3-20-2007

Lehman Board presentation on Subprime Mortgage Origination Business

Lehman Brothers Holdings Inc.

Confidential Presentation to:

Board of Directors

Update on Lehman Brothers' Subprime Mortgage Origination Business

March 20, 2007

LEHMAN BROTHERS

Executive Summary

- Subprime mortgage business has been attractive market for Lehman Brothers
  - 30% plus industry growth with attractive margins 2001-06
  - Vertically integrated business model enables us to achieve high level of cross-cycle profitability
  - Significant part of a broader-based mortgage business

- Over past year, difficult markets have led to declining profitability among all industry participants
  - Overcapacity has led to reduced pricing and increased risk taking, lowering overall profitability
  - Virtually all independent subprime originators cutting back operations or going out of business

- Firm has taken aggressive steps to enhance performance during downcycle and position for long term
  - Reduced headcount and significantly enhanced operating model
  - Modified product offering to reduce risk
  - Aggressively pursued best-in-class operators from other firms to strengthen our franchise

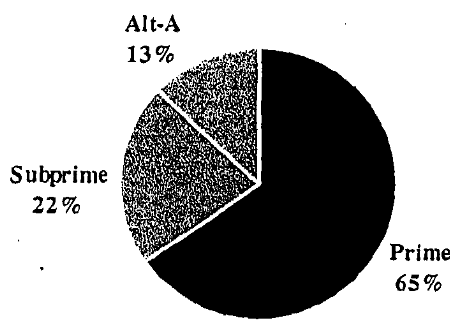
- Expect to be fundamentally better positioned for profitable growth when industry cycle turns

Types of Residential Mortgages

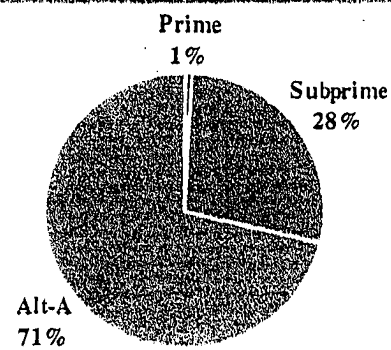
	Prime	Alt-A (Aurora)	Subprime (BNC)
Credit score (FICO) avg.	◆ 720	◆ 705	◆ 625
Interest rate	◆ 6.13% (30 yr Fixed)	◆ 7.35%	◆ 8.35%
Purchase / refinance	◆ Purchase or cash-out refinance	◆ Cash-out refinance: 24%	◆ Cash-out refinance: 63%
Rate structure	◆ Fixed rate; Hybrid ARM	◆ Hybrid ARM: 50%	◆ Hybrid ARM: 70%
Payment type	◆ Principal & Interest; Interest Only	◆ Interest Only: 65%	◆ Interest Only: 22%
Debt-to-income avg.	◆ 36%	◆ 39%	◆ 42%
Loan-to-value avg.	◆ < 80%	◆ 80% (up to 100% Combined LTV)	◆ 81% (up to 95% Combined LTV)
Documentation % full	◆ Approx 100%	◆ 20%	◆ 60%
Use of proceeds	◆ Primary residence	◆ Investment: 18%	◆ Investment: 8%

2006 U.S. Residential Mortgage Originations

Market = $2,500B



Lehman Brothers = $52B



I-Bank Purchases of Residential Mortgage Originators

I-Bank	Mortgage Business	Acquired	Credit Quality	Est. Price ($MM)
Lehman Brothers	Aurora Loan Services	1998	Alt-A	$10
	Finance America	1999	Subprime	$36
	Lehman Brothers Bank	1999	NA	$8
	SPML (U.K.)	1999	Non-conforming	$28
	BNC Mortgage	2000	Subprime	$81
	Financial Freedom (Sold in 2004)	2000	NA	$40
	Preferred Mortgages (U.K.)	2003	Non-conforming	$134
	SIB Mortgage Corp	2004	Alt-A	$13
	London Mortgage Co. (U.K.)	2006	Non-conforming	$12
Merrill Lynch	Wilshire Credit Corp	2004	Subprime servicing	$52
	Mortgages plc (U.K.)	2004	Non-conforming	NA
	20% Min. Interest in OwnIt (shut down Dec '06)	2005	Subprime	NA
	Freedom Funding (U.K.)	2006	Non-conforming	NA
	First Franklin	2006	Subprime	$1,310
Bear Stearns	EMC Mortgage	Founded in 1990	Subprime	NA
	ECC Capital (Subprime Mortgage Orig. Platform)	2006	Subprime	$9
Morgan Stanley	Advantage Home Loans (U.K.)	2005	Non-conforming	NA
	Saxon Capital	2006	Subprime	$706
	CityMortgage Bank (Russia)	2006	Prime	NA
Deutsche Bank	Chapel Funding (DB Home Lending)	2006	Subprime	NA
	MortgageIT	2006	Alt-A	$429
Credit Suisse	SPS Holdings	2005	Subprime servicing	$100
Barclays	HomeEc	2006	Subprime servicing	$469
	Equifirst	2007	Subprime	$225

Lehman Brothers' Subprime Economics

Lehman Brothers' Subprime P&L

BNC + Related Trading Desk

($ in millions)	2003[1]	2004[1]	2005	2006	Q1 2007	2007E
BNC Origination Volume	6,715	10,789	24,844	14,073	2,754	11,800
Revenue [2]	496	747	876	229	(95)	(60)
Compensation	174	282	341	196	44	180
Non-Personnel Expense	48	61	62	54	11	56
MCD Admin & Firm Allocations	20	22	72	45	10	42
Pre-Tax Income [2]	**254**	**382**	**400**	**(67)**	**(160)**	**(338)**

2007 Forecast Revenue Assumptions:

- Gain on sale / securitization = 100 bps
- Loan loss reserves = $172MM
- Cost to originate = 196 bps

Drivers of Decrease in Profitability Since 2005

	2005		Q1 2007
◆ Significant decrease in run rate origination volume	$24.9B	➡	$11.2B annualized
◆ Decline in gain on sale and securitization margins	351 basis points	➡	88 basis points
◆ Increase in loan loss reserves due to loan performance	$40MM	➡	$92MM

(1) Trading Desk revenues & expenses for 2003 and 2004 are estimates.
(2) Other subprime-related capital markets revenues: 2003 = $133MM; 2004 = $300MM; 2005 = $435MM; 2006 = $501MM; Q1 2007 = $60MM; 2007E = $200MM.

Changes to Subprime Industry Landscape

Top 20 Subprime Originators of 2006

Rank	Firm	2006 Production ($BN) Total	Wholesale	Retail	Status
1	New Century	51.6	47.5	4.1	Stopped funding loans; major downsizing or bankruptcy expected
2	HSBC	50.8	38.6	12.2	Additional $1.7B write-off; fired senior U.S. managers
3	Countrywide	40.6	25.4	15.2	Cutting workforce; foreclosures at 5-yr high
4	CitiMortgage	38.0	17.9	20.2	Buying distressed businesses (took stake in Opteum unit)
5	WMC Mortgage (GE)	33.2	33.2	0.0	Cutting 20% of workforce; question of long term GE fit
6	Fremont General	32.3	32.3	0.0	Stopped funding loans; sold loan portfolio; seeking rescue funding
7	Ameriquest	29.5	22.6	6.9	Citi provided secured / unsecured funding - has option to buy
8	Option One (H&R Block)	28.8	26.8	2.0	Working towards final bid; outcome uncertain
9	Wells Fargo	27.9	8.9	19.0	Cutting workforce
10	First Franklin	27.7	25.4	2.3	Bought by Merrill Lynch in 2006 ($1.3B)
11	Washington Mutual	26.6	26.6	0.0	Cutting workforce
12	ResCap (GMAC)	21.2	20.9	0.3	$1B post-closing purchase price adjustment; management changes
13	Aegis Mortgage (Cerberus)	17.0	10.2	6.8	Exited wholesale subprime business
14	Accredited Home Lenders	15.8	13.4	2.4	Farallon has provided $200M funding line with option to buy
15	BNC (Lehman Brothers)	13.7	13.7	0.0	
16	Chase Home Finance	11.6	6.9	4.6	
17	American General Finance	11.5	10.5	1.0	
18	Mortgage Lenders Network	11.2	NA	NA	Went bankrupt in February; Lehman hired part of salesforce
19	Equifirst	10.8	10.8	0.0	Bought by Barclays in 2007 ($225M)
20	NovaStar	10.5	NA	NA	Stock down 78% YTD

Other Notables

	Firm	Total	Wholesale	Retail	Status
	Ownit	9.5	NA	NA	Out of business; partially-owned by Merrill Lynch & BofA
	ResMae	7.7	NA	NA	Bought by Citadel out of bankruptcy in 2007 ($180M)
	ECC	5.5	NA	NA	Bought by Bear Stearns ($26M)
	Fieldstone	5.0	NA	NA	Bought by C-Bass in 2007 ($260M); price reset 3/17; rescue funding provided
	Nationstar	4.6	3.6	1.0	Bought by Fortress in 2006 ($575M)

"Sold" or Bankrupt | Currently in Play

Changes to BNC Operating Model

New Leadership Team

- CEO – Steve Skolnik
  - Ex-First Franklin
- Head of Sales – Tim Owens
  - Ex-Option One
- COO – Scott Anderson
  - Ex-Accredited
- VP of Process Improvement – Chuck Hutt
  - Ex-MLN
- VP of Learning & Development – Kate Perez
  - Ex-New Century

Reduction in Force

2006

- Reduced headcount by 23% (510 employees) vs. yr end 2005 levels
  - 55 Account Executives
  - 455 admin / ops staff

2007

- Additional 26% headcount reduction planned for May
  - 49 Account Executives
  - 372 admin / ops staff

Change in Operating Model (May 2007+)

- Convert from branch model (34 locations) to regional operational center model (ultimately 5 locations)
- Make changes to better align compensation with loan performance
- Double Ops staff efficiency by employing best practice file flows
- Continue to work with trading desk on new products and optimizing profitability of existing products

Improvements to BNC Risk and Credit Profile

Tightening of Lending Criteria

- 80 / 20 loans
  - Terminated exceptions
  - Raised required applicant credit score
- First-time homebuyers
  - Maximum of 90% combined loan-to-value
  - Maximum of 1 unit
- Stated documentation
  - 100% combined loan-to-value and loan-to-value eliminated
  - Maximum of 50% debt-to-income

Improvement in Loan Characteristics from March 2006 to March 2007

Loan Characteristic	March 2006 Fundings		Week of 3/16/07 Submissions
2nd Lien Percentage	6%	⇨	0.4%
Combined Loan-to-Value >95%	34%	⇨	9%
Non-Owner Occupied	16%	⇨	10%
Purchase	44%	⇨	24%
Full Docs	50%	⇨	60%

BNC Run Rate Economics – Per Loan Basis

	Recent Trough	Transitional Market	Normalized Environment
	◆ Low gain on sale / securitization ◆ Lower origination volume leads to higher costs ◆ High level of defaults	◆ Medium gain on sale / securitization ◆ Unit costs fall – Volume pick-up – Staff reductions – Operating model changes ◆ Medium level of defaults	◆ High gain on sale / securitization ◆ Unit costs fall further – Positive scale effects – Staff upgrades – Operating model changes ◆ Low level of defaults
Drivers			
Monthly Origination Volume	$500MM	$1B	$1.5B
Gain on Sale / Securitization	50 bps	200 bps	250 bps
Carry	30 bps	30 bps	30 bps
Cost of Origination	(250) bps	(177) bps	(150) bps
Loan Loss Reserve	(120) bps	(55) bps	(35) bps
Pre-Tax Income* (bps)	**(290) bps**	**(2) bps**	**95 bps**
Revenue	**$(24)MM**	**$210MM**	**$441MM**
Pre-Tax Income* ($MM)	**$(197)MM**	**$(25)MM**	**$148MM**

** Before Firm allocations and MCD Admin.*

Limited Contagion To Other Markets

Prime / Alt-A Mortgages

- Significant migration to higher quality credits by investors
- Credit performance not problematic – delinquencies are within expected range
- Greater risk of subprime impacting house prices negatively, which in turn could reduce origination volumes in Prime / Alt-A

UK Non-Conforming

- Less mature market than U.S.
  - Loan terms & pricing currently less aggressive, but competition is intensifying – may put pressure on the economics of Lehman's business in the near term
- Loan to value, delinquency and default rates lower than U.S.
- House price appreciation higher & more evenly distributed
  - Supported by fundamental housing shortage

Broader credit markets

- Only limited widening of spreads
- Structural integrity of facilities should withstand asset underperformance
- Existing market losses are manageable

Summary and Planned Next Steps

- Most of large subprime independents have gone out of business, have been sold or are selling
- But substantial part of subprime market is here to stay
  - Meets a clear need from households
  - Profitability will return when environment improves
    - Lending standards tighten, pricing improves & excess capacity is removed – starting to see this
    - Outlook becomes stable enough for the return of capital markets' risk appetite
- Have taken corrective measures to address current market
  - New leadership team in place
  - Reduction in headcount and locations, changes to operating model
  - Tightened lending standards, increased pricing – loan loss provisions will come down after Q1
- Current distressed environment provides substantial opportunities, as in late 1990's
  - Post-fallout, competition will be reduced
  - Opportunity to continue to add high quality personnel and platforms
  - Important component of broad-based mortgage origination franchise