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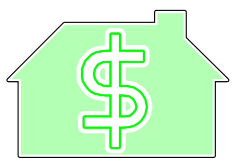
IN THIS MONTH'S ISSUE



MACROECONOMIC MOVES AND MORTGAGE MARKET ANALYSIS

LABOR MARKET IMPROVING (week ending 12/6/2013)

A wide range of major economic data released this week revealed an unexpectedly strong level of improvement in the labor market and other areas. This is good news for the economy, but it was negative for mortgage rates. As a result, mortgage rates ended the week higher.

The data released earlier in the week hinted at healthy improvement in the labor market, and Friday's Employment report confirmed the gains. Against a consensus forecast of 180K, the economy added 203K jobs in November. The Unemployment Rate declined from 7.3% to 7.0%, the lowest level since November 2008. The economy has added an average of 193K jobs over the past three months. Several Fed officials have suggested that they would like to see sustainable job gains around 200K per month to confirm that the labor market is back on more stable ground before scaling back on monetary stimulus. This data brings the Fed closer to tapering its bond purchase program.

This week's economic data revealed that the strength in the labor market is consistent with improvement in the overall economy as well. Third quarter GDP was revised substantially higher to 3.6% from 2.8%, well above the consensus of 3.0%. This was the fastest pace of growth since the first quarter of 2012. The ISM national manufacturing index rose to the highest level since April 2011. October New Home Sales increased 25%, but this was from a somewhat depressed level in September. Finally, Consumer Sentiment jumped to the highest level since July.

FED MAY TAPER SOON (week ending 12/13/2013)

Stronger than expected economic data and progress on a budget deal in Congress caused investors to move forward their expected timing for the Fed to begin to scale back its bond purchases. This hurt both stocks and bonds, and mortgage rates ended the week a little higher.

Fed officials have revealed several conditions which will help them determine when to reduce their bond purchases. Recent economic events and comments from Fed officials suggest that those conditions may have been met. The performance of the economy may be sufficient to make Fed officials comfortable reducing the level of monetary stimulus. A broad range of recent economic reports revealed gains in the labor market, GDP growth, Retail Sales, and manufacturing. In addition, Congress moved closer this week to reaching a two-year budget deal. The proposed deal would reduce the level of uncertainty about fiscal policy, which is another concern of Fed officials. As a result, investors expect the Fed to announce in the near future that it will begin to taper its bond purchases, and some think that it may take place as soon as next Wednesday's Fed meeting.

FED ANNOUNCES TAPER (week ending 12/20/2013)

Heading into Wednesday's highly anticipated Fed meeting, investors were divided about what the Fed statement would reveal. The Fed announced that it will begin to scale back its bond purchase program. The stock market rallied after the news, but mortgage rates rose modestly and ended the week a little higher.

The Fed announced that it will begin to scale back its bond purchases from $85 billion per month to $75 billion. Treasury and MBS purchases each will be reduced by $5 billion per month. Fed officials expect to continue reducing the pace of bond purchases at future meetings depending on the performance of the economy. According to the statement, Fed officials anticipate that the fed funds rate will not be raised until the Unemployment Rate declines "well past" the 6.5% level. The statement also noted some concern that inflation has remained below the Fed's objective of 2.0%, giving them reason to remain highly accommodative. The Fed's decision reflects increased confidence that the economic recovery is sustainable.

The housing data released this week revealed that the pace of improvement slowed a bit toward the end of the year, but also provided reasons to be optimistic heading into next year. November's Existing Home Sales declined a little from October, and the total inventory of existing homes available for sale also dropped. According to the National Association of Realtors, there is a "pent-up demand" for housing, but tight supply conditions have constrained home purchases.

Addressing this issue, home builders are ramping up their pace of construction. November's Housing Starts surged 23% from October to the highest level since February 2008. Housing Starts were 30% higher than one year ago. Building Permits also increased in November. The December NAHB Home Builders confidence index jumped to the highest level since August.

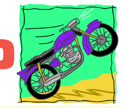
QUIET HOLIDAY WEEK (week ending 12/27/2013)

The mortgage market was quiet during Christmas week. The few economic reports released this week, including Durable Orders, Jobless Claims, and New Home Sales, were mostly stronger than expected. As a result, mortgage rates ended the week a little higher.

While the headline results for this week's New Home Sales report revealed a decline from the prior month, this obscured the substantial improvement. New Home Sales dipped slightly in November, but this was from a level in October which was revised substantially higher. In fact, the revised October reading was the highest level since July 2008. November New Home Sales were 17% higher than one year ago. This was another in a string of recent housing market reports which provide reasons to be optimistic heading into 2014.

On December 18, the Fed announced that it will begin to scale back its bond purchases. The added demand from the Fed for mortgage-backed securities (MBS) has been a major factor helping to keep mortgage rates low, so a reduction in bond purchases is clearly negative for mortgage rates. Considering this, it is interesting to see that mortgage rates have moved only a little higher since the Fed announcement. In other words, the taper was almost completely priced in to mortgage rates ahead of the actual announcement. By contrast, the reaction in the stock market to the Fed statement was much larger. Investors were pleased that the Fed intends to hold the fed funds rate low until much greater labor market improvement is seen, and the Dow stock index has climbed roughly 600 points to a record high.

U.S. ECONOMY REVVED UP

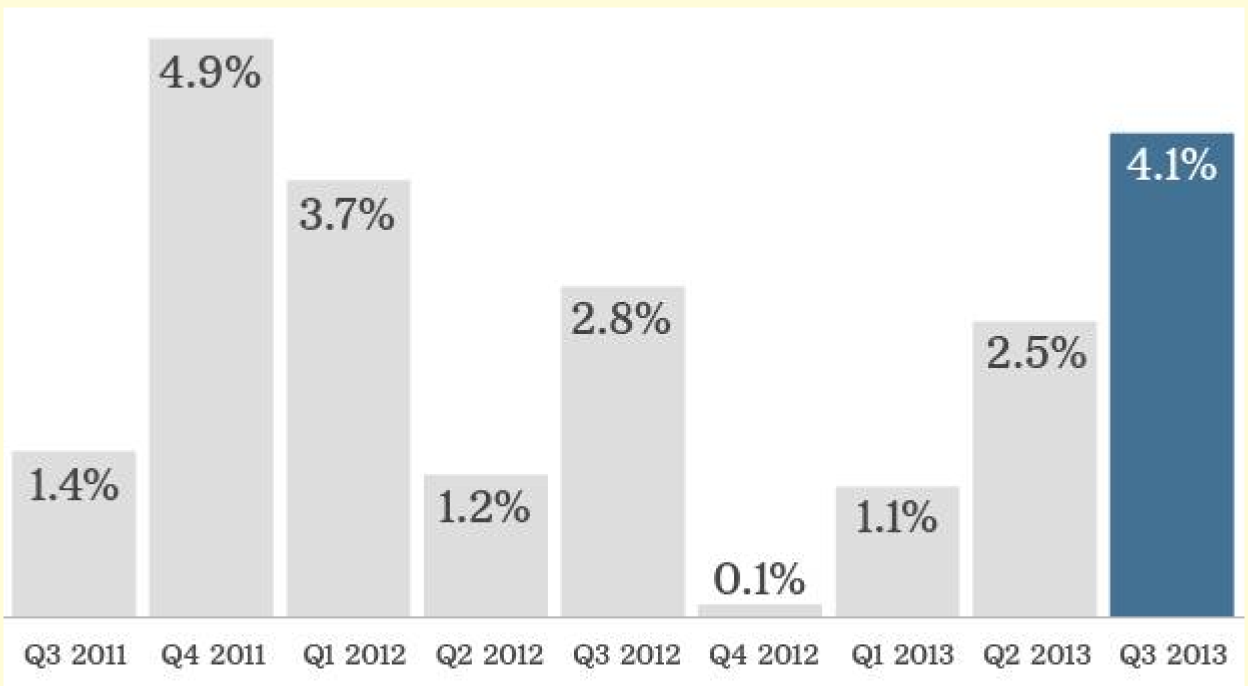


The U.S. economy suddenly looks a lot perkier in the third quarter, according to revised data released by the government on December 20th. Gross domestic product—the broadest measure of economic activity—grew at a 4.1% annual pace in the third quarter, up from the 2.8% pace that was first reported in November.

It was the fastest quarter for economic growth in two years, according to the Bureau of Economic Analysis. The government typically reports its GDP figures at least three times, and Friday's report was the final number for the third quarter.

Larger increases in consumer spending as well as business investments in commercial real estate, industrial equipment and intellectual property like software were some of the main reasons why GDP was revised higher. This is encouraging news, especially after economists had largely written off the previous GDP revision for the third quarter because much of the growth came from businesses building up their inventories.

When businesses stockpile goods, it can be a mixed signal. It could be a sign that companies expect demand will pick up in the future—so they are stocking their shelves in advance. Or, it could be an indication that demand is weaker than expected, and goods are lingering on the shelves longer than planned as a result.



NOTE: GDP % QUARTERLY CHANGE, SEASONALLY ADJUSTED AT ANNUAL RATES; SOURCE: BUREAU OF ECONOMIC ANALYSIS

Friday's report showed that larger inventories still accounted for about a third of the economic growth--and that boost could be unsustainable. Looking ahead, economists expect fourth quarter GDP to look a bit weaker, as businesses draw down those inventories.

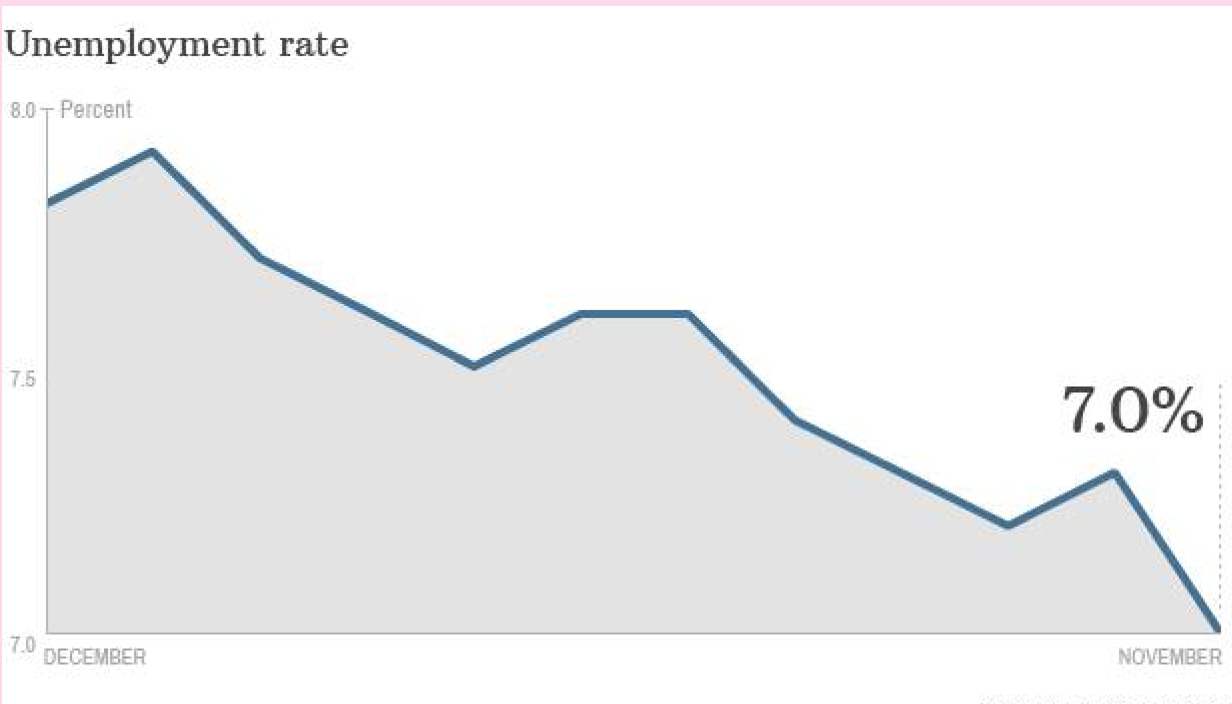
Considering the economy also grew at a far slower rate in the first half of the year, growth will probably average between 2% and 3% for 2013 overall. While the economy is expected to slow in the fourth quarter, experts are more hopeful about 2014. It suggests the economy is poised for stronger growth in the New Year than the middling 2.0% pace of the past year.

UNEMPLOYMENT FALLS TO 7%

Has the job market finally hit its stride? Hiring continued at a solid pace in November, and the unemployment rate fell to a five-year low ... for the right reasons. The U.S. economy added 203,000 jobs in November. Economists had predicted payroll gains of 183,000 jobs. The unemployment rate fell to 7.0% -- the lowest level since November 2008, as more people said they got jobs and joined the labor force. This is encouraging news for the 11 million Americans who remain unemployed. The job market has been improving for three years now, but at a frustratingly slow pace.

The hiring was broad based, with big gains for sectors that tend to pay low wages as well as those that offer higher salaries. While retailers, restaurants and bars all hired more workers, traditionally higher wage sectors boasted even stronger job growth. For example, professional and business services added 35,000 jobs. The transportation and warehousing sector added 30,500 jobs, and health care added 28,000 jobs. Meanwhile, manufacturers hired 27,000 workers and construction companies hired 17,000.

The federal government continued to cut jobs, but state and local governments more than made up for those losses, hiring 14,000 workers. 2013 is on track to be the best year for job creation since 2005, but the job market still has a long way to go until it's entirely healed from the recession.



Only about 63% of Americans over the age of 16 participate in the job market -- meaning they either have a job or are looking for one. That's nearly the lowest level since 1978, driven partly by Baby Boomers retiring, but also by workers who had simply given up hope after long and fruitless job searches. The United States lost 8.7 million jobs in the aftermath of the financial crisis. As of November, it had gained about 7.4 million of those jobs back.

FHA TO PULL BACK ON BIG MORTGAGES

The Federal Housing Administration has announced plans to reduce its stake in the market, an indication it sees some signs of strength in real estate. The agency, which insures low down-payment mortgages, is reducing the upper limits of what it will backstop in areas where home prices are high. Starting in the new year, the biggest cap in these areas will drop to $625,500 from $729,750. Limits will be set lower in about 650 counties as a result, the agency said. The FHA will maintain current limits in areas where home prices are lower and said the move will allow it to refocus on less wealthy homebuyers.

The agency stepped in amid the housing market meltdown -- which was at the core of the 2008 financial crisis -- and raised limits so it could help more homebuyers. The FHA said the program quadrupled its activity "as the private market retreated." But by doing so, it also took significant hits from defaults, and the agency has been trying to right its own balance sheet.

The agency was forced to ask Congress for $1.7 billion in late September, and has hiked premiums. Several years earlier, the government took over housing giants Fannie Mae and Freddie Mac. FHA Commissioner Carol Galante said the new changes are "an important and appropriate step as private capital returns to portions of the market and enables FHA to concentrate on those borrowers that are still underserved."

The agency does not make home loans, but insures lenders against losses, allowing buyers who can afford as little as a 3.5% down payment to receive a mortgage. The FHA says it currently has nearly 5 million mortgages in its portfolio.

NEW-HOME SALES SURGE 25% IN OCTOBER

New-home sales are surging, according to a December 3rd report from the Commerce Dept. Sales of new single family homes jumped to a seasonally adjusted annual rate of 444,000 in October, up 25.4% from the previous month's revised rate. The rate was the highest level in six months.

On a year-over-year basis, sales rose nearly 22%. This year's stock market gains could be the prime factor in driving the housing market. Another key reason could be easier financing for buyers, as builders are motivated to get folks into homes. While 30-year fixed mortgage rates are about a percentage point higher than they were in the spring, they are off the recent high of 4.58% set in August, according to Freddie Mac. In the week ended Nov. 27, the rate was 4.29%.

Inventories of existing homes are thin in several markets, prompting people to build new homes rather than buy old ones. Nationwide, the government said there is enough new home inventory to last for 4.9 months, if the market manages to maintain its October rate of sales for that time.

While the sales jump is impressive, the rate remains less than half that of the peak of the housing bubble; in 2006, the annual sales rate topped 1 million.

BANKS AGAIN OFFERING MORTGAGES WITH ONLY 5% DOWN

Good news for homebuyers who don't have a lot of cash on hand: Banks are offering loans with down payments of just 5%. After the housing bubble burst, buyers needed to come to the table with as much as 20% down or they had to turn to the Federal Housing Administration for a low down-payment loan.

But now banks are loosening the purse strings, offering loans with down payments that are as low as 5%. It also allows them to receive as much as 2% of the sale price as a gift from a relative or other third party, so they would really only need 3% down.

Why the change of heart? Market opportunity for one thing. FHA dominated the market for low down payment loans during the housing bust. Taking on all those risky loans, however, depleted the agency's

reserves and has forced it to increase costs. Over the past couple of years, the FHA has been raising premiums. And this year, it started requiring borrowers to buy private mortgage insurance for the life of the loan--an expensive proposition that has sent many prospective borrowers looking elsewhere.

While the loans were far too risky for private lenders to take on before, rising home prices have made them less of a gamble. Plus, the banks think they can offer a better deal than FHA. As the FHA selectively reduced market share by increasing premiums, lenders introduced a substitute for FHA loans.

While the private lenders that are offering the 5%-down loans are also requiring borrowers to buy private mortgage insurance, they are only requiring them to do so until they build up 20% equity in the home. The difference can really add up. Paying an insurance premium over the life of a $200,000, 30-year fixed-rate loan from FHA that carries an effective mortgage rate of 4.4% (5.75% when you tack on the insurance premium), can add up to nearly $60,000 over the life of the loan. Of course, homeowners can always refinance to end their FHA insurance, but rates are so low that by the time an FHA borrower is able to refinance to a lower rate, it may not be worth it.

FHFA ANNOUNCES LOAN LIMITS FOR 2014

Although there were rumors that the Federal Housing Finance Authority (FHFA) was considering lowering the conforming loan limits, the current ones remain in effect for 2014. they are as follows:

San Diego, $546,250

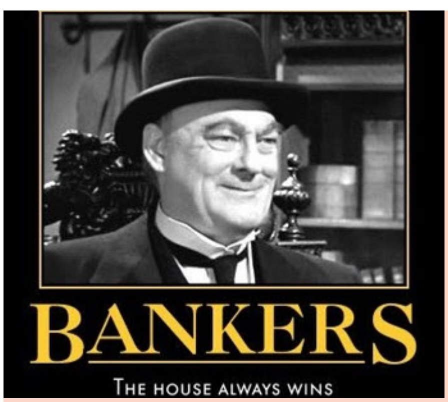
Los Angeles $625,500

Orange County $625,500

Riverside $417,000

San Bernardino $417,000

MORTGAGE BOONDOGGLES PAST AND PRESENT



The purported aims of the changes that were ushered in this past few years were to make real estate financing cheaper and more comprehendible to the lay borrower. Unfortunately, the legislation enacted has had quite the opposite effect. The Home Value Code of Conduct (HVCC) that went into effect on May 1, 2009 proscribed mortgage brokers and bankers from ordering appraisals directly from appraisers. While its goal was to insure fairly-priced, objective valuations it resulted in appraisals being 20% more expensive and often inaccurate than was formerly the case. Veteran appraisers saw their years of experience, professionalism and reputation rendered worthless (or devalued by 40%) by government mandates because under the HVCC most appraisers received about 40% less for the same work while appraisals became 20% more expensive. The inaccurate appraisals that sellers, buyers and homeowners complained about were frequently being done by out-of-area appraisers unfamiliar with neighborhoods and communities they were appraising. The lengthened closings that brokers and processors had to deal with were due to the new waiting periods mandated by the legislation. In so many ways, it has became a lose, lose, lose situation all the way around.

On July 30, 2009 the Mortgage Disclosure Information Act mandated that borrowers be provided with lender disclosures before ordering an appraisal or collecting fees for it. The reason for its implementation was due to the fact that some mortgage bankers and brokers would routinely collect fees covering appraisal, inspection, and application at the time of the application—sometimes amounting to hundreds of dollars and thereby tethering the borrower to the lender, thus seriously hindering their ability to shop for a loan. Again, the goal was a worthwhile but due to the imposition of various waiting periods and the need for a new re-disclosure (if fees and charges changed the APR during processing by more than 1/8th of a percent) closings were delayed.

This resulted in borrowers being stuck paying for a lock extensions and incurring additional moving expenses. In so many instances, the cure proved worse than the affliction. Moreover, since the appraisals were no longer portable (in that most lenders would not accept an appraisal from any appraisal management other than their own) it negated the borrower's ability to shop for a loan, its primary raison d'etre.

The N.Y. Times ran an article on its front page titled "U.S. Loan Effort Is Seen as Adding to Housing Woes" on Jan. 2, 2010. In it, some economists and real estate experts contended that the Obama administration's loan modification program under the Home Affordability and Stability Plan (HASP) had done more harm than good. In my April '09 newsletter I pointed out the two major flaws in the plan 1) like the Bush administration's HOPE plan, it was wholly voluntary despite lenders having received billions in bailout funds from tax payers and 2) it did nothing to address principal reduction for mortgagors even though owing more than a home is worth is an even more important predictor of defaults than unemployment. The net result was that few loan modifications were done—less than 1 percent of those who were eligible received permanent loan modifications—and depending on payment reduction—between 38.6% to 66.7% of those receiving trial modifications re-defaulted in the first 12 months. Foreclosures rose rather than abated. In 2008, more than 1.7 million homes were "lost" through foreclosures, short sales or deeds in lieu of foreclosure, according to Moody's Economy.com. More than two million homes were lost in 2009. Economy.com prophesied that 2010's number would swell to 2.4 million. By trying to 'modify' loans this way, the government simply slowed the foreclosure pipeline and lengthened the crisis.

...AND NOW FOR 2014 — GOOD - BYE "RISKY LOANS", HELLO, QMs

During the housing bubble, some banks issued loans without verifying applicants' income or assets. As a result of the Dodd Frank law passed in 2010, lenders have to ensure that monthly mortgage payments are affordable.   Beginning January 10th, lenders will be required to write "qualified mortgages" or QMs which are intended to not only make mortgages safer, BUT MORE IMPORTANTLY TO SHIELD LENDERS FROM FUTURE LITIGATION. In order to be deemed QMs, lenders must follow new ATR (ability to repay) rules that have the following:

- No risky features like negative amortization or interest only payments and no loan term greater than 30 years
- Limiting points and fees to 3% of the amount financed
- The borrower's total debt-to-income ratio is not higher than 43%

My quibbles with the new legislation is that there was really nothing wrong with interest only loans, loan terms greater than 30 years or even the much vilified Option ARMS. The problems lay with the borrowers not understanding what kind of mortgage instruments they had signed up for. And, yes, some blame needs to be laid at the foot of unscrupulous brokers that sold these loans without sufficiently explaining the possible pitfalls. By having to observe new ATR rules it has made an already cumbersome process even more so in having to double and triple-check borrowers income and assets. Finally, with reducing the borrower's total debt-to-income ratio from 45% to 43% it will reduce the number of borrowers that qualify for refinances or purchases.

I would gladly embrace these new rules, if any of them made it cheaper or easier for borrowers to obtain credit, but they haven't in the past. As a colleague of mine put it, "The rules are being written by people who have never worked in the industry".

500 PAGE MORTGAGE APPLICATIONS ARE THE NEW NORMAL

Every so often, I sense that borrowers think this guy is making a lot of money for arranging a loan for me and probably not having to work all that hard to do it. Unfortunately, nothing could be further from the truth. Without getting into the specifics of how much one's commission is divvied up among the brokerage, one's processor, E & O (errors and omission) insurance, and licensing fees, I can assure borrowers that my field is not very lucrative. As for the work, borrowers have no idea of how much is involved in originating and processing a loan. A 500-page mortgage application file is the new normal and I have had some that have run to 750 pages. On top of this, amassing 400 emails per file among those from the borrower, the lender, the appraisal management company, insurance, title and escrow and providers of ancillary services is not uncommon. The amount of work that is involved for even a simple purchase money loan or a refinance is considerable and when compressed into the space of 4 to 6 weeks it is daunting.

Since the housing bubble burst, file size has grown steadily and dramatically. Just seven or eight years ago, the typical application file ran to about a hundred pages. Some for "no-doc" loans were thin indeed, not much more than a credit report, plus an appraisal and property information. But now files are more jam-packed than ever, with income and asset records, tax returns and other financial documents. We now need two years tax returns, two months' bank statements, sourcing of every deposit...on every file. A middle-income worker financing a median-priced house may get away with just a few hundred pages, but business owners or wealthy people with several income streams can generate paperwork better measured with yardsticks than page numbers.

After the housing meltdown, tighter rules were put in place, requiring an explosion of disclosures to be included in mortgage applications. Those alone account for nearly 50 pages. One disclosure invokes the Patriot Act, the post-9/11 legislation, designed to combat terrorists. The Feds require lenders to verify the borrower's identity to make sure they're not suspected of funding or laundering money for terrorist groups. Some of the documentation that's required can seem silly. An applicant may have $1 million in the bank, for example, but if there has been a recent deposit of, say $5,000, he is required to show where that sum came from. The rationale is that Fannie Mae and Freddie Mac frown upon buyers who use loans from friends or family to apply to the down-payment. If borrowers have to repay those private loans, it can make it harder to pay off the mortgage. So every deposit coming into an account has to be accounted for and scrutinized.

All this amassing and analyzing of documents costs both time and money. And new mortgage lending rules that are going into effect in January will make it even more complicated. The checklist lenders use to manage the application can run three pages long (and is also added to the file). The one that some brokerages use has four categories: disclosures, credit package, appraisal package and items needed prior to closing. There are 55 separate boxes to check, covering such items as the good faith estimate, asset statements, and the original appraisal report.

Of course, you can always pay cash instead. That's what a former client's husband did recently and it certainly simplified the transaction. "There were only three pieces of paper at the closing," she said.

RATE SUMMARY

As the stock market hit new highs, mortgage rates worsened this month

Conforming programs—a 1/8th higher ↑

Jumbos— up a quarter ↑

Governments— worse an 1/8th to a ¼ ↑

FOR CURRENT INTEREST RATES FOR THE 16 MOST POPULAR PROGRAMS GO TO: www.mortgagestraighttalk.com Then, click on the menu tab labeled "RATES". The rate sheets are updated every Friday.

MORTY'S MAILBAG

There were no letters in the mailbag this month.

Recipients of the newsletter are invited to Ask Morty any real estate or financing questions. The answer to the question will be answered either by phone or email and posted in the next issue for the benefit of all. Questions may be forwarded via mail phone or fax. Due to the high incidence of spam, if you email me a question it needs to be identified as a "real estate question" on the subject line of the email. (See front of issue for phone and fax numbers). Morty's email address is morty@mortgagestraightTalk.com .

BEST BETS THIS MONTH

- Conforming 30 yr. fixed @ 4.375%
- Conforming 15 yr. fixed @ 3.375%
- Conforming 5/1 ARM @ 2.75%
- High Balance Conforming 30 Yr. fixed @ 4.500%
- Jumbo 5/1 ARM @ 3.000%
- Jumbo 30 yr. fixed @ 4.750%
- FHA/VA High Balance Conforming 30 Yr. fixed @ 3.875%/3.875%

MORTGAGE MIRTH