



## Editorial Update

11/29/05

The global financial markets are being buffeted by a multitude of countervailing forces. Some of these influences will resolve themselves in the very near future, while others are of a long-term secular nature. These forces are very broad in scope; including social, economic and geopolitical issues, predisposing us to a challenging future.

What does this mean to those of us in the United States, generally, and more specifically, in the Real Estate Finance Industry? Obviously, it means a great deal.

Today the real estate industry is the largest macro influence on the economy, having a profound effect on our Gross Domestic Product. One way this is demonstrated is the liquidation of home equity. Over the course of the past twenty years the industry has participated in unprecedented refinance waves, the latest of which has involved vast amounts of home equity extraction, last year alone \$600 billion in equity came out of homes. For each consumer spending contraction experienced over the past decade and a half the Federal Reserve (Fed) has provided massive amounts of liquidity via monetary policy. In so doing it has exerted downward pressure on interest rates across the entire yield curve, thus creating an environment supportive of refinancing debt; in particular, mortgage related debt. Each time the Fed has prescribed lower rates the effect has been minimized until new lows are established (longer term downward bias in rates).

Interestingly, this latest cycle down in rates has been accompanied by an ever expanding array of products. The over-leveraging by the American consumer and the incipient rise in real estate values has created a need for unique products to address affordability. In the past two years the affordability index has gone from 144 to 115, which means that two years ago, the average person had 44% more money than he/she needed to buy a house but today, he/she has only 15% extra. It is primarily because of this that we will see \$500 billion in subprime loans originated this year alone.

Leverage has been predominate in our balance sheet economy for years, and in fact, is what sustains growth. Take away leverage you reduce income; add too much leverage and you create unwanted "bubbles" like we experienced in the late 80's, the late 90's and are currently experiencing in the real estate markets.

Furthermore, the consumption associated with this leverage is creating unprecedented balance of payment problems for the entire global economy.

Where do we go from here? It is anyone's guess; however, a sound argument can be made that we will soon experience a profound shakeout in our industry. While not a comforting thought, it can lead to benefits for those that are properly prepared.

Network Funding elected to strengthen our position thereby enabling us to capitalize on an impending correction. We have made extensive changes in the protocol for hiring Branch Managers and Loan Origination staff. In as much, we look to hire only professional origination staff, persons with a demonstrated ability to know and understand their markets and products. The type of professional that creates, and values, long-term relationships cultivated over time. In return their approach to business fosters a reputation in the marketplace as being experts in their field.

During the course of the past two years Network Funding has undertaken to create an organization staffed with a support network that is determined to be "best of class". Network Funding has focused in on four key areas, 1) increasing the depth and breadth of our expertise; 2) leveraging technology to the fullest extent possible; 3) brand name awareness and 4) building a solid productive branch network. Together these will provide us the competence required to deal with the challenges that lie ahead.

Our industry has achieved much; however, greater accomplishments will be required. We at Network Funding stand ready to meet these challenges.