

ECONOMIC REAL ESTATE TRENDSSM

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PMI MORTGAGE INSURANCE CO.



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Will Demographics Support a Housing Recovery?

Cyclical economic factors are the most important determinants of housing demand in the short run. Items such as job growth, unemployment rates, income (both levels and growth), mortgage rates, home prices, and housing affordability drive the decision to buy, rent, or move-in with others at any specific time. Over the longer run, however, demographic factors – such as the number of new households, as well as the age and structure of households – tend to be the primary factors in determining housing demand. Demographics were strongly anti-housing during the Great Recession, but they have improved significantly in the past year. If continued, the stronger demographic factors suggest a pickup in housing activity.

The most important demographic driver of housing demand is household formations, as all households have to live someplace. A household may rent or it may own, but each household lives someplace and so adds to housing demand. Households are formed when immigrants move to the U.S., divorces occur (two households result from the split), children move away from their parents, or unrelated adults who had been living in the same household move apart. Household formations tend to be procyclical, as recessions incent people to move together

into a single household and make it more likely that adult children will move back in with their parents (especially if they have not found jobs, or have become unemployed).

The Census Bureau publishes two measures of households: an annual measure (which is based on data as of March of the year published), and a monthly measure taken from the quarterly Housing Vacancy Survey. The annual measure of households increases every year (and always should in the absence of disastrous wars or Steven

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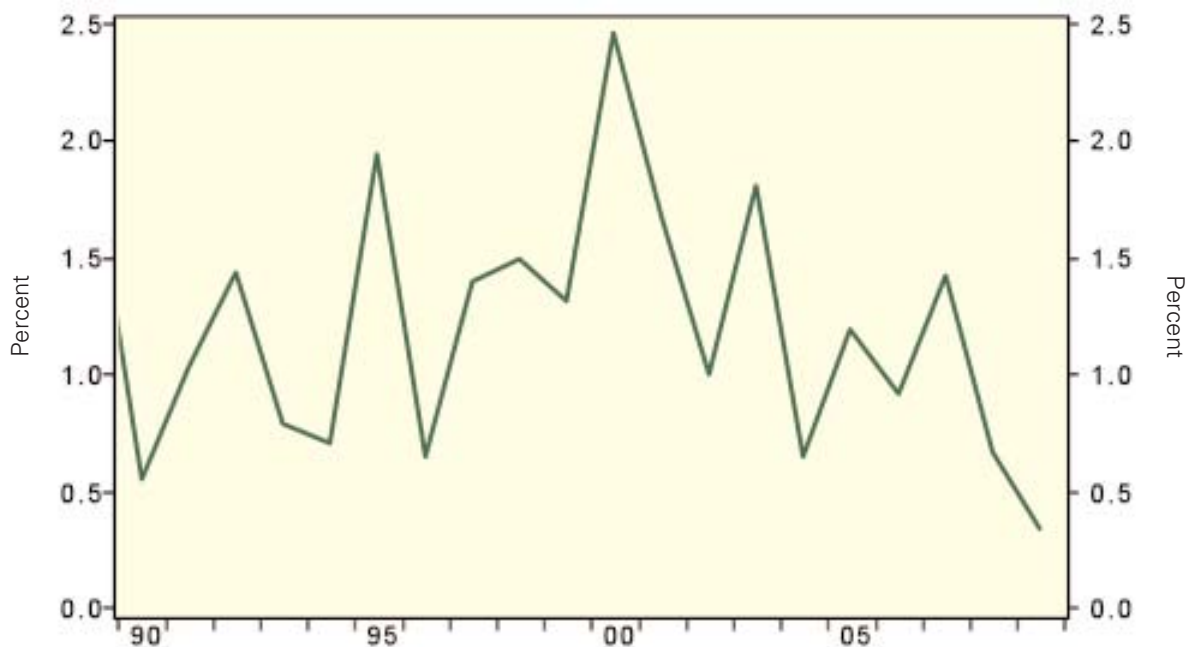
Will Demographics Support a Housing Recovery?

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King-type plagues), but the pace can vary sharply. **Figure 1** shows the growth rate of the annual measure of households. Especially striking is the sharp falloff in household formations for 2009, with the 0.3 percent gain being the smallest in the post-War period. The sharp drop in home sales was augmented by this decline in new households formed.

The monthly measure of households is more volatile, but gives a more timely measure of household growth than the annual measure. **Figure 2** shows the 12-month growth rate of the monthly measure and the same sharp drop during the Great Recession is evident in the monthly figures. Note that the 12-month decline in households for a couple of months during 2008 is due to the volatility of the survey rather than actual declines in the number of households.

FIGURE 1: Total Number of Households / % Change – Year to Year (thousands)



Source:
Census Bureau /
Haver Analytics

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Economic Trends in the Nation's MSAs

PMI's U.S. Market Risk Index measures the likelihood of lower home prices in two years for each of the nation's 366 metropolitan statistical areas (MSAs) and 29 Metropolitan (Metro) Divisions. (Note that 11 MSAs are divided into the 29 Metro Divisions, and we analyze only the remaining 355 MSAs plus all of the Metro Divisions. We refer to both MSAs and Metro Divisions as MSAs for simplicity.) The Risk Index uses economic, housing, and mortgage market factors (including home price appreciation, employment, affordability, excess housing supply, interest rates, and foreclosure activity) to determine these probabilities.

A According to PMI's Risk Index, risk in many of the nation's MSAs decreased during the first quarter of 2010. While there weren't as many decreasing risk scores as the previous quarter, this quarter was still a step in the right direction with less overall risk in an improving housing market. The average risk score has dropped for three consecutive quarters now and is nearing 50.0 percent. Affordability has declined slightly due to increasing mortgage rates (although these rates are still very low historically) and foreclosure rates increased slightly, but the negative effect of these factors on risk scores has been outweighed by decreasing unemployment rates and improvement in other economic and mortgage-related statistics. These offsetting factors are leading to overall decreases in the risk of house prices being lower in two years in many MSAs.

During the first quarter of 2010, risk decreased in 40 of the nation's 50 most populated (Top-50) MSAs. Among all MSAs, risk scores in 290 (75.5%) decreased. Despite the decline in risk scores across many MSAs, the average risk score was still above 50. The unweighted average risk score dropped from 53.8 to 51.9 between the fourth quarter 2009 and the first quarter 2010, the third consecutive quarter the average risk score has declined.

Trends in Risk

Among the Nation's Top-50 MSAs:

- Twenty eight had a risk score exceeding 70, placing them in the highest risk category.
- Seven had risk scores between 50 and 70, giving them an elevated risk designation.
- Six had moderate risk scores between 30 and 50.
- Eight were deemed low risk with scores between 10 and 30.
- And one had a minimal risk score of below 10.

Overall, 70 percent of the nation's Top-50 MSAs have a greater than 50 percent chance of lower house prices by the end of the first quarter of 2012, slightly up from 68 percent in the previous quarter. Note, however, that the Risk Index does not measure magnitudes, so these potential declines might not be big. Moreover, the Risk Index does not project the pattern of potential house price declines, so drops in 2010 could be followed by smaller increases in 2011.

Across all of the nation's MSAs, 51.6 percent (198) ranked in the elevated and high risk (of price decline) categories, while 48.4 percent (186) had a minimal-to-moderate risk of lower prices in two years. The MSAs in the elevated and high risk categories typically had higher unemployment rates, higher new foreclosure rates, lower affordability, a larger excess housing supply, and more volatile house prices, than the MSAs in minimal-to-moderate risk categories.

All MSAs in **Florida** and **Nevada** had risk scores that remained in the 90s (most in the upper 90s). **Arizona** still had very high risk scores as well, mostly because of high foreclosure rates and rising unemployment. **New Jersey** also had very high risk scores, with all of its MSAs in the high risk category and only one that was not in the 90s.

Risk in **California** showed solid improvement, with most of its MSAs decreasing in risk. Only three of California's 28 MSAs suffered increasing risk scores. Even with this improvement, California's MSAs had high risk scores, but we expect to see further improvement in coming quarters. **New York** is another state with improving risk scores, with **Syracuse** (down by 16.7 percentage points) and **Rochester** (down by 14.2 percentage points) improving more than any other MSAs in the country.

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Worst Performing MSAs

COMPARISON BY PMI RISK SCORE

MSA	RISK CLASSIFICATION	RISK SCORE
Naples-Marco Island, FL	High	99.9
Lake Havasu City-Kingman, AZ	High	99.9
Lakeland-Winter Haven, FL	High	99.9
Port St. Lucie, FL	High	99.9
Cape Coral-Fort Myers, FL	High	99.9
Miami-Miami Beach-Kendall, FL	High	99.9
Punta Gorda, FL	High	99.9
Las Vegas-Paradise, NV	High	99.9
Fort Lauderdale-Pompano Beach-Deerfield Beach, FL	High	99.9
Riverside-San Bernardino-Ontario, CA	High	99.9

COMPARISON BY ANNUAL HOUSE PRICE APPRECIATION RATE

MSA	RISK CLASSIFICATION	HOUSE PRICE APPRECIATION RATE
Carson City, NV	High	-30.3
Gainesville, GA	Elevated	-30.3
Las Vegas-Paradise, NV	High	-30.3
Lewiston, ID-WA	Elevated	-30.0
Ocala, FL	High	-29.9
Reno-Sparks, NV	High	-29.9
Boise City-Nampa, ID	High	-29.9
Manhattan, KS	Minimal	-29.2
Orlando-Kissimmee-Sanford, FL	High	-28.4
Flagstaff, AZ	High	-28.4

COMPARISON BY Demeaned UNEMPLOYMENT RATES

MSA	RISK CLASSIFICATION	DEMEANED UNEMPLOYMENT RATE
El Centro, CA	High	13.5
Palm Coast, FL	High	11.4
Rockford, IL	High	10.6
Ocala, FL	High	10.5
Elkhart-Goshen, IN	High	10.0
Cape Coral-Fort Myers, FL	High	9.9
Yuba City, CA	High	9.6
Port St. Lucie, FL	High	9.3
Riverside-San Bernardino-Ontario, CA	High	9.1
Sebastian-Vero Beach, FL	High	9.1

COMPARISON BY HOUSING AFFORDABILITY

MSA	RISK CLASSIFICATION	AFFORDABILITY SCORE
Honolulu, HI	High	82.6
Yuma, AZ	High	87.7
Kingston, NY	High	90.4
Ocean City, NJ	High	90.5
Atlantic City-Hammonton, NJ	High	92.7
Nassau-Suffolk, NY	High	94.9
Barnstable Town, MA	High	100.0
New York-White Plains-Wayne, NY-NJ	High	102.2
Parkersburg-Marietta-Vienna, WV-OH	High	102.3
Santa Ana-Anaheim-Irvine, CA	High	102.4

Best Performing MSAs

COMPARISON BY PMI RISK SCORE

MSA	RISK CLASSIFICATION	RISK SCORE
Fargo, ND-MN	Minimal	<1
Grand Forks, ND-MN	Minimal	<1
Killeen-Temple-Fort Hood, TX	Minimal	<1
Fayetteville, NC	Minimal	<1
Lawton, OK	Minimal	1.0
Bismarck, ND	Minimal	1.1
Cedar Rapids, IA	Minimal	1.2
Texarkana, TX-Texarkana, AR	Minimal	1.2
Ames, IA	Minimal	1.2
Iowa City, IA	Minimal	1.7

COMPARISON BY ANNUAL HOUSE PRICE APPRECIATION RATE

MSA	RISK CLASSIFICATION	HOUSE PRICE APPRECIATION RATE
Honolulu, HI	High	15.1
Alexandria, LA	Moderate	13.3
Sherman-Denison, TX	Low	7.5
Kennewick-Pasco-Richland, WA	Low	7.1
Erie, PA	Moderate	7.0
San Jose-Sunnyvale-Santa Clara, CA	High	6.5
Oshkosh-Neenah, WI	Low	5.9
Elizabethtown, KY	Moderate	5.9
Macon, GA	High	5.7
Oxnard-Thousand Oaks-Ventura, CA	High	5.6

COMPARISON BY Demeaned UNEMPLOYMENT RATES

MSA	RISK CLASSIFICATION	DEMEANED UNEMPLOYMENT RATE
Manhattan, KS	Minimal	0.8
Grand Forks, ND-MN	Minimal	0.8
Lawton, OK	Minimal	1.1
Bismarck, ND	Minimal	1.1
Lincoln, NE	Minimal	1.2
Kennewick-Pasco-Richland, WA	Low	1.2
Topeka, KS	Low	1.2
Lawrence, KS	Minimal	1.2
Houma-Bayou Cane-Thibodaux, LA	Minimal	1.2
Fargo, ND-MN	Minimal	1.3

COMPARISON BY HOUSING AFFORDABILITY

MSA	RISK CLASSIFICATION	AFFORDABILITY SCORE
Fayetteville, NC	Minimal	222.8
Merced, CA	High	221.1
Cape Coral-Fort Myers, FL	High	202.5
Killeen-Temple-Fort Hood, TX	Minimal	195.7
Lawton, OK	Minimal	191.4
Niles-Benton Harbor, MI	Moderate	189.7
Youngstown-Warren-Boardman, OH-PA	Minimal	189.0
Springfield, OH	Low	188.4
El Centro, CA	High	187.1
Las Vegas-Paradise, NV	High	184.1



MSA

	STATE	RISK RANK	PMI U.S. MARKET RISK INDEX ¹		PRICE APPRECIATION ³			
			1Q '10	4Q '09 ²	Volatility ⁴	1Q '10	1Q '09	Difference
Miami-Miami Beach-Kendall	FL	High	99.9	99.9	46.6	-4.1	-28.5	24.43
Las Vegas-Paradise NV	NV	High	99.9	99.9	42.7	-13.4	-28.3	14.81
Fort Lauderdale-Pompano Beach-Deerfield Beach FL	FL	High	99.9	99.9	40.3	-6.5	-19.4	12.97
Riverside-San Bernardino-Ontario CA	CA	High	99.9	99.9	44.5	-0.1	-27.3	27.25
Tampa-St. Petersburg-Clearwater FL	FL	High	99.9	99.9	32.6	-6.9	-18.3	11.45
Orlando-Kissimmee-Sanford FL	FL	High	99.9	99.9	40.1	-10.8	-21.9	11.16
Jacksonville FL	FL	High	99.9	99.9	22.9	-8.0	-12.5	4.51
Los Angeles-Long Beach-Glendale CA	CA	High	99.9	99.9	37.6	2.1	-20.2	22.22
Santa Ana-Anaheim-Irvine CA	CA	High	99.7	99.8	28.8	1.9	-15.0	16.83
Phoenix-Mesa-Glendale AZ	AZ	High	99.4	99.6	40.4	-5.9	-23.3	17.36
San Diego-Carlsbad-San Marcos CA	CA	High	98.8	99.2	28.9	4.8	-17.1	21.94
Detroit-Livonia-Dearborn MI	MI	High	98.7	98.9	6.6	-10.7	-19.5	8.75
Sacramento--Arden-Arcade--Roseville CA	CA	High	98.0	98.5	35.5	-2.8	-18.1	15.33
Newark-Union NJ-PA	NJ	High	94.7	96.1	18.6	-4.0	-10.4	6.38
Edison-New Brunswick NJ	NJ	High	94.7	96.0	19.0	-2.7	-8.7	6.05
Providence-New Bedford-Fall River RI-MA	RI	High	93.6	96.2	19.3	-2.3	-12.6	10.26
Oakland-Fremont-Hayward CA	CA	High	91.9	95.0	32.8	4.4	-21.5	25.82
Nassau-Suffolk NY	NY	High	91.5	94.4	18.0	-2.4	-11.1	8.65
New York-White Plains-Wayne NY-NJ	NY	High	90.4	93.5	20.1	-2.6	-9.9	7.31
San Jose-Sunnyvale-Santa Clara CA	CA	High	90.0	92.6	27.8	6.5	-21.6	28.11
Baltimore-Towson MD	MD	High	88.7	90.0	23.1	-3.7	-9.1	5.40
San Francisco-San Mateo-Redwood City CA	CA	High	83.5	87.5	21.2	1.5	-15.0	16.54
Portland-Vancouver-Hillsboro OR-WA	OR	High	82.4	84.0	20.6	-4.0	-11.4	7.35
Atlanta-Sandy Springs-Marietta GA	GA	High	80.2	83.6	8.5	-3.0	-11.2	8.17
Virginia Beach-Norfolk-Newport News VA-NC	VA	High	78.7	83.5	22.4	-2.2	-6.2	3.95
Warren-Troy-Farmington Hills MI	MI	High	75.4	77.9	8.3	-5.0	-12.1	7.11
Washington-Arlington-Alexandria DC-VA-MD-WV	DC	High	74.0	78.4	29.1	3.6	-13.7	17.29
Boston-Quincy MA	MA	High	72.1	76.8	13.1	0.6	-7.2	7.82
Cambridge-Newton-Framingham MA	MA	Elevated	64.7	67.1	10.1	-0.3	-5.3	5.04
Austin-Round Rock-San Marcos TX	TX	Elevated	60.1	65.6	5.6	-0.9	-6.3	5.38
Minneapolis-St. Paul-Bloomington MN-WI	MN	Elevated	56.7	63.8	12.9	-2.1	-10.4	8.33
Philadelphia PA	PA	Elevated	55.7	56.3	13.1	-4.2	-3.7	-0.49
Seattle-Bellevue-Everett WA	WA	Elevated	51.9	59.1	20.3	-5.5	-11.7	6.26
Milwaukee-Waukesha-West Allis WI	WI	Elevated	51.5	55.1	12.0	-1.3	-7.6	6.28
Indianapolis-Carmel IN	IN	Elevated	50.1	49.9	2.4	2.3	-8.2	10.48
Cincinnati-Middletown OH-KY-IN	OH	Moderate	49.6	49.0	4.3	1.8	-5.6	7.37
Houston-Sugar Land-Baytown TX	TX	Moderate	41.3	44.9	1.8	1.7	-7.1	8.75
Chicago-Joliet-Naperville IL	IL	Moderate	40.8	46.5	16.1	-5.7	-10.4	4.71
Nashville-Davidson--Murfreesboro--Franklin TN	TN	Moderate	39.6	48.1	8.0	-1.2	-4.5	3.26
Kansas City MO-KS	MO	Moderate	37.9	40.8	4.8	-0.5	-8.7	8.14
Denver-Aurora-Broomfield CO	CO	Moderate	37.2	47.5	5.0	3.5	-5.1	8.63
Dallas-Plano-Irving TX	TX	Low	29.1	32.9	1.4	1.4	-7.7	9.16
Fort Worth-Arlington TX	TX	Low	27.7	31.8	2.0	0.4	-6.5	6.89
St. Louis MO-IL	MO	Low	26.2	34.8	7.4	-0.1	-5.6	5.49
Charlotte-Gastonia-Rock Hill NC-SC	NC	Low	26.1	33.3	4.6	-3.2	-6.8	3.63
Memphis TN-MS-AR	TN	Low	17.5	22.1	7.3	0.1	-7.5	7.68
Cleveland-Elyria-Mentor OH	OH	Low	14.1	17.8	8.9	-0.5	-6.7	6.16
Pittsburgh PA	PA	Low	12.6	14.3	3.0	1.7	0.0	1.72
San Antonio-New Braunfels TX	TX	Low	12.0	13.9	4.9	1.4	-7.6	9.01
Columbus OH	OH	Minimal	9.5	14.6	5.5	1.8	-4.1	5.94

Weighted Average Values by Risk Rank:

High	92.1	93.8	27.2	-2.0	-16.0	14.0
Elevated	55.6	59.4	11.9	-2.3	-7.6	5.3
Moderate	46.4	51.3	8.5	-0.9	-8.7	7.8
Low	21.9	26.3	4.5	0.4	-6.1	6.5
Minimal	9.5	14.6	5.5	1.8	-4.1	5.9
All	70.4	73.2	19.47	-1.55	-12.42	10.87

Top 50 Weighted Averages:

AFFORDABILITY INDEX ⁵		
1Q '10	4Q '09	Difference
145.2	145.6	-0.4
184.1	184.3	-0.3
139.0	136.9	2.1
129.9	133.5	-3.6
133.1	131.1	2.0
156.8	157.7	-0.9
132.8	132.2	0.6
115.9	115.7	0.3
102.4	100.6	1.8
142.4	141.0	1.5
122.2	122.3	-0.1
125.7	128.9	-3.1
144.7	147.1	-2.3
124.8	122.8	2.0
106.2	105.2	1.0
122.4	120.3	2.0
135.5	132.8	2.7
94.9	93.0	1.9
102.2	100.8	1.3
116.5	116.3	0.2
128.0	127.3	0.6
118.8	118.1	0.7
110.0	108.3	1.7
145.5	142.1	3.4
119.2	116.7	2.5
132.6	136.6	-4.0
127.2	124.6	2.6
110.1	108.8	1.3
113.3	114.5	-1.1
110.9	111.6	-0.8
116.5	116.7	-0.2
122.5	124.1	-1.7
119.4	117.8	1.7
125.0	128.7	-3.6
142.4	145.5	-3.1
147.0	149.0	-1.9
136.9	137.2	-0.3
154.1	151.5	2.6
132.9	130.9	2.0
129.6	131.4	-1.8
132.3	129.6	2.8
132.2	133.1	-1.0
140.1	140.6	-0.5
140.1	137.6	2.6
147.0	143.4	3.5
175.9	173.9	2.0
184.1	183.0	1.1
152.7	151.6	1.1
136.5	137.4	-0.9
174.9	168.7	6.2

124.2	123.5	0.7
121.1	122.1	-1.0
157.7	157.1	0.6
147.4	146.6	0.7
174.9	168.7	6.2
130.23	129.59	0.65

UNEMPLOYMENT RATE		
Rate ⁶	Demeaned ⁷	
1Q '10	1Q '10	4Q '09
11.9	7.0	6.4
13.5	8.8	8.4
10.7	6.7	6.2
14.8	9.1	8.8
12.9	8.6	8.0
12.4	8.4	7.5
11.9	7.8	7.0
12.4	6.7	6.5
9.9	5.9	5.7
8.8	4.6	4.4
10.7	6.2	5.9
16.2	7.6	8.2
12.6	7.3	6.9
9.7	4.8	4.8
9.3	4.8	4.9
12.6	7.1	6.8
11.6	6.3	6.1
7.3	3.0	3.0
9.8	4.1	4.1
11.8	5.9	5.8
8.1	3.8	3.3
9.5	4.8	4.4
10.6	4.4	4.2
10.5	5.7	5.5
7.4	3.6	3.4
14.5	8.1	8.6
6.8	3.3	2.8
9.0	4.0	3.9
7.7	3.4	3.4
7.1	2.4	2.5
7.2	3.0	3.2
8.8	3.8	3.5
8.7	3.8	3.8
9.2	3.9	3.6
8.8	4.2	3.8
10.3	5.1	4.7
8.6	3.0	2.6
11.0	5.2	5.2
9.5	5.1	5.1
8.6	3.1	3.2
7.7	2.6	2.3
8.3	2.8	2.7
8.3	3.1	3.0
10.3	4.7	4.7
12.4	7.0	6.8
10.7	4.9	4.7
9.4	3.6	3.7
8.4	3.3	2.7
7.3	2.2	1.9
9.4	4.3	3.8

10.8	5.8	5.6
8.2	3.5	3.4
10.5	4.6	4.3
9.2	3.7	3.6
9.4	4.3	3.8
10.12	5.00	4.81

EXPLANATORY NOTES

1. The **U.S. Market Risk IndexSM score** translates to a percentage that predicts the probability that house prices will be lower in two years. For example, a Risk Index score of 100 means there is a 100 percent chance that the Loan Performance All Transactions House Price Index for that MSA will be lower two years from the date of the data.
2. Historical risk scores may change as updated/ revised source data become available.
3. Past **price appreciation** is a key predictor of future price appreciation potential. In general, rapid and continued increases in the rate of price appreciation lead to increases in the risk of future price declines.
4. **Price volatility** is calculated as the standard deviation of quarterly two-year house price appreciation rates for the previous five years. In general, higher price volatility indicates a greater risk of future home price declines.
5. Using per capita income, CoreLogic house price appreciation rates, and a blended interest rate based on the mix of 30-year fixed rate and 1-year adjustable rate mortgages (as reported by the Mortgage Bankers Association), PMI's proprietary **Affordability IndexSM** measures how affordable homes are today relative to a baseline of 1995. An Affordability Index score exceeding 100 indicates that homes have become more affordable; a score below 100 means they are less affordable. The value of this index is generally inversely related to the value of the Risk Index – as affordability increases, the Risk Index score declines. By using a blended rate, the index factors in the use of adjustable rate mortgage products, which can increase affordability.
6. The **local unemployment rate** is calculated with Bureau of Labor Statistics MSA-wide quarterly averages, not seasonally adjusted.
7. The **demeaned unemployment rate** is the current unemployment rate minus the five-year average unemployment rate. A negative number means that the current unemployment rate is lower than the five-year average, indicating that labor markets are strong by the area's historical standards. High employment levels are generally associated with strong housing demand.
8. All averages are population weighted.



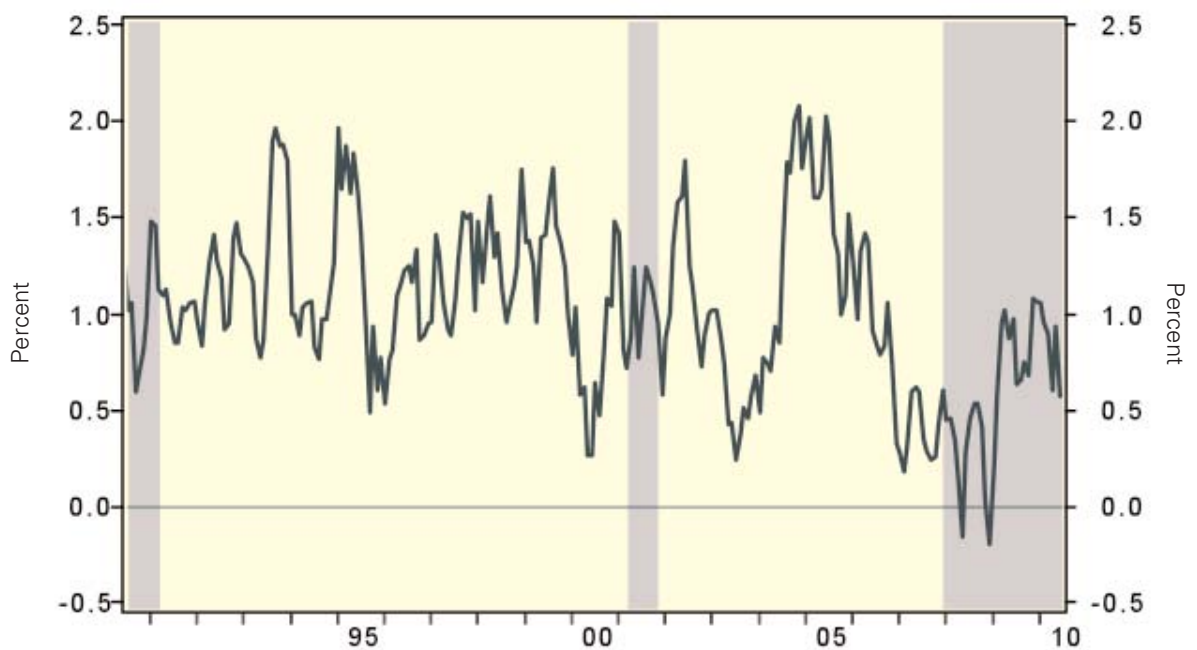
Will Demographics Support a Housing Recovery?

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More importantly for near-term housing demand is the large increase in household formations over the past year. In the first quarter of 2010, growth in households from a year-earlier increased to nearly 1.0 percent – translating into 1.07 million additional households. The pace of household formations slowed in the second quarter, rising by only 0.7 percent from a year earlier. This was still substantially faster than the growth rate of household formations during the recession. The pace of household formations over the next year will be a key determinant of housing demand. If, as we expect, the economy continues to expand and the job market improves (albeit slowly), then house-

hold formations should rise at a faster rate over the next year. Given the procyclical nature of household formations, it is often the case that household formations climb above their long-term trend (approximately 1.0-1.1 percent per year) as economic recovery takes hold. The current jobless recovery may hold this down in the near-term, but at some point in this recovery growth of 1.5 percent or more should occur. That would translate into an additional 1.7 million households – which would go a long way toward reducing the still high levels of rental and homeowner vacancy rates that exist today. ♦

FIGURE 2: Total Number of Households – Break Adjusted / % Change – Year to Year (thousands)



Source:
Census Bureau /
Haver Analytics



Trends in the Nation's MSAs

(continued from page 3)

New York was helped by its second consecutive quarter of declining new foreclosure rates. MSAs in four states (**North Dakota, Nebraska, South Dakota, and Vermont**) had only minimal risk scores. **North Dakota** has the lowest risk scores in the nation, with the highest score in the state at just 1.1 percent.

Denver-Aurora-Broomfield, CO also had a large decrease in risk, falling by 10.2 percentage points – the largest decline in the top-50. **Cincinnati-Middletown, OH-KY-IN** had the largest increase in risk, although it rose by just 0.5 percentage points. There are still many MSAs with very high risk scores, such as **Miami-Miami Beach-Kendall, FL** with a risk score of 99.9 percent. **Columbus, OH** had the lowest risk score at 9.5 percent and was the lone MSA of the top-50 in the minimal risk category.

Trends in Credit Quality

In the latest quarter the slight increase in foreclosure and delinquency rates held many MSAs back from further decreases in risk scores. The overall delinquency rate on one-to-four-family residential properties rose to 10.07 percent at the end of the first quarter of 2010 (up by 59 basis points from the fourth quarter), according to the Mortgage Bankers Association's (MBA) National Delinquency Survey. This increase followed a decline in the fourth quarter, which was the first quarterly rate drop since the first quarter of 2007.

After falling in each of the last two quarters of 2009, new mortgage foreclosures increased slightly in the first quarter of 2010. New mortgage foreclosures rose in the first quarter to 1.17 percent (up by only 3 basis points). Thirty-five states (including D.C.), had increasing foreclosure rates in the first quarter, while only ten had decreasing rates. The largest increase was in **Washington**, which has been very volatile over the past year.

Nevada continued to have the highest new foreclosure rate in the country at 3.23 percent, followed by **Florida** and **Arizona** at 2.41 and 2.24 percent, respectively.

On the bright side, the percentage of loans in serious delinquency (mortgage payments 90 days or more past due, plus the inventory of mortgages in foreclosure) dropped to 9.54 percent. While still very high, this was the first quarterly drop since the second quarter of 2006. Even with the slight increase in new foreclosures many MSAs still had decreasing risk scores as a result of other factors.

Trends in Home Price Appreciation

National home prices decreased once again in the first quarter of 2010. According to CoreLogic's House Price Index (HPI), national home prices dropped by 1.7 percent in the first quarter (although seasonally adjusted prices fell by less). Even with the recent home price decrease, national home prices were only down by 0.5 percent between the first quarters of 2009 and 2010, the smallest annual decline since the first quarter of 2007. Many MSAs still had year-ago price declines. Across all 384 MSAs, 59.4 percent had lower prices in the first quarter of 2010 than a year earlier, while 37.8 percent had higher prices.

Year-earlier house price appreciation remained weakest in **Nevada**, with home prices down by 12.5 percent. **Florida** and **Arizona** also continued to show weakness with home prices falling by 7.0 and 6.6 percent, respectively. All three states have not had a quarterly home price gain since the third quarter of 2006. Home prices in still struggling Michigan have dropped by 6.8 percent, lead by **Detroit-Livonia-Dearborn's** 10.0 percent drop. **Idaho** also suffered a 6.8 percent decline over the past year.

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Trends in the Nation's MSAs

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Hawaii led the nation with a 6.0 percent increase in home prices over the past year, followed by **North Dakota** and **California** with 5.0 and 3.6 percent gains, respectively. Even with the gains in home prices, **Hawaii's** lone MSA, **Honolulu**, still had a high risk score due to other factors. **North Dakota** has had the lowest risk of any state and continues to boast positive home price. Home prices in **California** started gaining ground in 2009. Of California's eight most populated MSAs, six had home price gains over the past year.

Trends in Housing Affordability

While still at very high levels, housing affordability fell slightly during the first quarter because of increased mortgage rates (note that rates have fallen sharply again since then). PMI's proprietary Affordability Index measures the affordability of homes today in a given MSA relative to a baseline of 1995. An Affordability Index score exceeding 100 indicates that homes have become more affordable; a score below 100 means they are less affordable.

The average Affordability Index reading was 139.4 in the first quarter across all MSAs, compared with the fourth quarter reading of 139.8. Of the nation's 384 MSAs, 57.6 percent showed lower affordability, while 41.9 percent showed greater affordability. The **Youngstown-Warren-Boardman, OH-PA** MSA's affordability increased the most, rising by 8.7 points and has minimal risk. Affordability in **Cleveland-Elyria-Mentor, OH**, declined the most, dropping by 11.8 points, but still has an above-average affordability score and a moderate risk score. As expected, affordability of MSAs in the high risk classification continued to be much lower than in minimal risk MSAs. High risk-ranked MSAs had an average affordability of 131.7, compared with 154.8 for those MSAs classified as minimal risk.

Trends in Employment

Unemployment rates in the United States fell to 9.7 percent (seasonally adjusted, SA) during the first quarter 2010, down from 10.0 percent during the fourth quarter 2009. The decrease in unemployment helped push risk scores down in many MSAs.

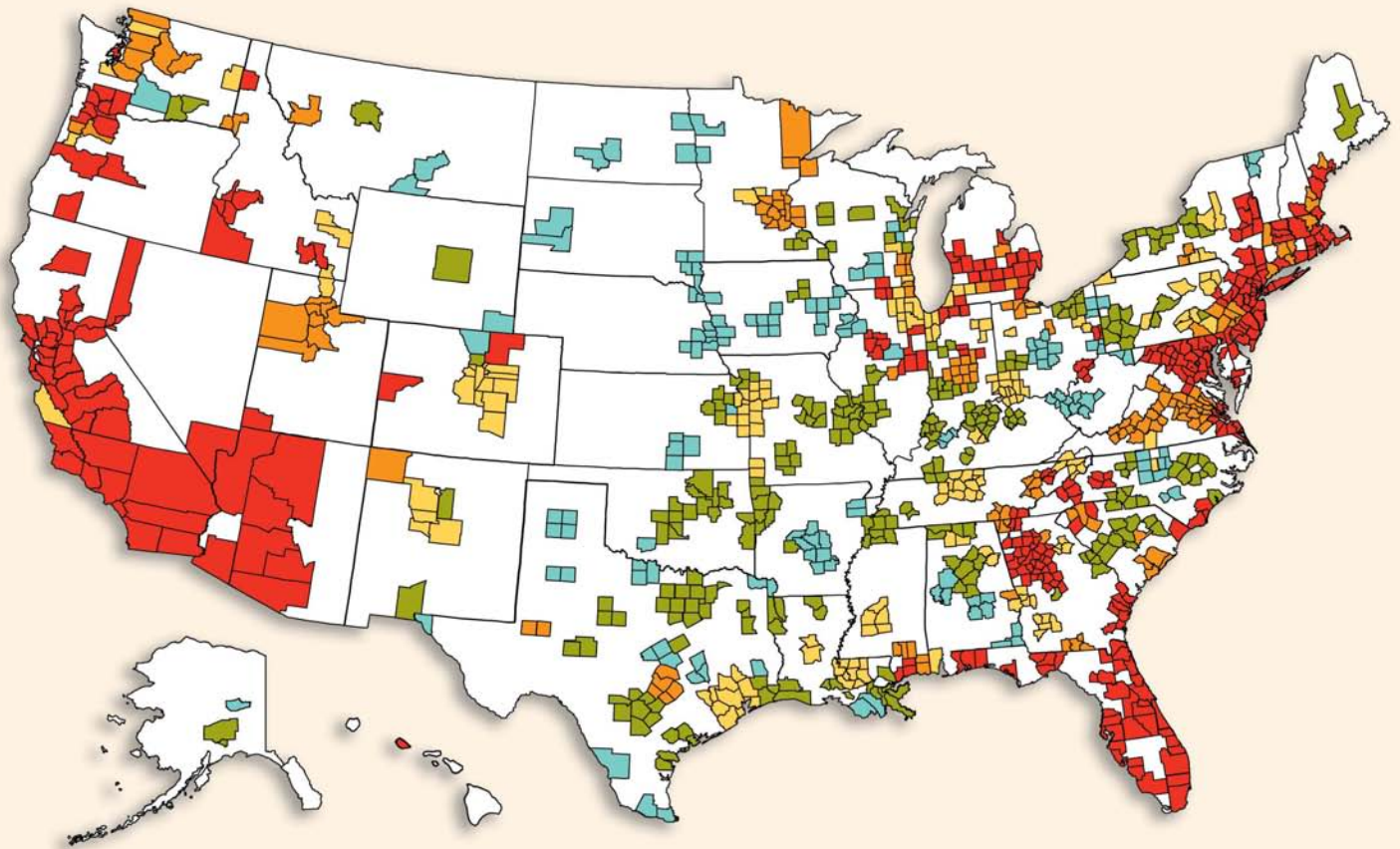
Note that the national unemployment rate remained at 9.7 percent and mortgage rates fell in the second quarter 2010, which should bode well for future risk score declines.

While the national unemployment rate fell, rates varied throughout the nation. Unemployment rates tended to be above average in the high risk MSAs. The unweighted average unemployment rate in the high risk MSAs was 11.8 percent, compared with only 7.5 percent in the minimal risk MSAs. Of the top-50 MSAs, **Detroit-Livonia-Dearborn** continued to have the highest unemployment rate at 16.2 percent along with a high risk score of 98.7 percent, while the lowest unemployment rate was in **Washington-Arlington-Alexandria** at 6.8 percent. The **Washington** MSA also had a high risk score of 74.0 percent, but it was because of other factors. Of all 384 MSAs, **El Centro, CA** had the highest unemployment rate at 29.9 percent along with a high risk score of 93.6 percent, while **Bismarck, ND** still had the lowest rate at 4.1 percent (and one of the lowest risk scores at 1.1 percent).

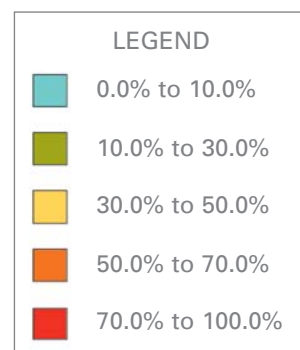
Conclusion

Overall risk in the nation decreased during the first quarter of 2010, with 290 of the 384 MSAs having declining risk scores. The national unemployment rate fell to 9.7 percent which helped reduce risk scores in many areas. The slight increase in foreclosures started coupled with a small decrease in affordability held many MSAs back from falling even further in risk. House prices dropped in the first quarter in many locations, mostly due to seasonal factors and high foreclosure rates. It is likely that home prices will increase once again during the second quarter of 2010. MSAs in **California** were much improved and seem poised to improve again next quarter. **Florida, Arizona, and Nevada** were still the riskiest markets, while MSAs in the **Dakotas, Nebraska, and Vermont** had the least risk. While overall risk scores should continue to decline as the economy improves, we expect a number of MSAs (especially in **Nevada** and **Florida**) to maintain high levels of risk in the near-term. ♦

Geographic Distribution of HOUSE PRICE RISK



The above map depicts the geographic distribution of house price risk for all 366 MSAs and 29 Metro Divisions. Each is assigned a risk rank and corresponding color. Among the 50 largest, **Miami-Miami Beach-Kendall, FL** ranks the highest on the index, with nearly a 100 percent chance that home prices will be lower in two years. At the other end of the risk spectrum lies a group, largely located in the central and southern parts of the nation, whose risk scores are moderate to low.



The Risk Index scores for all MSAs and Metro Divisions are provided in an appendix, available on the publications page of the media center at www.pmi-us.com.

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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 be lower in two years, with an index value of 100 implying a 100 percent probability that house prices will be lower in two years.

House price data are provided by CoreLogic. The CoreLogic house price index (HPI) is a repeat-sales index that tracks changes in sales prices for the same homes over time, thereby providing a more accurate "constant-quality" view of house price trends than transaction-based measures. The index incorporates more than 30 years worth of repeat sales transactions, representing more than 45 million observations sourced from CoreLogic's industry leading property information database. The CoreLogic HPI provides a multi-tier market evaluation based on price, time between sales, property type and loan type (conforming vs. nonconforming).

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.

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