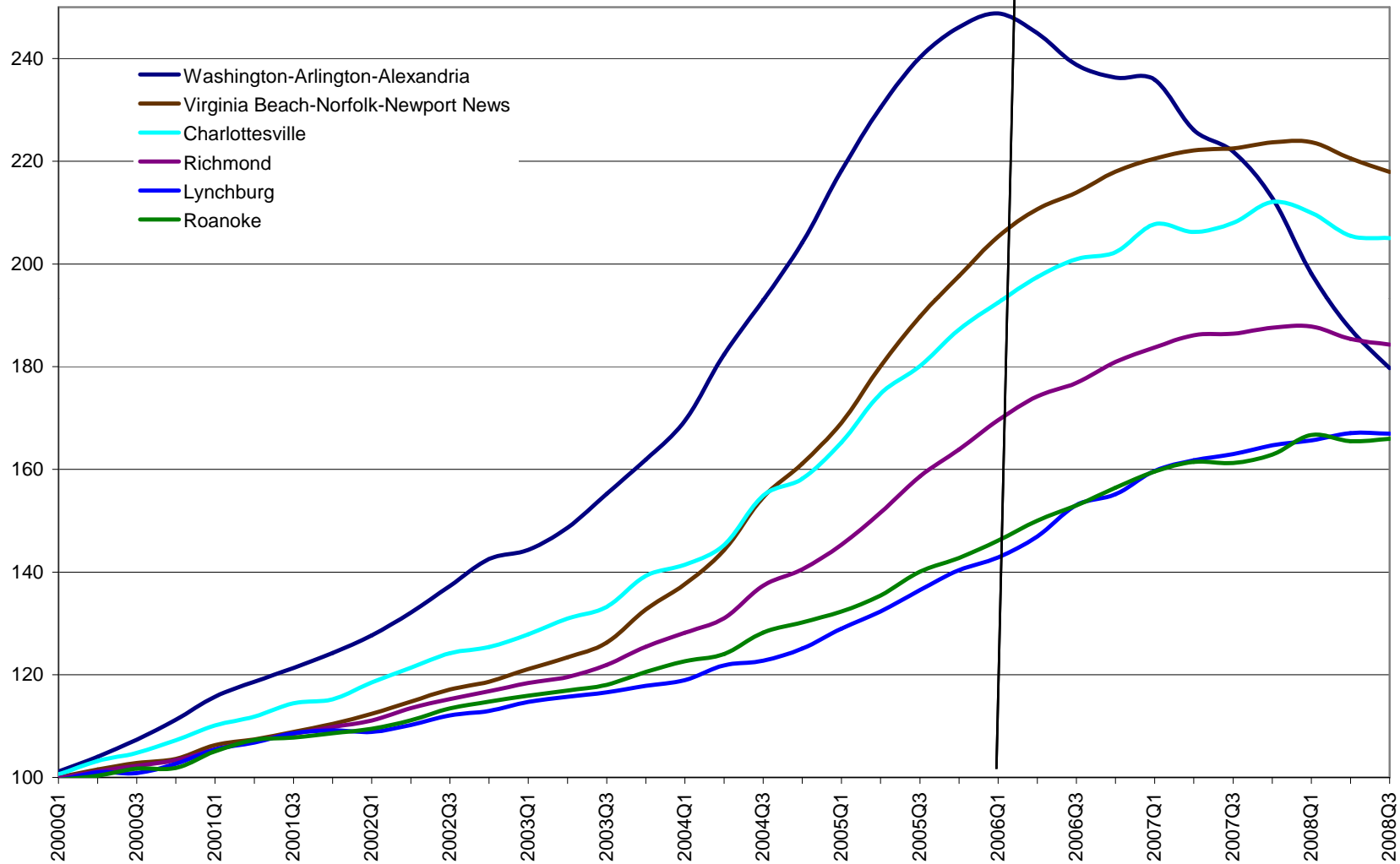
Home Prices Began Falling in 2007

Historical Home Price Levels by State



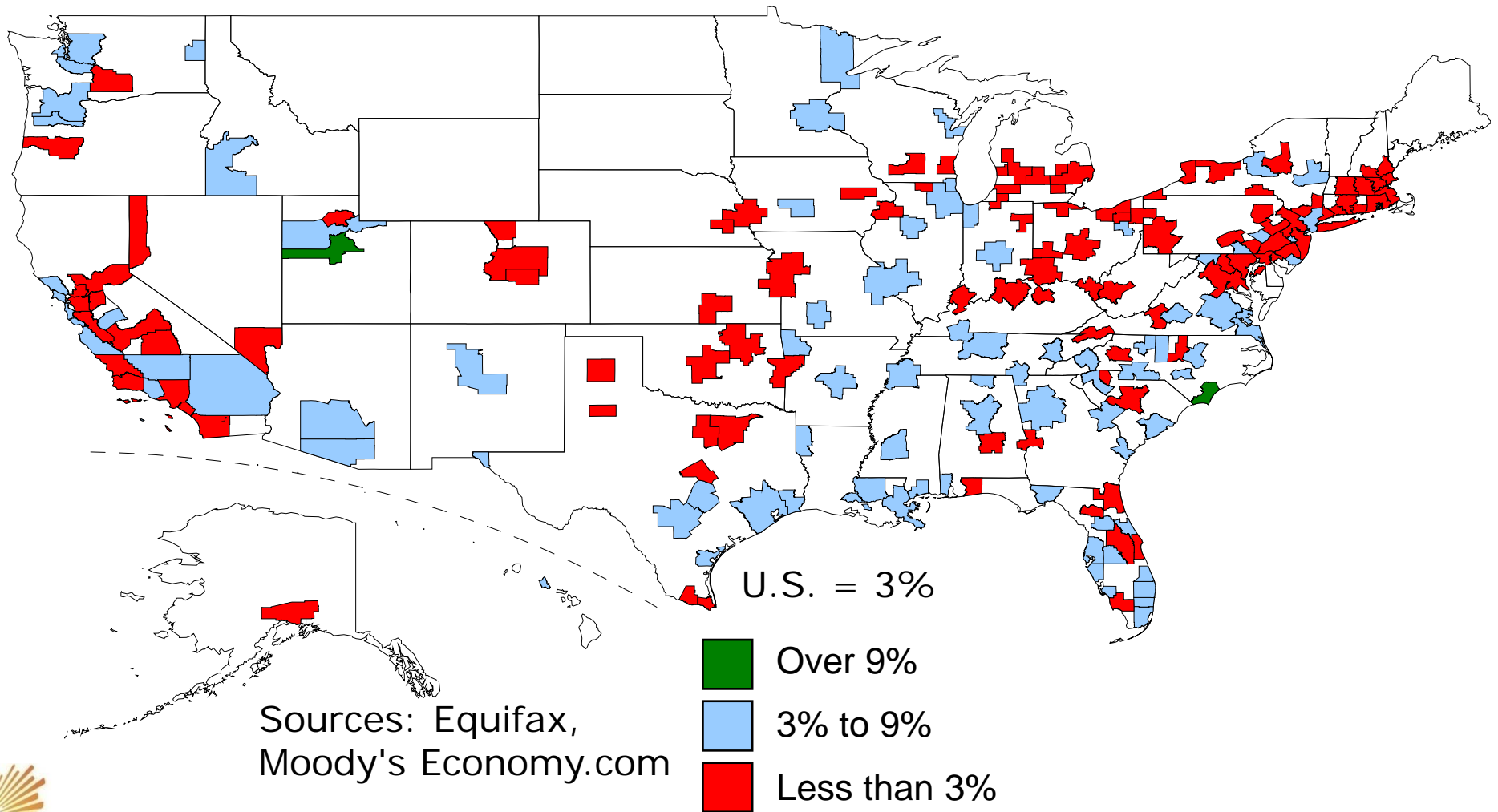
Northern Virginia Showed Fastest Decline

Virginia MSAs Historical Home Price Level
Based on Case Shiller Index



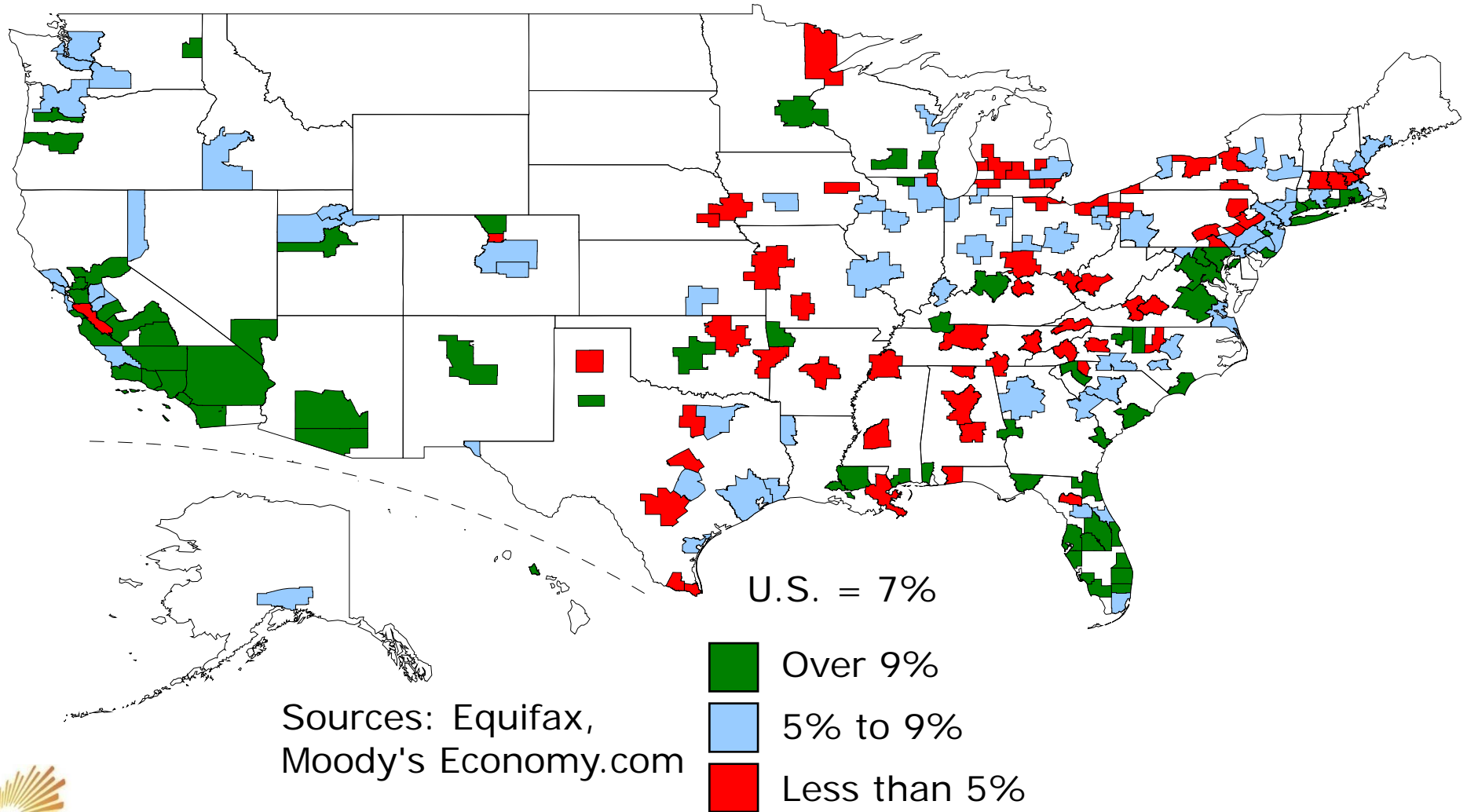
Equity Extraction Fades as Housing Boom Ends

Equity extraction as a share of household income, 2007



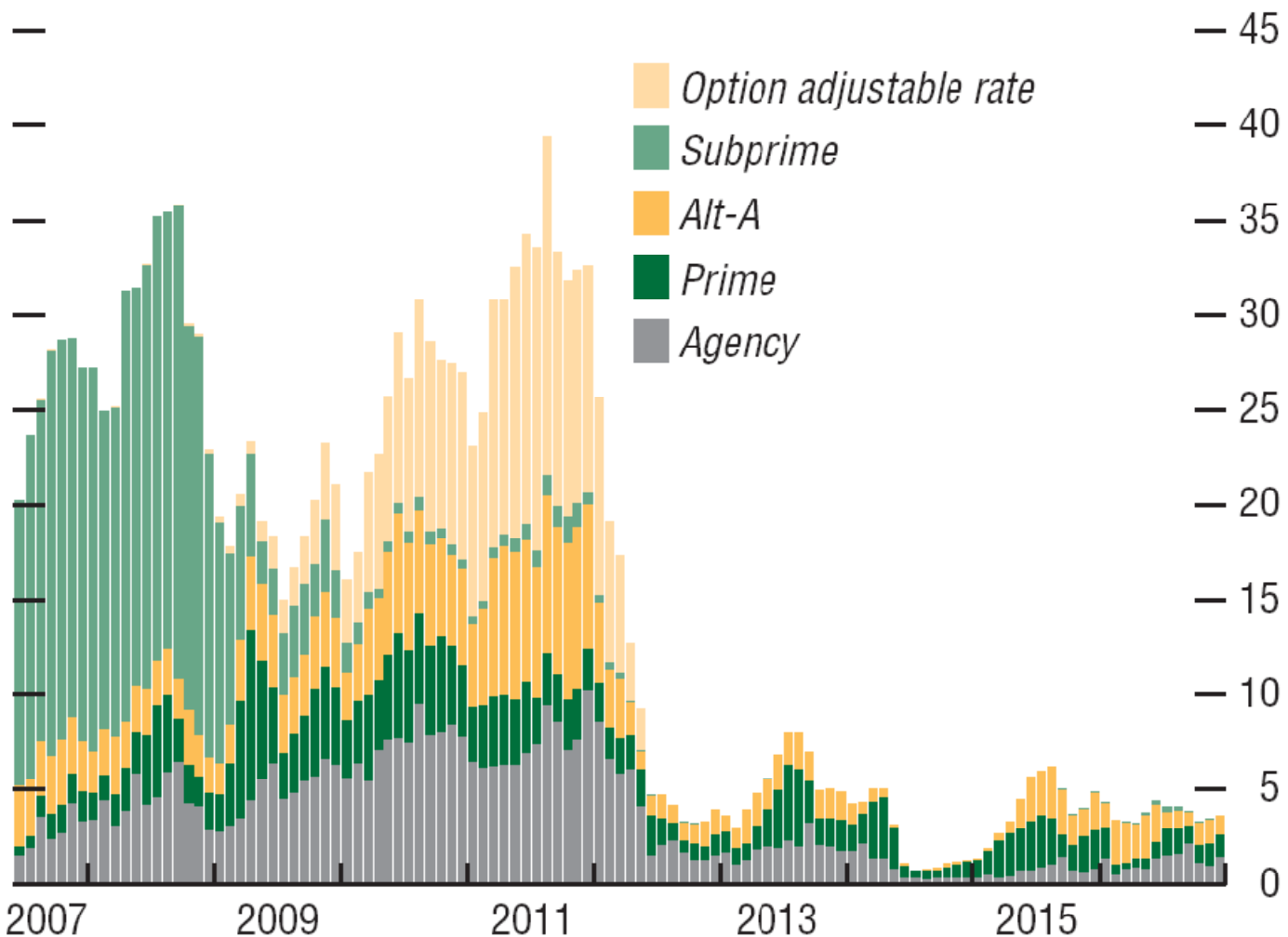
...Households Turn Back to Their Credit Cards

Annual increase in credit card balances, 2006Q3-2007Q3



Subprime ARM Resets Come in 2007

(First reset in billions of U.S. dollars)



Subprime first resets will tail off into 2009.

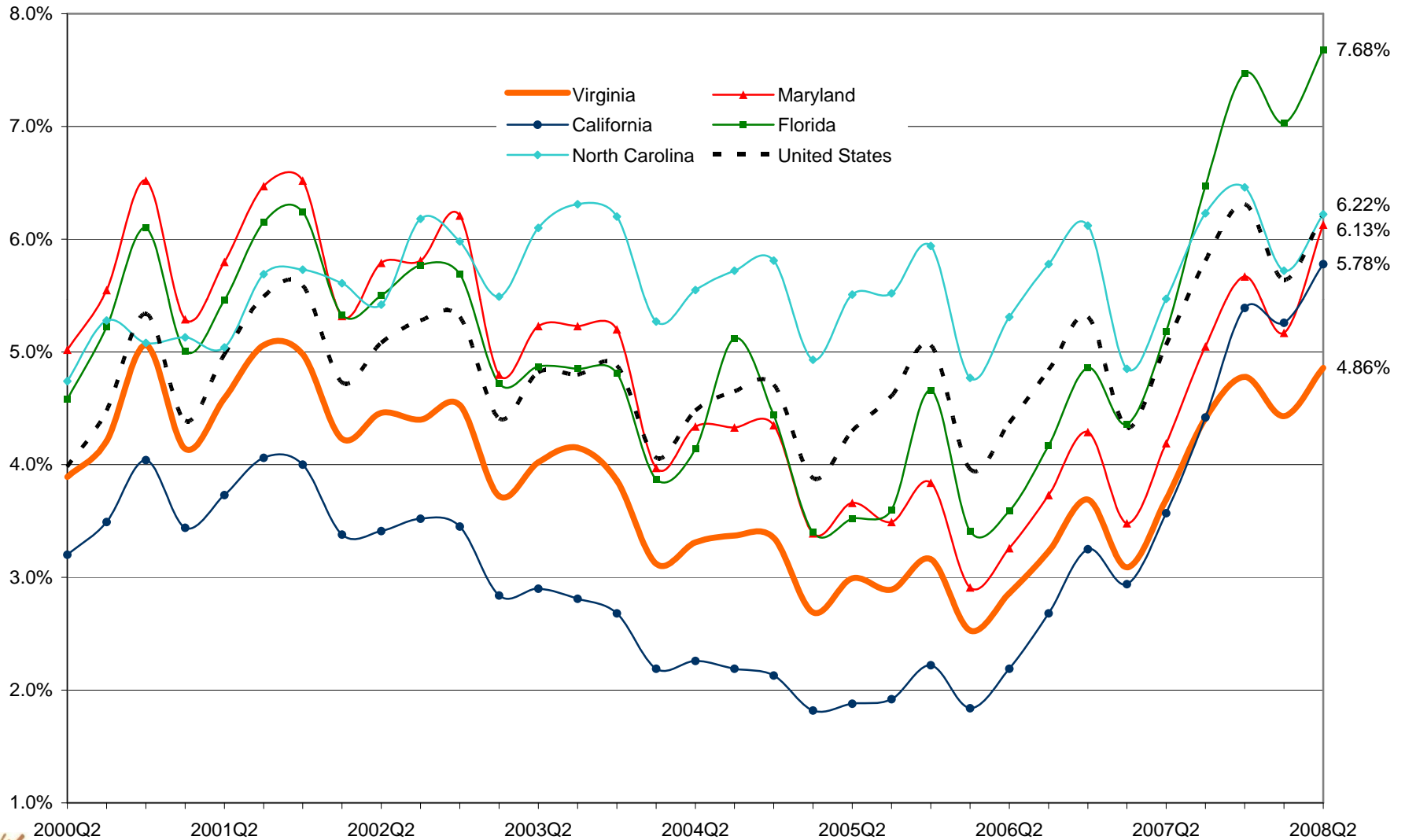
2009 first resets will consist of predominantly Agency and Prime product (~50% of \$243B in resets).

Option ARM reset volume will pick up during the second half of 2009 and increase markedly through 2011.

Source: Credit Suisse, IMF [Global Financial Stability Report](#), September 2007

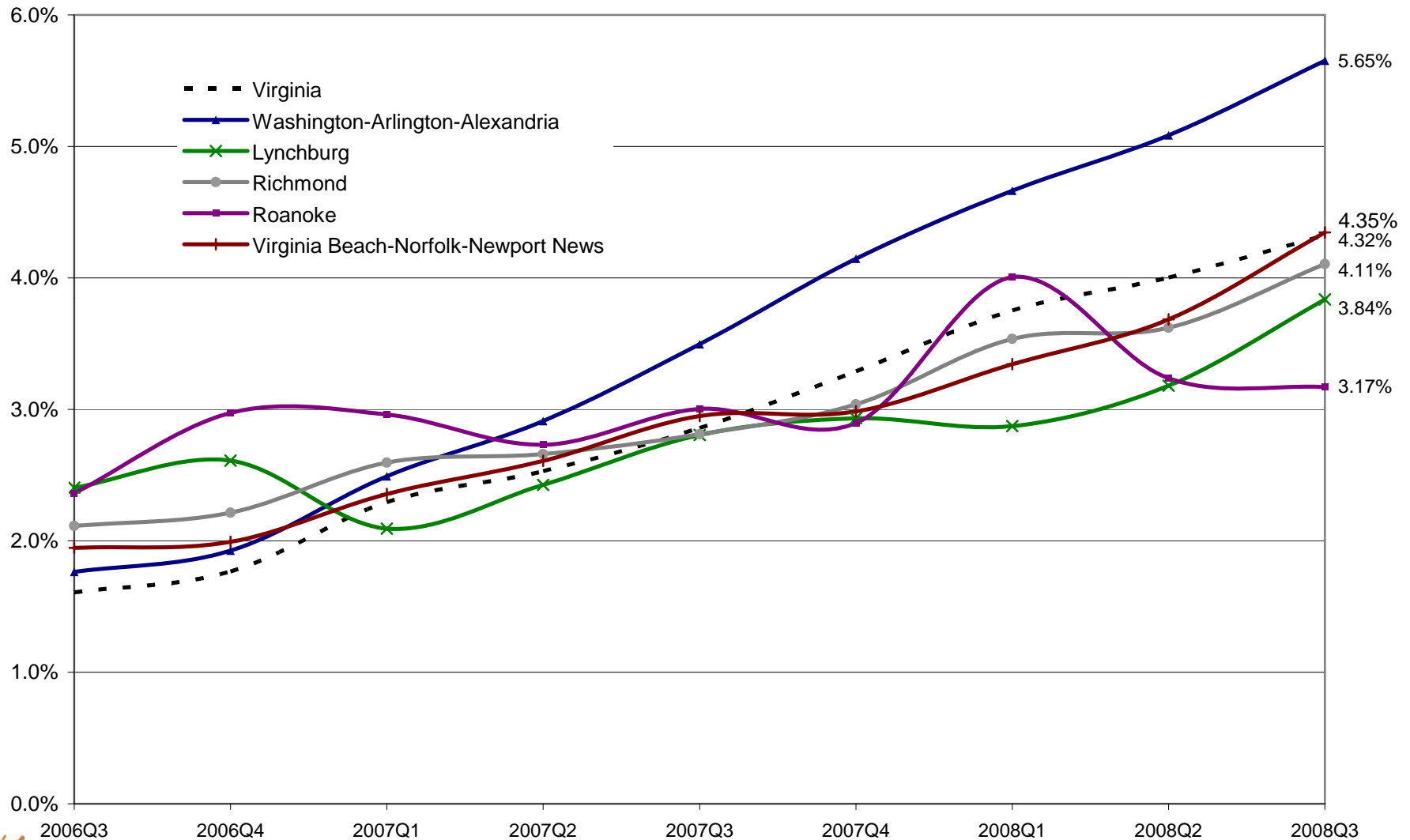
Without The Home Price Increases or Cushion in Debt Service 30+ Day Mortgage Delinquencies Trend Up

30+ Delinquency, All Mortgage Loans



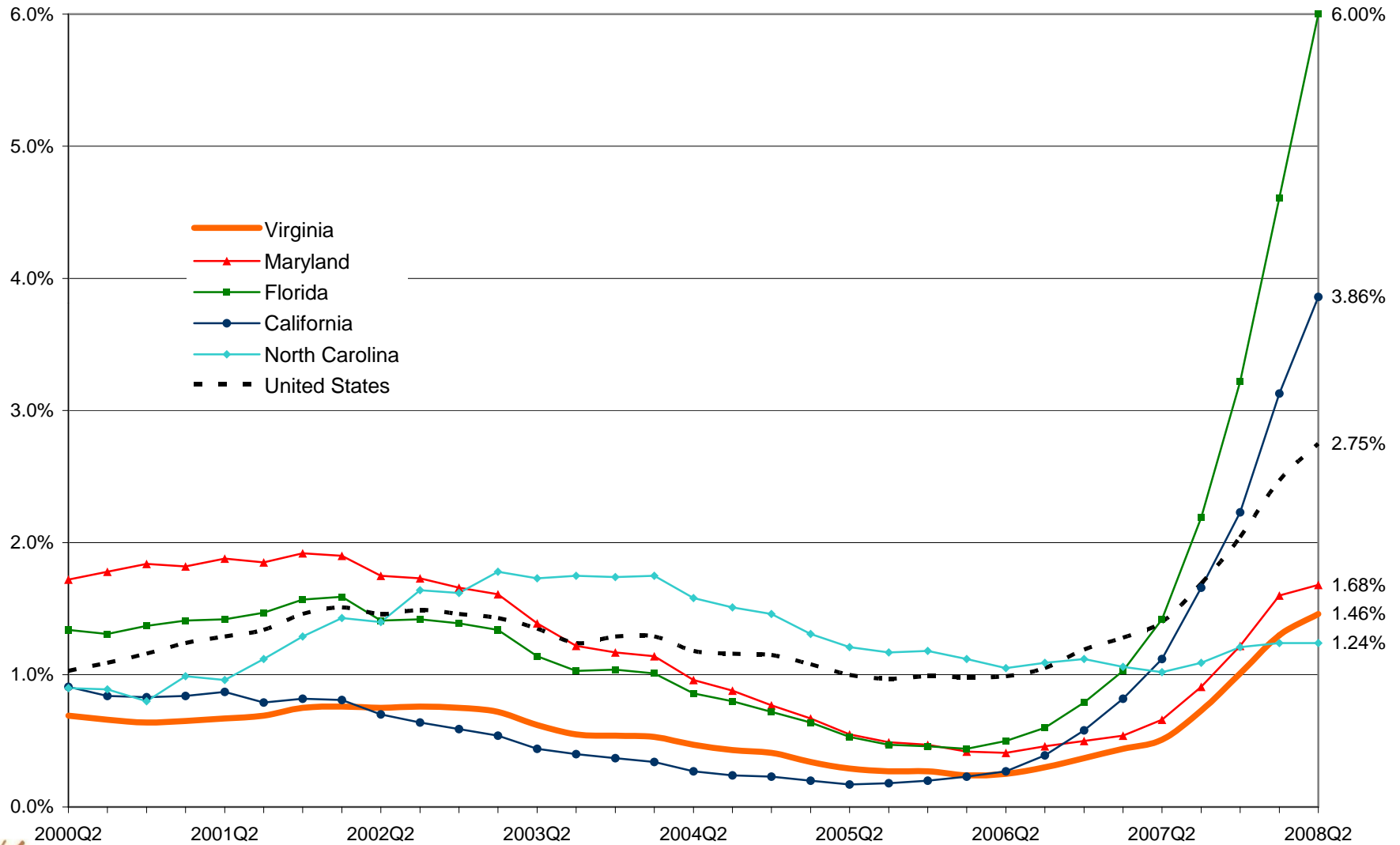
30+ Day Mortgage Delinquency Increases the Most in Northern Virginia

Virginia MSA Level 30+ Delinquency



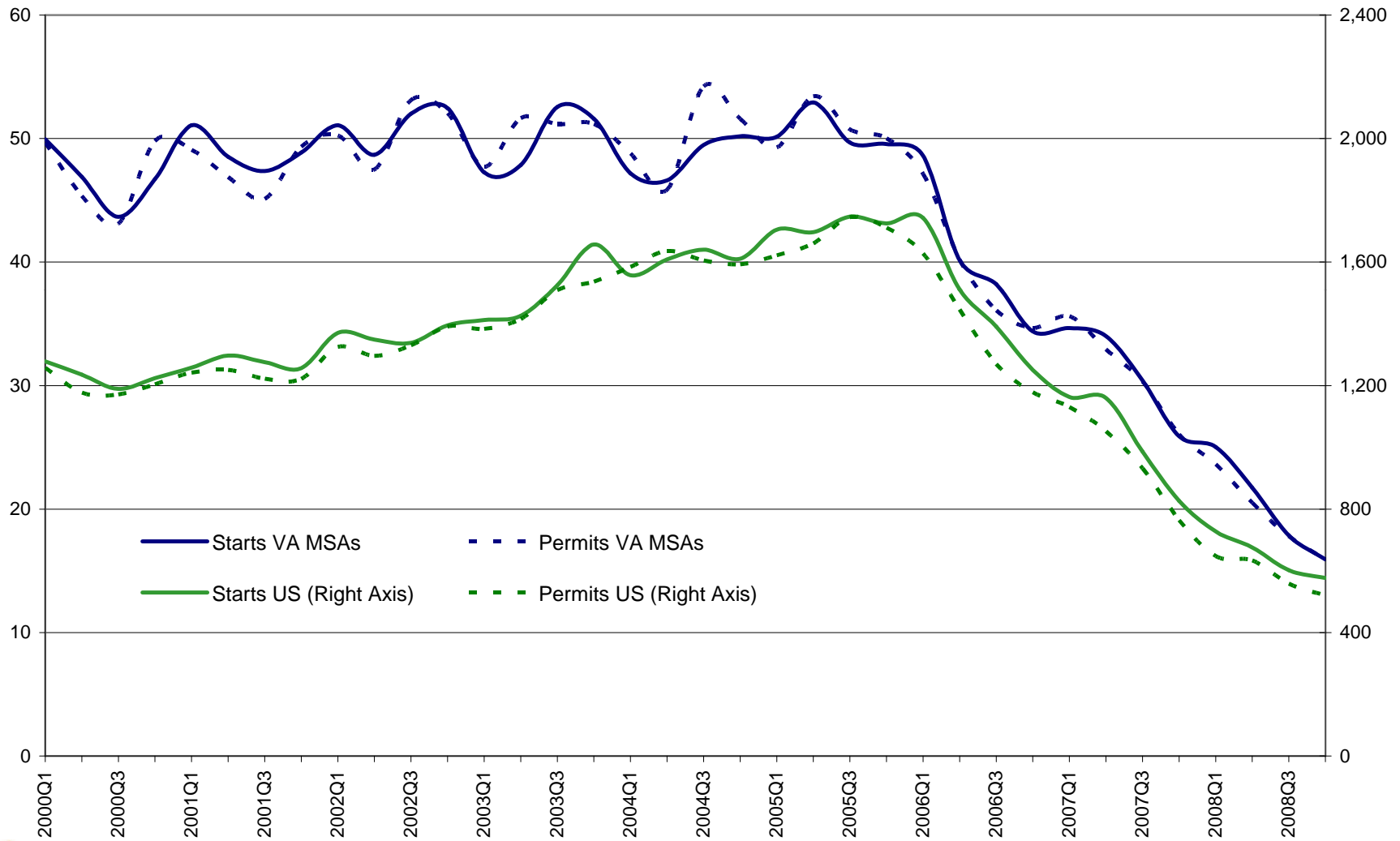
Foreclosure Inventory Rises

State Level Foreclosure Inventory



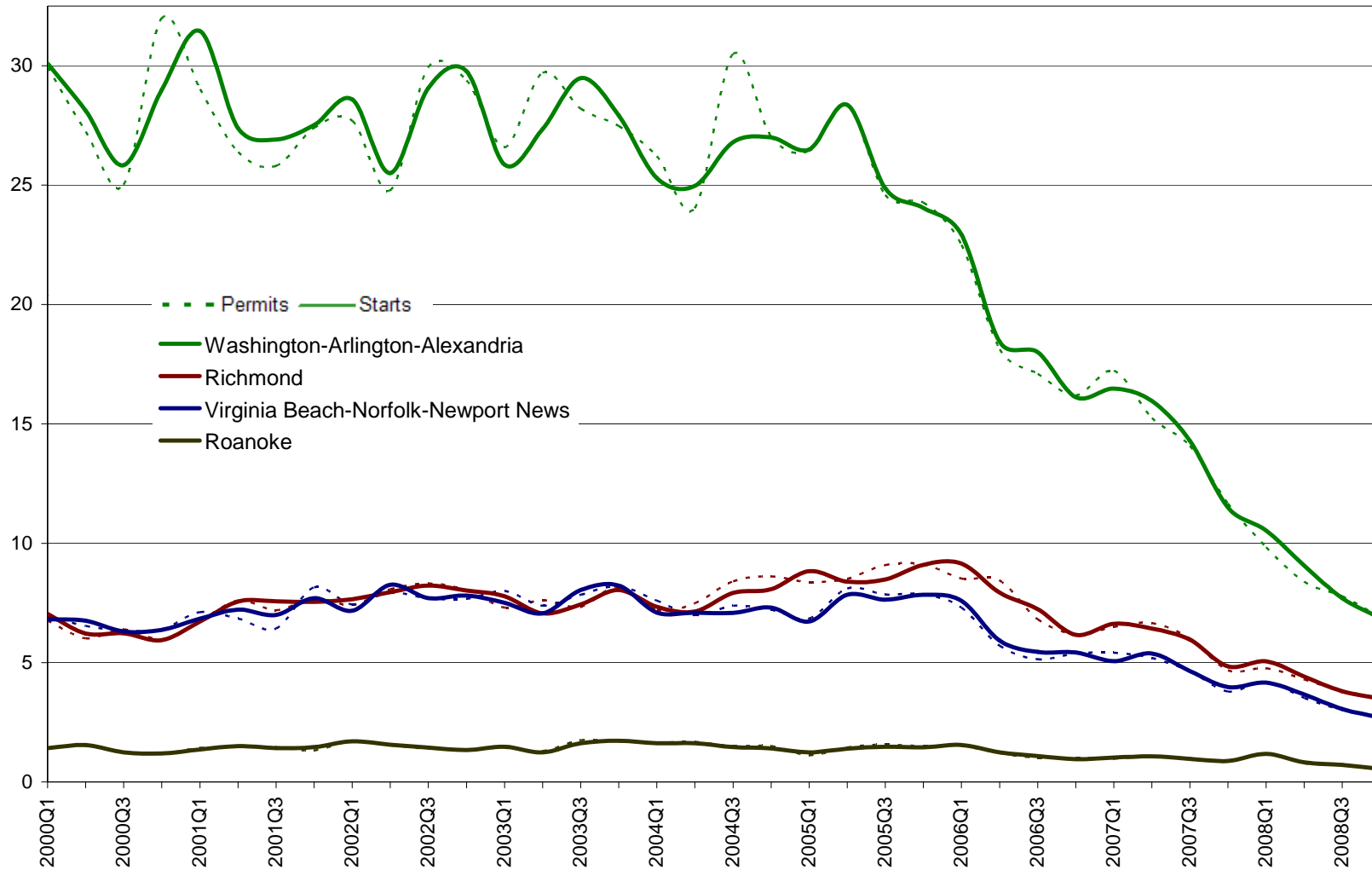
Building is Dramatically Reduced

Large Declines in Total Housing Starts and Permits
Thousands of Units at a SAAR



Northern Virginia Takes the Largest Hit in New Construction

Total Housing Starts and Permits, Large MSA Detail
Thousands of Units at a SAAR

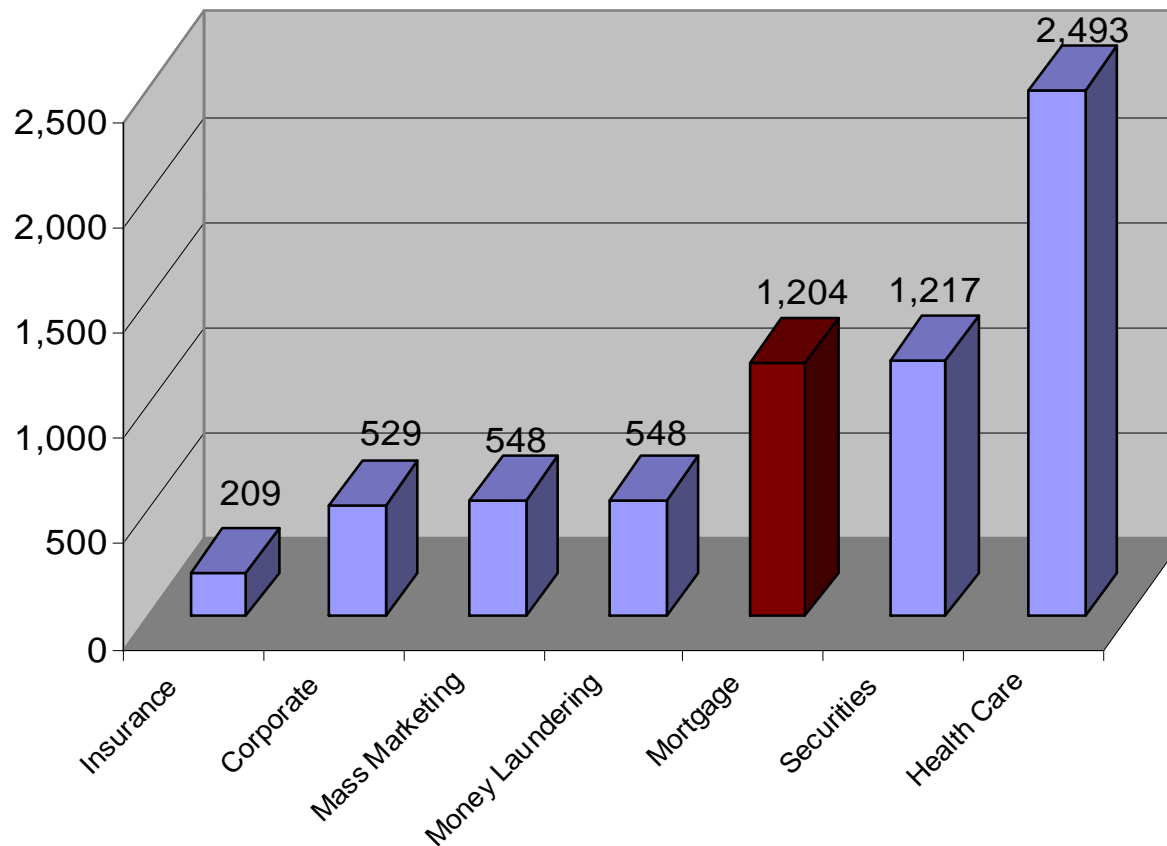


Mortgage Fraud Hits Record Levels in 2007

- Mortgage Fraud is now the 3rd highest financial crime; a close second to securities fraud

Number of Pending Cases *

* FBI Financial Crimes Report to the Public Fiscal Year End 2007



Mainly Located in States That Had Rapid House Price Decreases

The top five mortgage fraud states in the first quarter of 2008 are:

- Number 1: Florida
- Number 2: California
- Number 3: Illinois, Maryland and Michigan (tied for third place.)

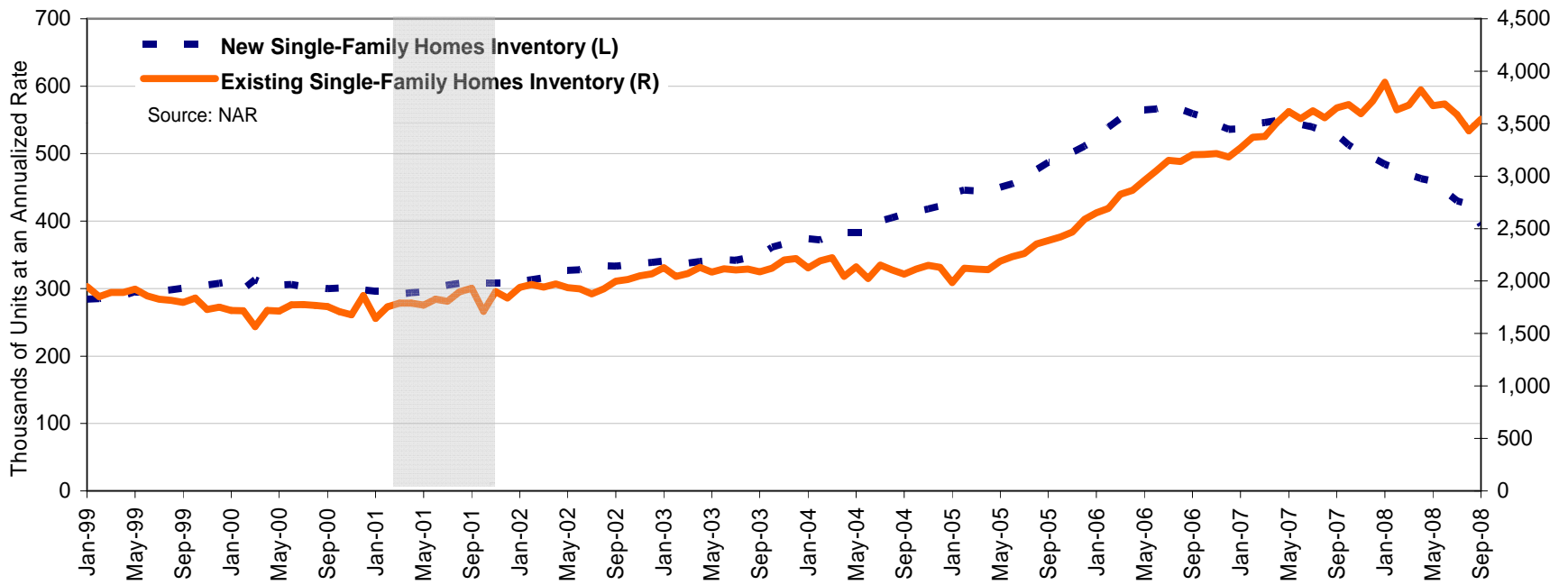
24% of all incidents reported nationwide were for properties in Florida

Fraud Classification	Mortgage Fraud Types ²				
	Analysis of 1Q 2008 State-Specific Findings:				
	Florida	California	Illinois	Maryland	Michigan
General Application Misrepresentation ¹	74%	76%	69%	56%	56%
Income Misrepresentation on the Application	51%	36%	31%	31%	6%
Employment Misrepresentation on the Application	25%	40%	38%	25%	6%
Asset and/or Debt Misrepresentation on the Application	25%	20%	19%	6%	38%
Occupancy Misrepresentation on the Application	23%	8%	6%	19%	6%
ID Theft	2%	4%	6%	0%	0%
Verification of Employment Misrepresentation	21%	16%	25%	19%	13%
Verification of Deposit and/or Bank Statement Misrepresentation	18%	24%	19%	13%	31%
Tax Return and/or Financial Statement Misrepresentation	18%	24%	25%	69%	6%
Undisclosed Non-Arms Length Transactions	11%	16%	0%	6%	6%
Appraisal Misrepresentation	7%	12%	13%	6%	19%
Credit History Documentation Misrepresentation	7%	0%	13%	0%	13%
Escrow and/or Closing Document Misrepresentation	4%	8%	6%	6%	0%

Source: Mortgage Asset Research Institute Quarterly Fraud Report



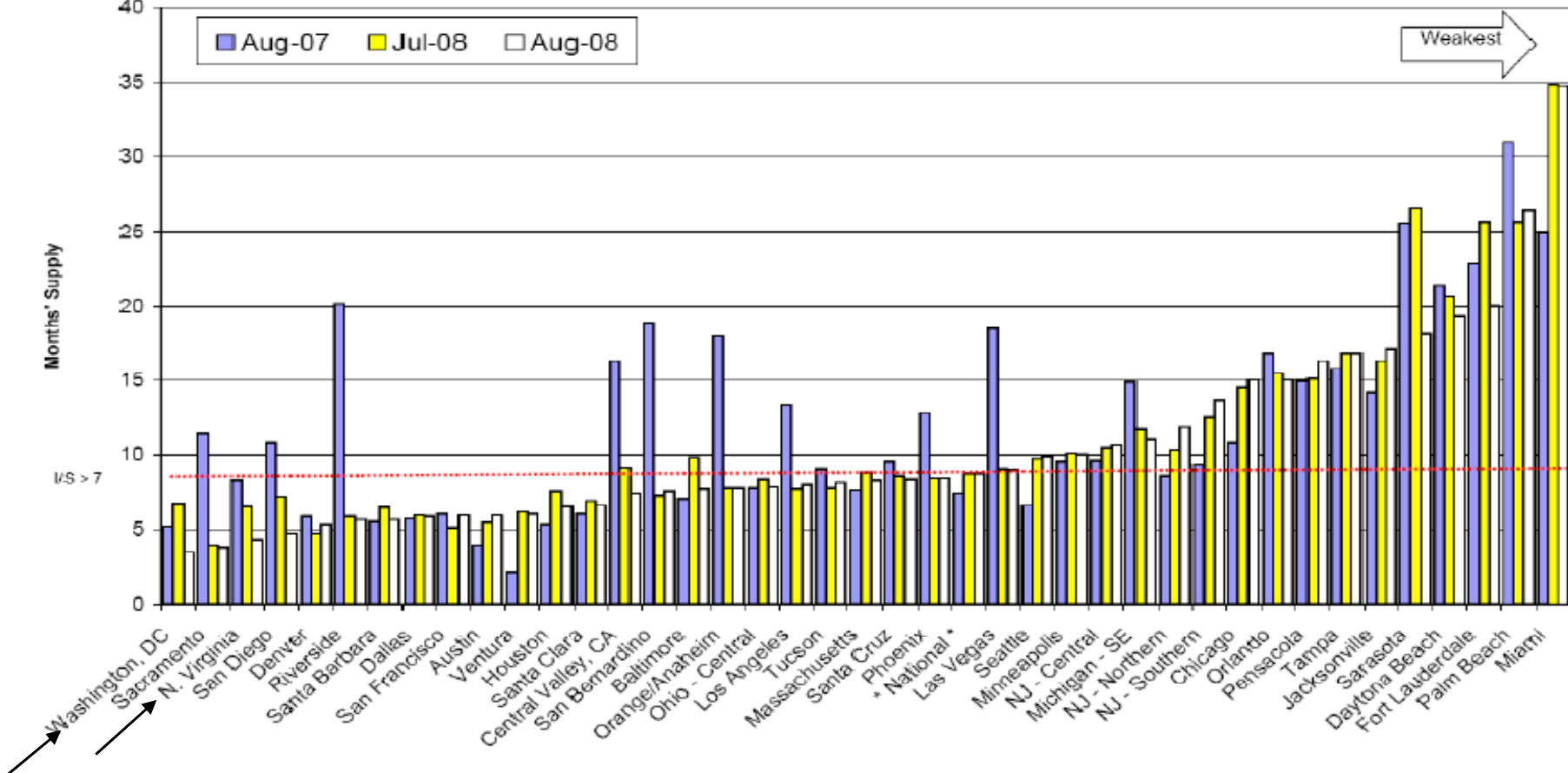
Inventory Increases to Record High Levels



Mostly in Florida

Months' Supply Of Existing Single Family (SFR) Homes On The Market Using August 2008 Data

(MSAs are ranked by recent month's highest I/S ratio, data is not seasonally adjusted)

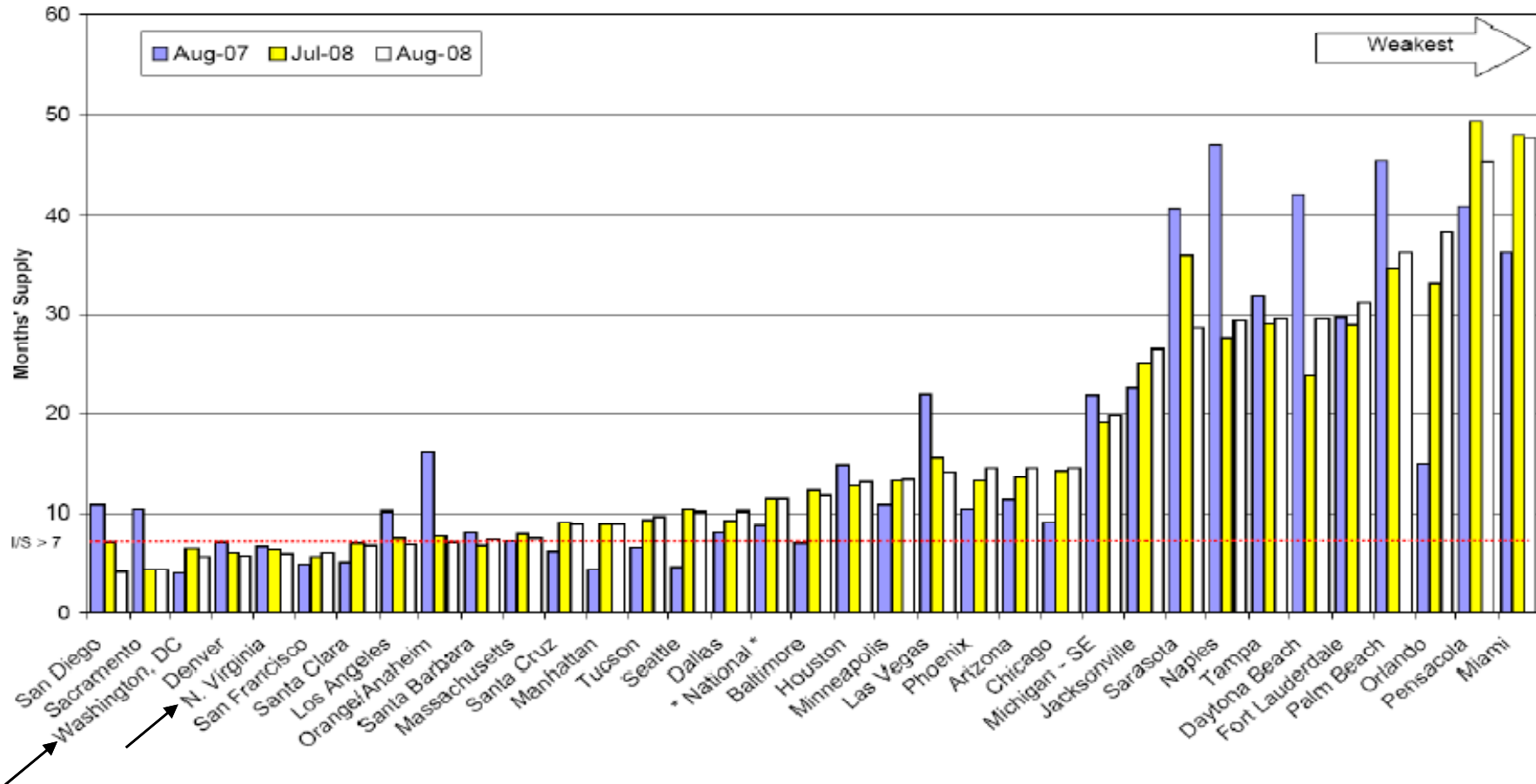


Source: Local Realtor Associations (NSA). Markets with I/S < 4 or > 7 are considered to be in disequilibrium. Some data is from prior month.

Condo Inventory

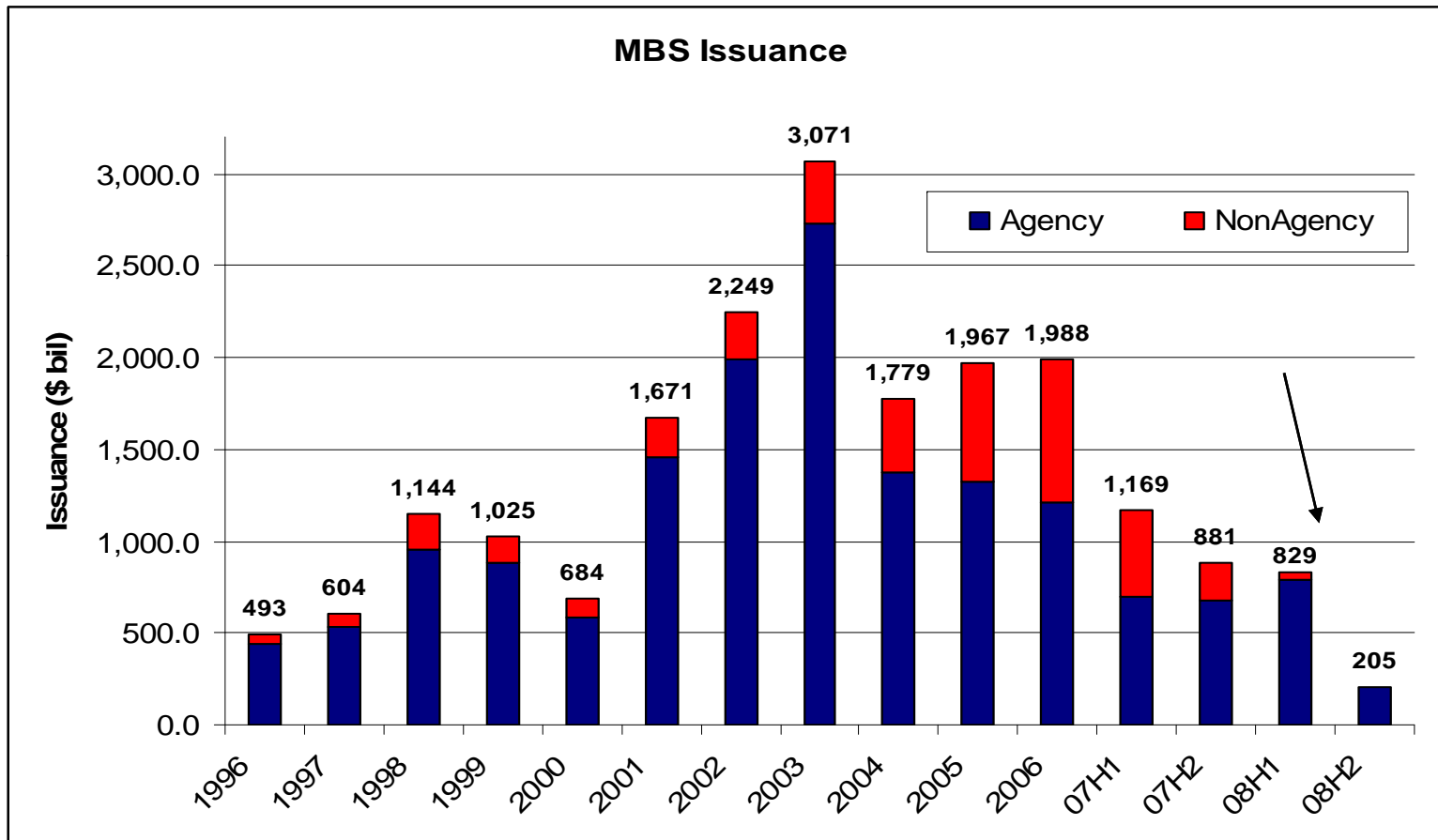
Months' Supply Of Existing Condos On The Market Using August Data

(MSAs are ranked by recent month's highest I/S ratio, data is not seasonally adjusted)



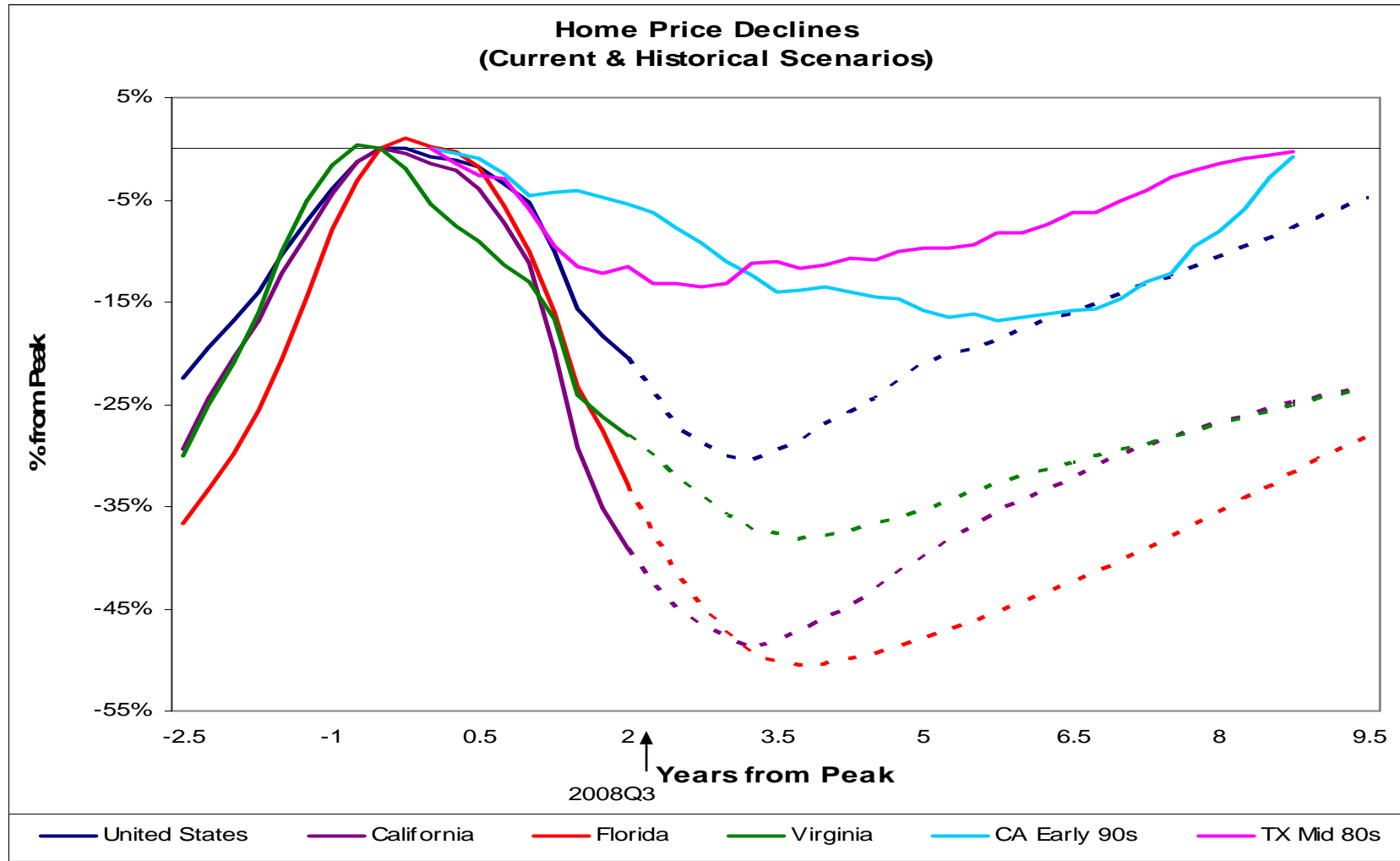
Source: Local Realtor Associations (NSA). Markets with I/S < 4 or > 7 are considered to be in disequilibrium. Some data is from prior month.

The Non Agency Market Ends In 2008



Source: Bond Market Association, 08H2 thru August 2008

Home Prices Will Decline More Than Any Other Downturn



Home Price Forecast by State

Top 15 Declining States plus Neighbor States

Based on July-Aug 2008 originations. Forecasted by Economy.Com as of 10/31/08 with actual through June.

Rank	Metro Area	Case Shiller Forecast Growth	
		4Q07 - 4Q08	4Q08 - 4Q09
1	Nevada	-38.1%	-23.6%
2	Arizona	-30.4%	-15.5%
3	California	-28.2%	-11.2%
4	Florida	-25.7%	-19.3%
5	District Of Columbia	-25.5%	-13.0%
6	Virginia	-16.0%	-10.4%
7	Rhode Island	-15.3%	-13.0%
8	New Jersey	-15.2%	-15.8%
	United States	-15.0%	-8.9%
9	Maryland	-11.8%	-13.0%
10	Minnesota	-11.4%	-2.7%
11	Connecticut	-11.0%	-12.8%
12	Michigan	-10.9%	-3.6%
13	Illinois	-10.5%	-6.1%
14	New Hampshire	-9.9%	-10.3%
15	Oregon	-9.5%	-13.6%
...
29	Tennessee	-3.2%	-2.9%
...
41	Kentucky	0.3%	-2.3%
...
48	North Carolina	1.5%	-3.1%
49	West Virginia	1.7%	-0.5%

Virginia MSAs Home Price Forecast

Virginia MSAs Ranked by Price Decline

Forecasted by Economy.Com as of October 31, 2008 with actual through June 2008

Rank	Metro Area	Case Shiller Forecast Growth	
		4Q07 - 4Q08	4Q08 - 4Q09
40	Washington-Arlington-Alexandria	-19.4%	-13.0%
71	Winchester	-12.2%	-14.8%
124	Virginia Beach-Norfolk-Newport News	-4.0%	-13.3%
125	Charlottesville	-3.8%	-2.5%
146	Richmond	-2.5%	-4.1%
194	Blacksburg-Christiansburg-Radford	-0.2%	-2.2%
248	Harrisonburg	0.7%	-10.8%
268	Lynchburg	1.1%	-2.5%
305	Roanoke	2.0%	-1.6%
306	Danville	2.0%	-1.5%

WHERE DO WE GO?

Viewpoint 2009

Major changes are occurring on a day to day basis. It is impossible to predict the future with certainty. But we do see a number of trends we can rely on for planning purposes.

Competitors and Markets

- Fewer large lenders
- Liquidity will be supplied by
 - GSE's
 - FHA
 - Bank portfolios
- Little jumbo liquidity
- Too soon to predict impacts from recent, history making, government actions. But likely impacts include;
 - Spreads narrow closer to Treasury yields
 - Treasury yields may have to rise due to increased national debt and weakened dollar
 - Net effect may be to create a moderately lower mortgage interest rate environment
 - Early yet to tell if rates will fall enough to trigger significant refinance activity

Viewpoint 2009

Housing Impacts

- **Government action is not the panacea to falling housing prices; laws of supply and demand still reign**
 - **Actions will provide credit and confidence to buyers**
 - **Many markets are still well oversupplied; price stability will take more time to be achieved**
 - **Home price stability on the national level not likely to occur until late 2009**
- **People still need housing**
 - **Affordability will be the new philosophy**
 - **Government support will supply liquidity and reasonable mortgage rates**
 - **Low unemployment rates and stable, documented, borrower incomes will be key**

Sales Channels

- **Lower risk from broker channel**
 - **Originator registration, licensing, and minimum standards being put in place**
 - **Fewer brokers**
 - **Major changes from NY Attorney General settlement with GSE's mandating appraisal ordering and control by lender and not the broker**
 - **Use of fraud tools to analyze broker, borrower, and property**

Viewpoint 2009

Cost of Production Rises

- **New technologies to combat fraud**
 - “Core Logic” – Appraisal validation; soon to add checks for borrower income, occupancy and identity
 - “MERS” – Checks for undisclosed mortgage debts
 - “FNC” – Provides for appraiser rotation; scores appraisal and appraiser quality
- **Quality control checks and secondary reviews will increase**
- **Secondary market and government agencies will demand increased quantity and quality of data**

Operational excellence is key to profitability

- **FHA loans insured on time**
- **Loan guidelines must be strictly adhered to**
- **Increased regulatory compliance and fair lending oversight should be expected**