

August 6, 2011

Housing Overview

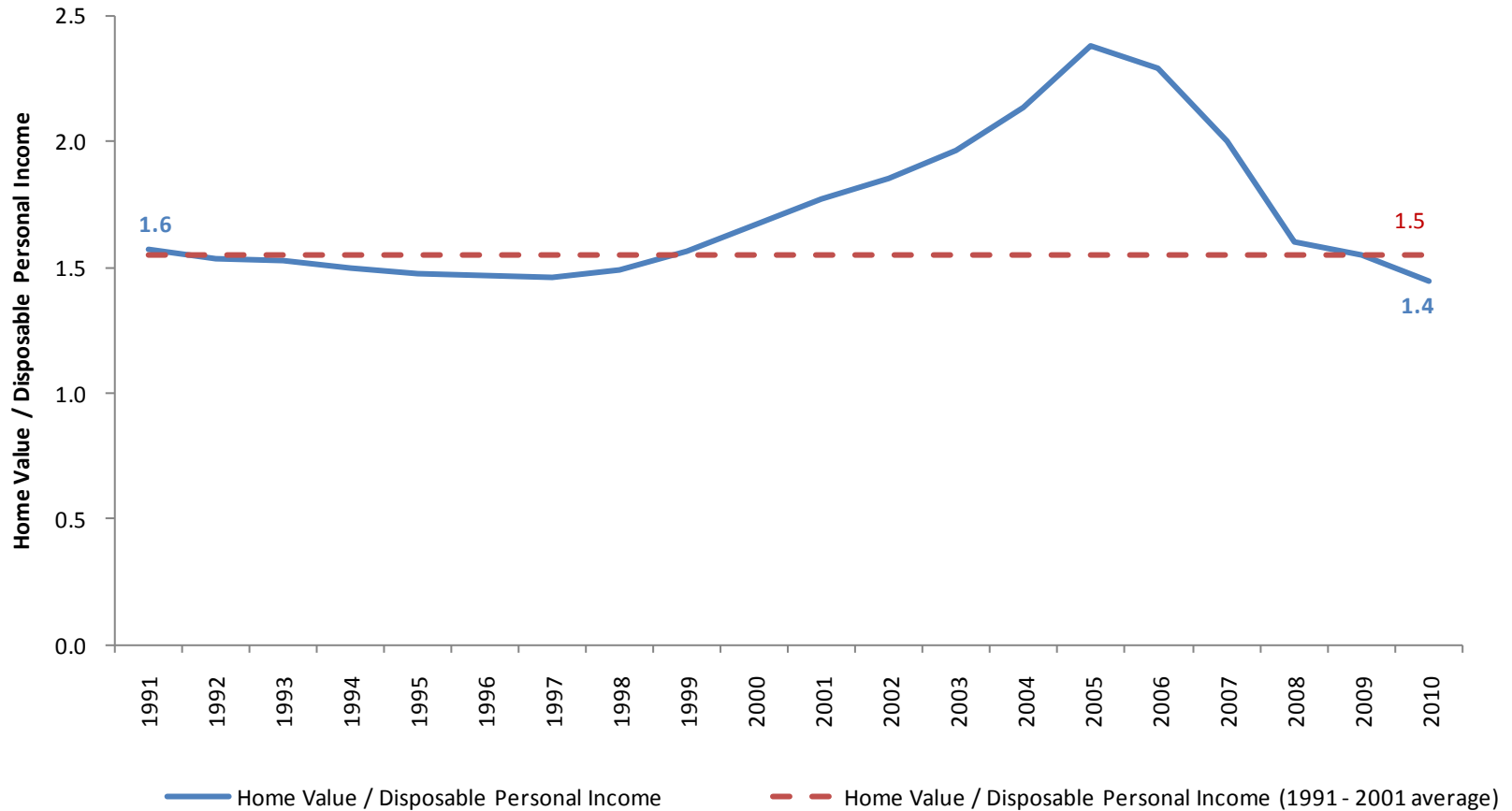
PINE BROOK

Housing Overview

- As you may remember, we believed housing was overvalued by approximately 30% when we were initially marketing the firm
 - Our view was driven by our analysis of “affordability” – the increase in housing prices vs. the increase in disposable personal income
- Since that time, housing affordability has largely been restored
 - Housing prices are back to approximately 2003 – 2004 levels
 - Disposable personal income has continued to increase over time
 - The combination of these factors brought housing affordability back to equilibrium
- However, housing prices continue to decline reflecting excess housing supply
- The primary way to reduce excess housing supply is through household formation
- The question is – how long will it take for the housing market to reach equilibrium?

Housing Affordability Is Restored

Housing Affordability



Source: Federal Reserve Flow of Funds.

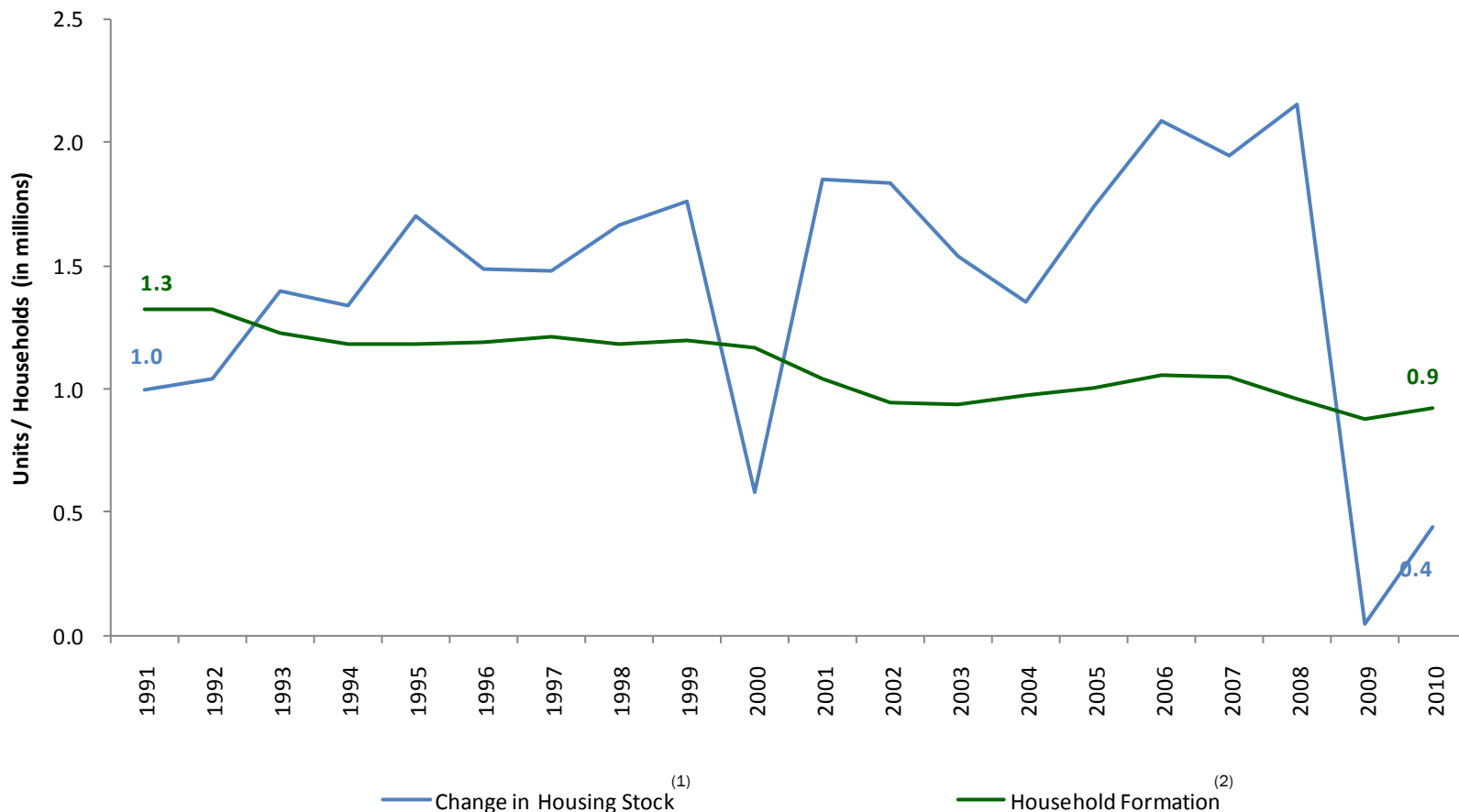
But Excess Housing Stock Remains

Pine Brook believes there are approximately 4 million excess homes

- Method 1: Estimate the cumulative amount of homes built in excess of household formation
- Method 2: Estimate the amount of vacant homes in excess of normalized vacancy rates

Method 1: The Housing Stock Grew Faster Than Household Formation, Creating Excess Inventory

Change in Housing Stock vs. Household Formation



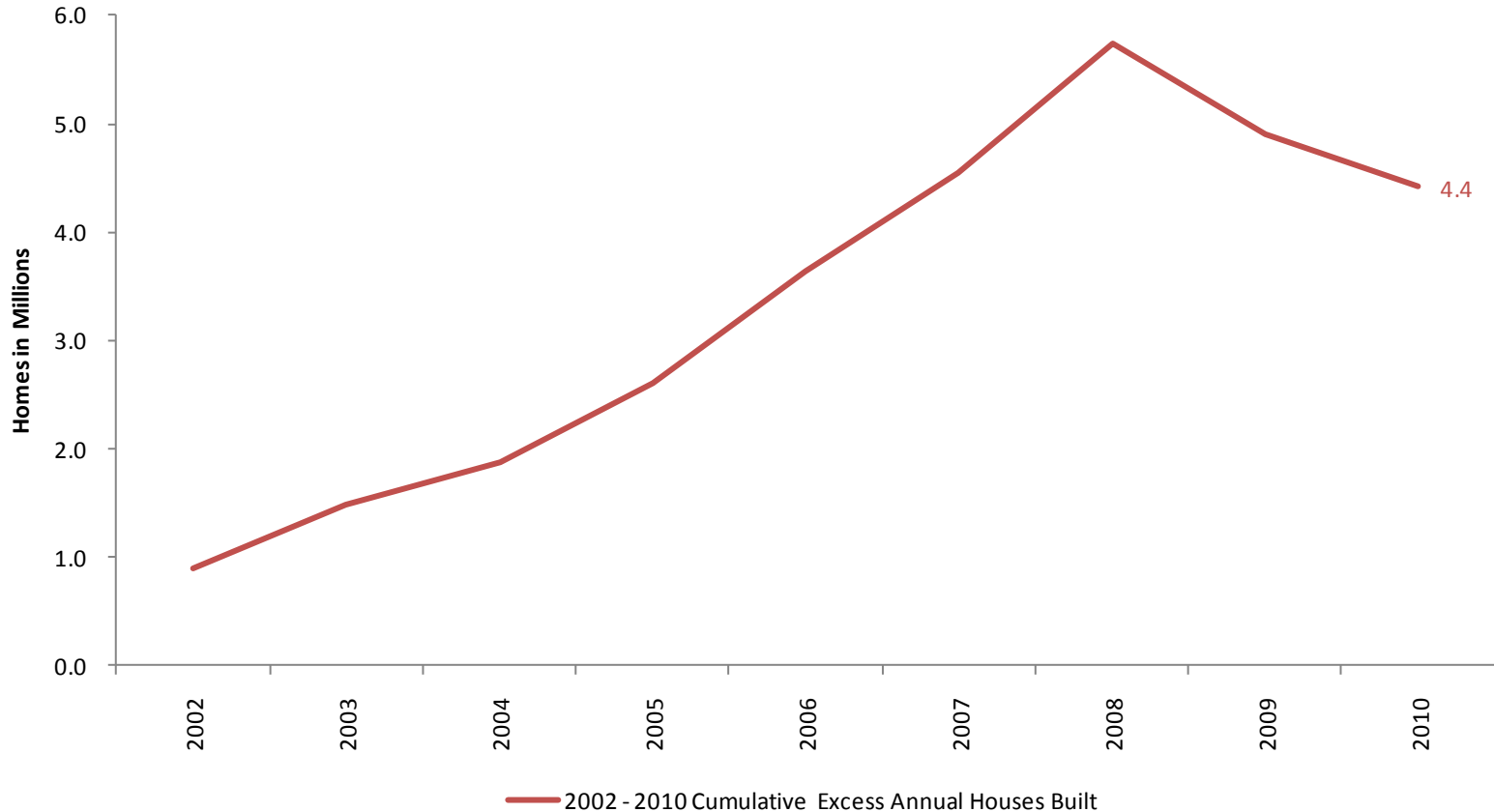
Source: Census Bureau.

(1) Defined as net change in housing stock. This metric accounts for new construction, teardowns, and other movements in the housing stock.

(2) Defined as increase in population divided by people per occupied house.

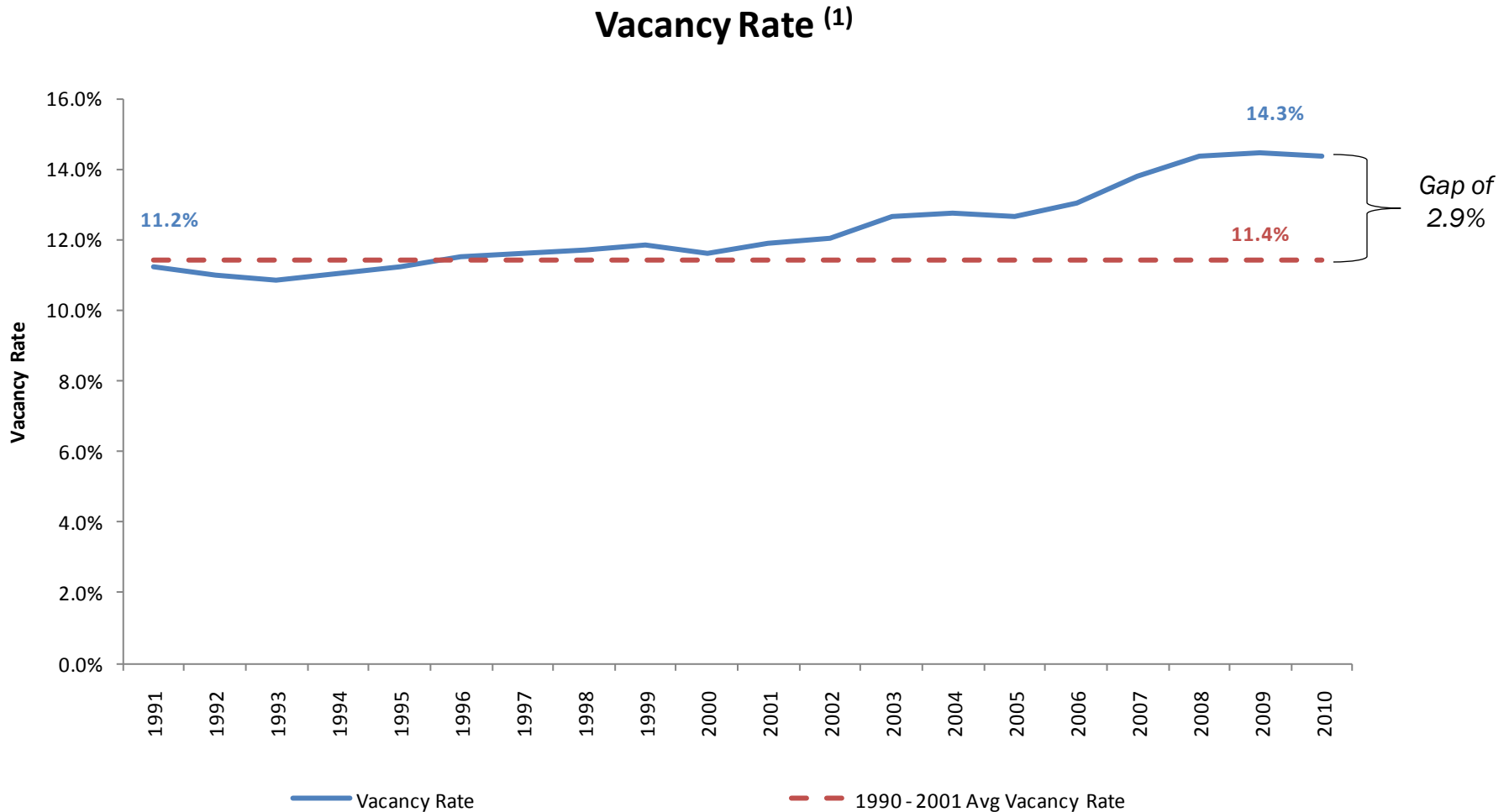
Method 1: Approximately 4.4 Million Homes were Built in Excess Of Household Formation Since 2002

Cumulative Excess Homes



Source: Census Bureau.

Method 2: The Vacancy Rate is Approximately 2.9% Above the Historical Average

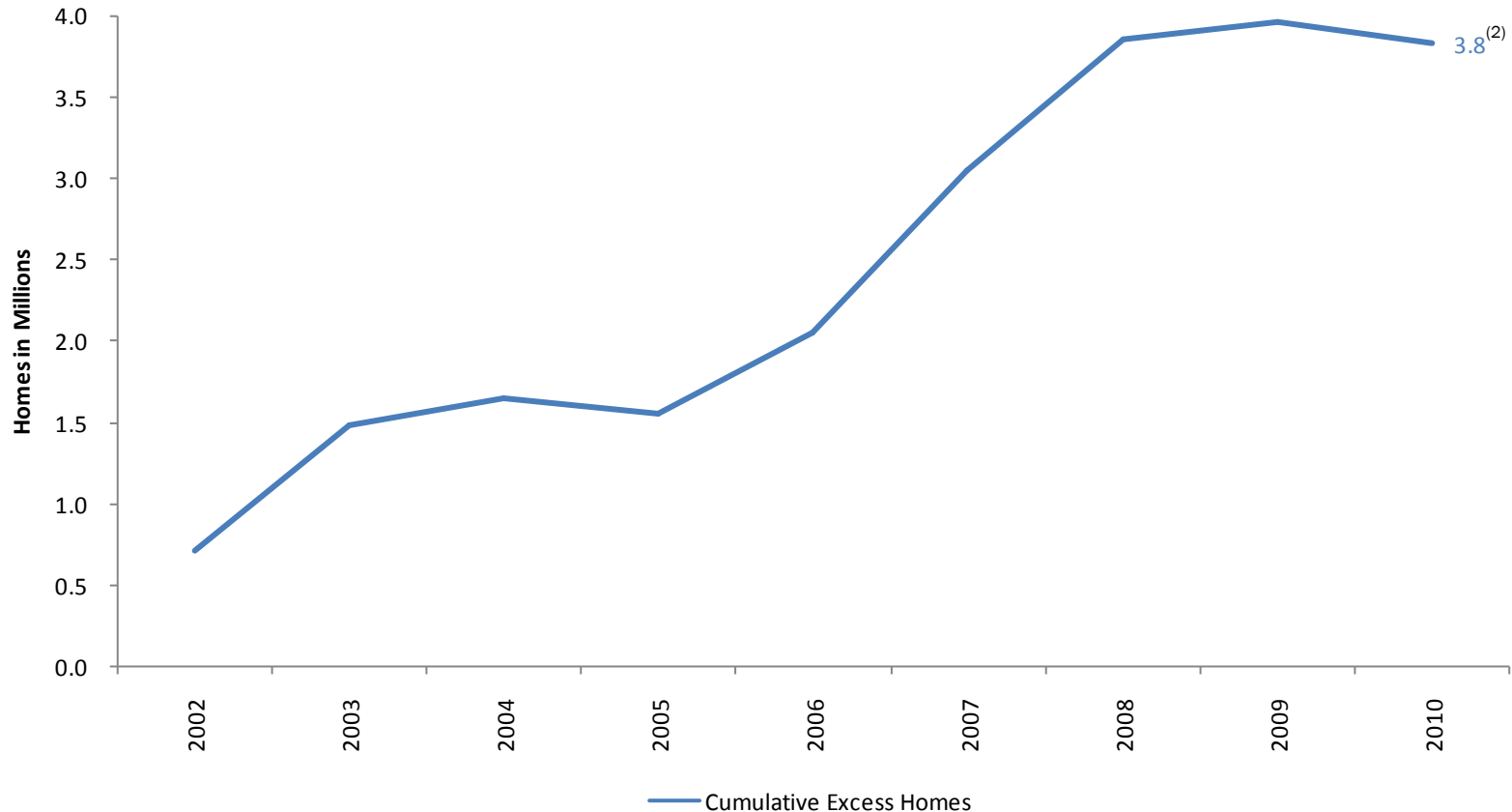


Source: U.S. Census Bureau.

(1) Defined as vacant houses divided by total housing stock.

Method 2: This Translates to Approximately 3.8 Million Excess Homes

Cumulative Excess Homes⁽¹⁾



Source: Census Bureau.

(1) Defined as the amount of vacant homes over the normalized vacancy level as calculated from 1990 – 2001.

(2) Calculated as 2.9% excess vacancy rate times approximately 131 million homes.

Conclusions

- Housing market has moved from “very unfavorable” to “unfavorable to neutral”
 - Homes are now affordable
 - The supply issue is in the process of being resolved through household formation

- If the U.S. were “one market,” than it would take between approximately 3 to 6 years to run off excess inventory ⁽¹⁾

- However, real estate is a local business
 - The real analysis needs to be done at the local level
 - Since there are housing starts, some markets must be close to equilibrium
 - Other markets, where the overbuild was substantial, will take longer to reach equilibrium
 - » Certain markets have homes that will never be filled, and need to be excluded from inventory

(1) 3 year time frame to run off excess inventory assumes that 50% of the excess homes will never be inhabited.

Conclusions

- Pine Brook consulted with Essent, our mortgage insurance company, to discuss the excess housing inventory problem
 - Essent agrees with Pine Brook’s methodology for analyzing the excess housing inventory

- Essent conducts an extremely thorough analysis of the housing market
 - Essent conducts a bottoms-up analysis by MSA instead of a top-down analysis at the national level
 - Essent utilizes complex models that forecast home price appreciation through analysis of historical housing market, economic, and demographic data
 - This information is input into Essent’s proprietary models, resulting in maximization of risk adjusted returns

- In summary, Essent believes the overall recovery is closer to 3 years away than 6 years, but varies by market
 - Quick recovery expected in Minneapolis, MN; Toledo, OH; and Forth Worth/Arlington, TX
 - Longer recovery expected in Miami, FL; Las Vegas, NV, and Riverside, CA