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IN THIS MONTH'S ISSUE

BEST BUYS THIS MONTH

- Conforming 30yr. fixed @ 3.500%
- Conforming 15 yr. fixed @ 2.625%
- Conforming 5/1 ARM @ 2.500%
- Jumbo 30yr. fixed @ 3.750%
- Jumbo 5/1 ARM @ 2.8750%
- FHA Conforming 15 Yr. fixed @ 2.500%
- VA Conforming 15 Yr. fixed @ 2.625%
- DU REFI PLUS/OPEN ACCESS 30 YR. FIXED @ 3.500%

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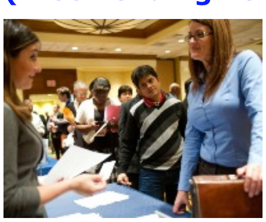
- **"HARD MONEY" LOANS**
- **REVERSE MORTGAGES**
- **FOREIGN NATIONALS**
- **DELAYED FINANCING**
- **STATED INCOME LOANS**
- **MANUFACTURED HOMES**
- **ASSET DEPLETION LOANS**

MACROECONOMIC MOVES AND MORTGAGE MARKET ANALYSIS

JOB GAINS SURGE
(Week ending February 6, 2015)



A positive outlook for the US economy caused investors to shift assets from bonds to stocks this week. The economic data was highlighted by Friday's strong labor market report. Mortgage rates ended the week higher.

Investors were shocked by the strength of Friday's Employment data. The economy added 257K jobs in January, which exceeded expectations. The bigger news was that upward revisions to prior months added another

147K jobs. Monthly job gains over 200K are considered strong, and the economy has added an average of 336K jobs over the past three months. Stronger growth increases expectations for future inflation, which is negative for mortgage rates, and mortgage rates rose after the announcement.

Another component of the Employment report caused inflation expectations to increase as well. Average Hourly Earnings, an indicator of wage growth, was 2.2% higher than one year ago, which was much higher than expected. Some of the increase in wages was due to higher minimum wage laws which went into effect in January in several states, so this portion of the wage growth will not be repeated in future months.

The Unemployment Rate unexpectedly rose from 5.6% to 5.7%, but this was due to a large increase in the size of the labor force. The Unemployment Rate measures the percentage of people who are actively looking for work (the labor force) but cannot find a job. Many people who had not previously been searching began to look in January. This is a sign of an improving labor market.

RETAIL SALES FALL SHORT (Week ending February 13, 2015)

On the heels of last Friday's strong labor market report, mortgage rates drifted higher during the first half of the week. They reversed direction on Thursday due to a shortfall in the Retail Sales data and ended the week just slightly higher.

Retail Sales, which account for about 70% of US economic activity, fell in January due to the large decline in gas prices. Economists had correctly predicted this, but they overestimated how much consumers would increase their spending in other areas, so the overall decline in Retail Sales was much larger than expected. Whether they spend the money they are no longer paying for gas, or they add to their savings or pay down debt, consumers are big beneficiaries of lower gas prices.

Investors paid significant attention this week to the negotiations over Greek bailout funds and the talks to end the conflict in Ukraine. Both situations moved closer to a positive resolution, but a great deal of uncertainty remains in both cases. The degree of investor confidence that these two situations will reach the desired outcome continues to influence mortgage rates

VOLATILE WEEK (Week ending February 20, 2015)

Mortgage rates experienced many sharp movements this week. News about Greece and the Fed Minutes produced surprisingly large reactions, while the economic data had little impact. The net result was a small increase in mortgage rates.

This week's volatility reflected the high degree of uncertainty investors face on a couple of key issues. One is the status of negotiations on a Greek aid package that is critical for its future financial stability and continued membership in the European Union (EU). Earlier in the month, a Greek exit from the EU was considered just a remote possibility, but now investors are trying to determine the significance for financial markets in case it does take place. Shifting expectations for an aid agreement are pushing investors in and out of safer assets, such as US bonds and mortgage-backed securities.

Investor expectations also range across a large spectrum for the timing of fed funds rate hikes. The Minutes from the January 28 Fed meeting released this week provided little guidance to help investors narrow down the possible time frame. Since Fed policy impacts economic growth rates and inflation expectations, it influences mortgage rates.

The latest housing data indicated that activity slowed during January likely due to unusually bad winter weather. Both Housing Starts and Building Permits declined a little, but both remain far above their levels seen one year ago. The NAHB Housing index also showed a small drop in home builder confidence.

RATES RESPOND TO YELLEN COMMENTS (Week ending February 27, 2015)

Yellen's semi-annual testimony to Congress caused investors to push farther in the future when they expect the Fed to begin raising the fed funds rate. Now the consensus outlook is for the first rate hike to take place in September. Yellen explained that the Fed can remain "patient" in tightening monetary policy because inflation

remains below the Fed's target level of 2.0%. Also, the labor market contains enough slack to allow room for further improvement without causing inflationary pressures.

The housing data for January released this week contained mixed news. Unusually bad winter weather played a role and likely will have an impact on next month's reports as well. Of note, both New Home Sales and Pending Home Sales are at or near multi-year highs, while Existing Home Sales fell 5% from December, to the slowest pace since April of last year.

Although all three reports cover activity in January, Existing Home Sales counts closings, while Pending and New Home Sales measure signed contracts (on existing and new homes). As a result, the latter two reports reflect more current activity, providing a reason to be optimistic about future closings.

THE STATE OF THE UNION

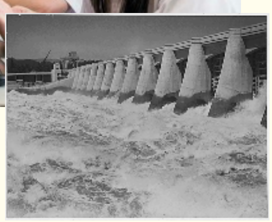
This is the ninth installment of my multi-part series on the macroeconomics of political and social issues that weigh heavily on our "State of the Union". As Theodore Parker, an early American Transcendentalist observed:

"The arc of the moral universe is long, but it bends toward justice."

While economics relies heavily on numbers and statistics it is invaluable indicator of the costs and benefits associated with "being on the right side of history".

INFRASTRUCTURE

In the concluding paragraph of my 2015 annual forecast, last month, I iterated a topic that has appeared in the four previous years' forecasts—the crucial need to spend money on the nation's crumbing infrastructure.



America used to be a country that built for the future. The U.S. was the first country to invest in mass elementary education for boys and girls, then in high schools, and then in widespread college education. Investment in education (our mental infrastructure) was the best explanation for America's rise to global pre-eminence.

Sometimes our government invested directly in public works projects—from the Erie Canal, to the Tennessee Valley Authority, to the Interstate HighwaySystem all of which provided the backbone for economic growth. The United States invested in the electrical grid and rural electrification. President Dwight Eisenhower, who had been part of an army convoy that took 62 days to cross the United States on wretched roads, invested in the 1950s in the interstate highway system. The interstates knitted together the country and created huge economic efficiencies.

Other times, the government provided incentives to the private sector, like land grants to spur railroad construction. Either way, there was broad support for spending that would make us richer. These hugely raised living standards and economic output. These were visionary schemes that, if newly proposed today, might not get off the ground. Our schools have tumbled by global standards, we haven't ensured access to the Internet the way we did to the electrical grid, and our highway trust fund is almost broke.

POLITICAL COURAGE AND RESOLVE: Today, it's a brave politician who acknowledges that sometimes money is better spent by the government than by individuals. In the fifties and sixties our infrastructure was unparalleled: Higher education at the state university level was virtually free, our interstate highway system, communications, energy and electrical grid systems were the envy of the world. Back then, the marginal tax rate on the mega wealthy was 92%, the middle class was healthy and growing, a larger percentage of the population could afford homes and even most in the lower class could afford a two-week vacation every year. Isn't it obvious that we're at a point where we would be better off as a nation paying a bit more in taxes and in exchange getting better schools, safer food, less congested roads—and, over all, a higher standard of living?

THE PROBLEM: Until the 1970's we were pre-eminent in mass education. As the economists Claudia Goldin and Lawrence Katz have written, "The 20th century was the American century because it was the human-capital century." Education continues to pay today, despite the scare stories to the contrary. The pay gap between college graduates and everyone else in this country is near its all-time high. The countries that have done a better job increasing their educational attainment, like Canada and Sweden, have also seen bigger broad-based income gains than the United States. But the United States is one of the few advanced countries that spends less educating the average poor child than the average rich one. And so, our once-large international lead in educational attainment has vanished, and our lead in inequality has grown.

According to the Organization for Economic Cooperation Development (OECD) as recently as 2000, the United States still ranked second in the share of the population with a college degree. Now we have dropped to fifth. Among 25 to 34-year olds—a glimpse of how we will rank in the future—we rank 12th, while once-impoverished South Korea tops the list. Russia now has the largest percentage of adults with a university education of any industrialized country—a position once held by the United States.

The best escalator to opportunity in America is education. But recent studies underscore that our educational infrastructure is in disrepair. Moreover, we have constructed an education system, dependent on local property taxes, that provides great schools for the rich kids in the suburbs who need the least help, and broken dangerous schools for inner-city children who desperately need a helping hand.

As for physical infrastructure, America's is now so wretched that, in some areas, the only people who drive straight are the drunks. Anyone who is sober swerves to avoid potholes. In New Jersey, the gas tax hasn't been increased since 1992, and two-thirds of the roads are now evaluated as in poor or mediocre condition. The upshot, one study found, is that the average motorist spends $601 per year in repair costs. It seems obvious that society would be better off spending a little in taxes to improve roads and reap a saving on car repairs—not to mention in injuries and fatalities averted.

The American Society of Civil Engineers gives America a grade of D+ for infrastructure and estimates congestion on highways costs the economy $101 billion annually in wasted time and fuel. The collapse of the I-35W Mississippi River Bridge in 2007 and the I-5 Skagit River Bridge in 2013 underscore the dire state of disrepair that our bridges are in. A study of American bridges found that more than 66,000 in America are structurally deficient; laid end to end, the deficient ones would reach from Canada to Mexico.

There are broken water mains throughout LA. It is particularly ironic that it is costing us millions of gallons of water when we are in the midst of a drought. Our infrastructure through out the state desperately needs improvement.

SOME BACKGROUND: The basic story of what went wrong is rather simple: We had an immense housing bubble, and, when the bubble burst, it left a huge hole in spending. And the appropriate policy response was simple, too: Fill that hole in demand. In particular, the aftermath of the bursting bubble was (and still is) a very good time to invest in infrastructure. Since 2008, our economy has been awash in unemployed workers (especially construction workers) and capital with no place to go (which is why government borrowing costs are at historic lows). Putting these idle resources to work building useful stuff should have been a no-brainer.

But what actually happened was exactly the opposite: an unprecedented plunge in infrastructure spending. Adjusted for inflation and population growth, public expenditures on construction have fallen more than 20 percent since early 2008. In policy terms, this represents an almost surreally wrong turn; we've managed to weaken the economy in the short run while we undermine its prospects for the long run.

And, it's about to get even worse. The federal highway trust fund, which pays for a large part of American road construction and maintenance, is almost exhausted. Unless Congress agrees to top up the fund somehow, road work all across the country will have to be scaled back just a few weeks from now. If this were to happen, it would quickly cost us hundreds of thousands of jobs, which might derail the employment recovery that finally seems to be gaining steam. And it would also reduce long-run economic potential.

THE COST: The timing couldn't be better as the financing is relatively inexpensive and yet…more than seven years have passed since the housing bubble burst, and ever since, America has been awash in savings—or more accurately, desired savings—with nowhere to go. Borrowing to buy homes has recovered a bit, but remains low. Corporations are earning huge profits, but are reluctant to invest in the face of weak consumer demand, so they're accumulating cash or buying back their own stock. Banks are holding almost $2.7 trillion in excess reserves—funds they could lend out, but choose instead to leave idle. And the mismatch between desired saving and the willingness to invest has kept the economy depressed.

It's also instructive to look at interest rates on "inflation-protected" or "index" bonds, which are telling us two things. First, markets are practically begging governments to borrow and spend, say on infrastructure; interest rates on index bonds are currently just 0.4 percent, so that financing for roads, bridges, and sewers would be almost free. Second, the difference between interest rates on index and ordinary bonds tells us how much inflation the market expects, and it turns out that expected inflation has fallen sharply over the past few months, so that it's now far below the Fed's target. In effect, the market is saying that the Fed isn't printing nearly enough money.

TAXES: The ratio of tax to G.D.P. has changed little in the United States in the last six decades. Other countries, as they grew richer, chose to increase taxes and services, but the United States has resisted that trend and is now near the bottom of the pack of industrialized countries in taxation levels. The wealthy, in particular, pay low income taxes in the United States. And loopholes mean that the corporate tax burden is lower in the United States than among our peers. Aside from the need to pay for public investment, there are other reasons as to why the taxes should be raised, ranging from climate concerns to reducing the dependence on the Middle East. But even if we wanted to delay raising taxes until the economy were stronger—we don't have to stop public investment in building and repairing roads.

The highway fund crisis is just one example of a much broader problem. Road spending is traditionally paid for via dedicated taxes on fuel. The federal trust fund, in particular, gets its money from the federal gasoline tax. In recent years, however, revenue from the gas tax has consistently fallen short of needs. That's mainly because the tax rate, at 18.4 cents per gallon, hasn't changed since 1993, even as the overall level of prices has risen more than 60 percent. Congress can and has topped up the highway trust fund from general revenue. In fact, it has thrown $54 billion into the hat since 2008. So, why not do it again?

But no, we're told, we can't simply write a check to the highway fund, because that would increase the deficit and deficits are evil—at least when there's a Democrat in the White House—even if the government can borrow at incredibly low interest rates. We can't raise gas taxes because that would be a tax increase, and tax increases are even more evil than deficits. So our roads must be allowed to fall into disrepair. Again, this didn't have to happen.

INTERVENING IDEOLOGY: But nowadays we simply won't invest, even when the need is obvious and the timing couldn't be better. What has actually happened is the reverse. After briefly rising after the Obama stimulus went into effect, public construction spending has plunged. And, once the G.O.P. took control of the House, any chance of more money for infrastructure vanished. Once in a while Republicans would talk about wanting to spend more, but they blocked every Obama administration initiative.

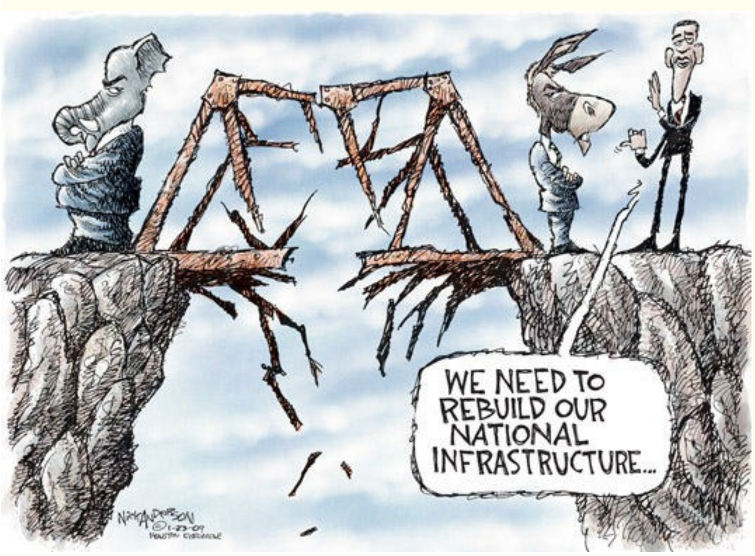
"GOT ANY OTHER IDEAS?"

It’s all about ideology, an overwhelming hostility to government spending of any kind. This hostility began as an attack on social programs, especially those that aid the poor, but over time it has broadened into opposition to any kind of spending, no matter how necessary and no matter what the state of the economy. As with so many of our problems, the answer is the combined effect of rigid ideology and scorched-earth political tactics.

If this sounds crazy, that’s because it is. But similar logic lies behind the overall plunge in public investment. Most such investment is carried out by state and local governments, which generally must run balanced budgets and saw revenue decline after the housing bust. But the federal government could have supported public investment through deficit-financed grants, and states themselves could have raised more revenue (which some but not all did). The collapse of public investment was, therefore, a political choice.

What’s useful about the afore-mentioned, looming highway crisis is that it illustrates just how self-destructive that political choice has become. It’s one thing to block green investment, or high-speed rail, or even school construction. While many are for such things, many on the right aren’t. But everyone from progressive think tanks to the United States Chamber of Commerce thinks we need good roads. Yet the combination of anti-tax ideology and deficit hysteria (itself mostly whipped up in an attempt to bully President Obama into spending cuts) means that we’re letting our highways, and our future, erode away. Our inability to invest doesn’t reflect something wrong with “Washington”; it reflects the destructive ideology that has taken over the Republican Party.

Never mind that the economic models underlying such assertions have failed dramatically in practice, that the people who say such things have been predicting runaway inflation and soaring interest rates year after year and keep being wrong; these aren’t the kind of people who reconsider their views in the light of evidence. Never mind the obvious point that the private sector doesn’t and won’t supply most kinds of infrastructure, from local roads to sewer systems; such distinctions have been lost amid the chants of private sector good, government bad.



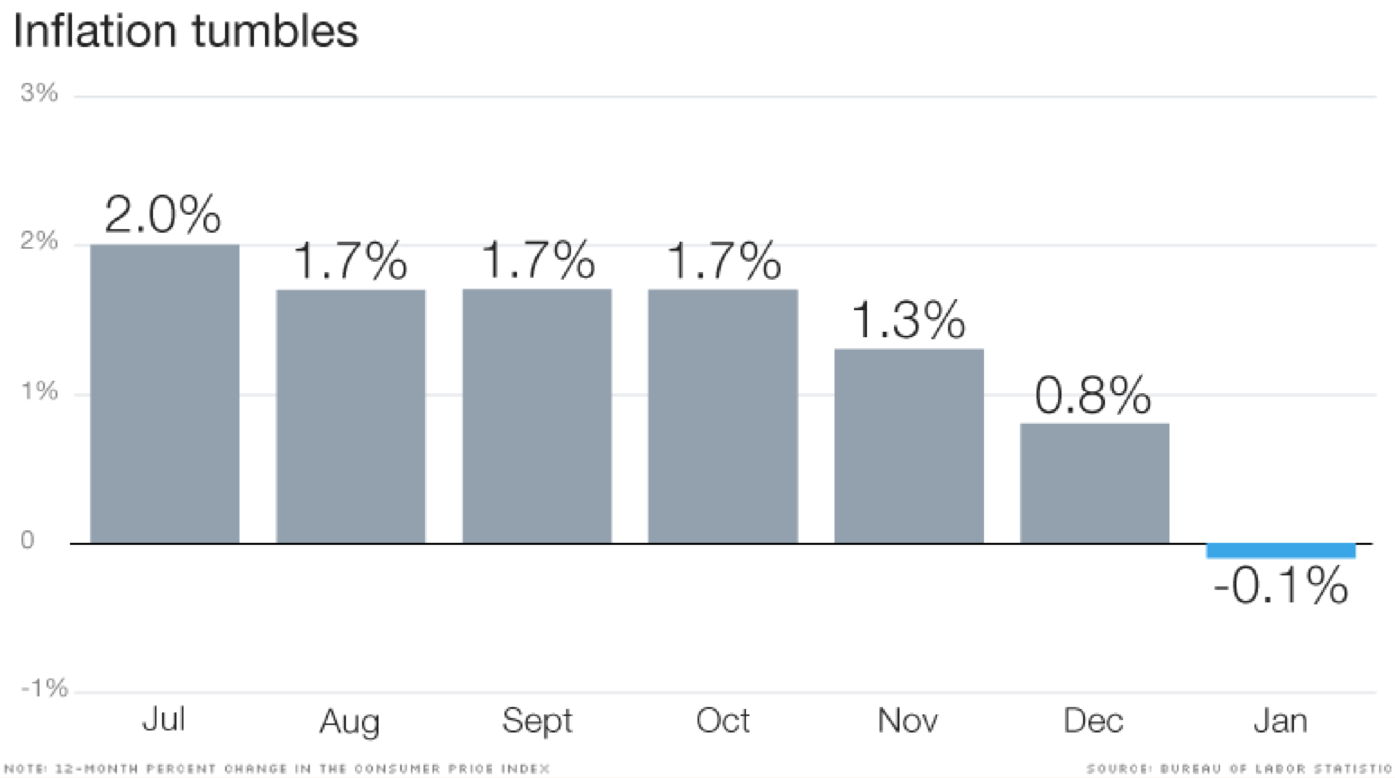
THE CONCLUSION

It would seem that America has turned its back on its own history. We need public investment and now is a great time to do it while interest rates remain near all-time lows. The members of Congress and particularly the Republican majority could do much more to help if they only would act to advance the broad interests of the public rather than the narrow interests of their party.

We need to recognize that some of our greatest national achievements aren’t tax cuts but public investments. So, let’s get real about government. Sure, tax money is sometimes squandered, as is money in business. But what strengthens us as a nation is often investments in public goods that benefit all Americans.

IT'S OFFICIAL: AMERICA HAS DEFLATION

America experienced something in January it hasn't seen in years: deflation. Prices for goods actually declined -0.1% in January from a year ago, according to the Labor Department. That means it actually cost less to buy things in America this year than it did in January 2014. It's the first time since October 2009 that the U.S. economy experienced annual deflation.



"There is little danger that this temporary bout of falling energy prices will develop into a more insidious debt-deflation spiral," says Paul Ashworth, chief U.S. economist at Capital Economics. The main driver of falling prices is cheap gas. A year ago, a gallon of gas was about $3.40. Last month a gallon cost around $2.15 on average. Prices have since stabilized with some saying gas is likely to rise from here.

At the moment, inflation is the only major yardstick of the economy going in the wrong direction. A strong and growing U.S. economy typically has inflation of around 2% a year, so a negative number is far from the mark. January was the third straight month of price declines. If gas prices rebound more, then the total inflation figure should start heading up again. While most Americans pay attention to the prices of food and energy, economists also look at so-called core inflation that excludes those two items. Core inflation actually rose 1.6% from a year ago, another sign that gas is the key swing factor.

January's deflation could cause the Federal Reserve to hesitate on raising interest rates, which many expect them to do later this year. Federal Reserve Chair Janet Yellen and her fellow board members do not want to raise interest rates until the economy shows real momentum. Overall, the U.S. economy has many signs of improvement. The unemployment rate is dropping, growth is picking up and hiring has been strong. But many Americans haven't seen any real improvement in their paychecks in years.

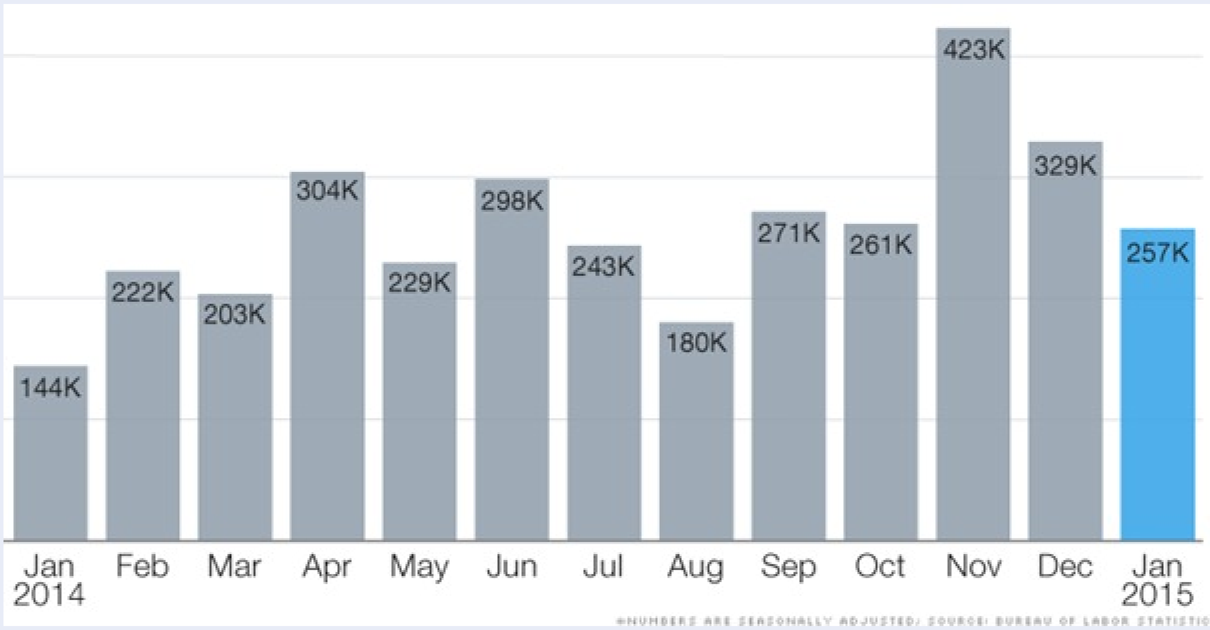
Since wages are staying flat, consumers have been thankful for low gas prices, but don't expect it to last for long. Most economists believe the cheap gas and deflation will be short-lived.

HIRING STILL STRONG: 257,000 JOBS ADDED IN JANUARY

America continued its solid job growth in January. The U.S. economy added 257,000 jobs in January, adding to the gains from last year, which was the best for job growth since 1999. The official unemployment rate ticked up to 5.7%, a notch higher than December. More people are looking for work now as they see others get employment. The higher unemployment rate is actually good news--it's a sign of confidence in the job market.

The optimism doesn't stop there. There were huge upward revisions to the job gains in November and December. The economy added about an extra 150,000 job in those two months combined, according to the Labor Department.

Headwinds ahead: January's job news was a reprieve from the economy's rocky start to 2015. The S&P 500 and Dow fell 3% as the strong U.S. dollar is starting to hurt American businesses selling products overseas. There is growing concern that the dollar's pressure could hurt sales abroad so much that it could eventually cause layoffs in U.S. later this year.



Oil bust: One of the biggest worries is that the dramatic fall in oil prices in recent months will cost many American workers their jobs in the energy sector. Texas, the second-largest state economy, could be hard hit. A number of big oil companies have already announced thousands of layoffs. The economy still added almost 200,000 oil and gas jobs in January, but that is down slightly from December's energy job gains. The strong dollar and oil prices are rising red flags, but wages could take center stage in the debate about the economy's health this year, economists say.

Wage gains: Perhaps the best news for many Americans is that wages grew a healthy 2.2% in January compared to a year ago. Last year wages barely rose. President Obama touted wage growth in his State of the Union address, but wages have not changed much for many Americans. Some of the wage gains could have come from several states increasing their minimum wages at the start of the year. Over 3 million workers got a raise from the wage hikes. The Federal Reserve wants to see consistent wage growth before it raises its key interest rate--- a sign that the U.S. economy is healthy. It aims to see wage growth above at least 2%. In December, wages only grew 1.7% on the year.

MORTY'S MAILBAG

Q. I've read various places that the cause of the mortgage meltdown in 2008 was due to home-ownership purchase programs sponsored by Fannie Mae and Freddie Mac. As a mortgage professional, did that mirror your experience?

A. No, not really. But, allow me to elaborate. One of the most abjectly false narratives about the financial crisis is that risky mortgages proliferated so that people who couldn't afford homes could nonetheless buy them. It was the confluence of so many things, from unregulated investment banking (credit default swaps, derivatives and the repeal of Glass-Steagall) to the lack of government oversight on mortgage securitization and the ratings agencies having a conflict of interest in their assessment of various CMOs, CDOs and SIVs. (For a good synopsis of this whole mess see the August 2008 issue of the newsletter Volume 5, Issue 8).

The debacle did not stem from subprime homeownership; it was simply that modern subprime lending lit the fuse. Beginning in the 1990s the crop of subprime mortgage makers allowed people with bad credit to borrow against the equity in their existing homes. According to a joint HUD-Treasury report published in 2000, by 1999, a staggering 82 percent of subprime mortgages were refinancings, and in nearly 60 percent of those cases, the borrower pulled out cash, adding to his debt burden. The report noted that "relatively few subprime mortgages are used to purchase a house."

Much, and at times most, of what happens in the mortgage market doesn't have anything to do with homeownership. A sizable percentage of mortgages— including most of the risky ones that were made in the run-up to the financial crisis—were not used to buy a home. THEY WERE USED TO REFINANCE AN EXISTING MORTGAGE. When home prices are rising and mortgage rates are falling, many homeowners choose to replace their mortgage with a bigger one, taking the difference in cash. In other words, mortgages are a way to provide credit.

Refinancing is a relatively modern phenomenon. According to Joshua Rosner, a managing director at the research consultancy Graham Fisher & Company, by 1977, only 8 percent of homeowners had ever refinanced. By 1999, 47 percent had refinanced at least once. By the peak of the bubble, homeowners were extensively using refinancings to extract cash. Mr. Rosner also points out that while homeownership peaked in 2004, home prices peaked in 2006, because refinancing drove up prices.

According to the financial statements of New Century, the huge lender whose bankruptcy in early 2007 helped kick off the financial crisis, cash-out refinancings were 64.2 percent and 59.5 percent of its business in 2003 and 2004; home purchase loans made up only 25 percent to 35 percent for the two years. A New Century executive told Congress that its customers needed to "tap into their home equity to meet other financial needs, such as paying off higher-interest consumer debt, purchasing a car, paying for educational or medical expenses and a host of other personal reasons." I recall seeing a bank ad in the winter of 2009 that read—"Let your home take you on vacation". According to Jason Thomas, now the director of research at the Carlyle Group, only about a third of subprime mortgages that were turned into mortgage-backed securities between 2000 and 2007 were used to buy homes.

Putting the financial crisis aside, the logic behind this is completely messed up. If we want homes to be a vehicle for saving and building wealth, as they used to be, why are we instead encouraging people to increase their indebtedness? Even worse, we now know that too much credit results in people who once owned their homes losing them. It creates homelessness, not homeownership.

The problem, of course, was that the conflation of homeownership and consumer credit was so convenient for the powers that be. It allowed lenders to cloak themselves in the American-as-apple-pie mantle of homeownership, thereby making it less likely that anyone would crack down on their practices. It allowed members of Congress, many of whom depended on the financial industry for campaign contributions, to pretend that something that was bad for us was actually a good thing for which we should have been grateful.

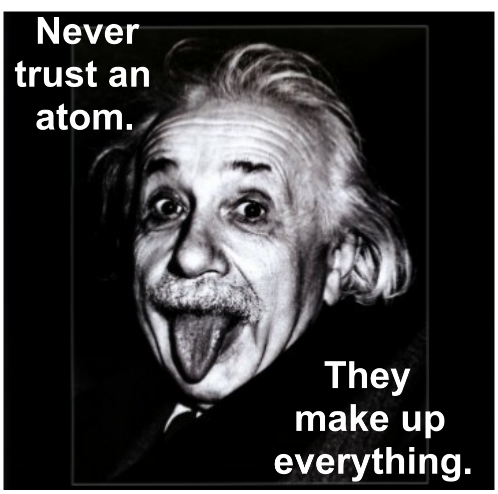
There's an argument that refinancing doesn't much matter today. Because interest rates can't go much lower, and home prices aren't skyrocketing, "refis" will be a smaller part of the market. According to Freddie Mac, 28 percent of borrowers took cash out in the third quarter of 2014. But that's still a significant percentage of the market, and ideally, we're setting up a housing finance system that should be right, not just for now, but for decades to come.

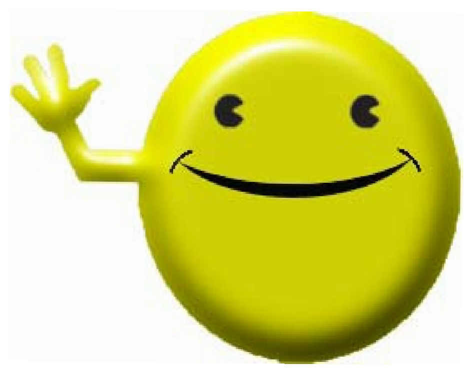
One possible solution would be much tougher standards for cash-out refinancings than for mortgages used for purchases, such as requiring far more equity in a home, or making lenders keep the loan on their own books instead of selling it. Or perhaps Fannie Mae and Freddie Mac shouldn't be allowed to guarantee payment on a mortgage unless it is used to purchase a primary residence.

In Washington, there's been scant public discussion of this. Nine of the ten members of the Financial Crisis Inquiry Commission reported in 2011 that Fannie & Freddie "contributed to the crisis, but were not a primary cause", According to the Commission, Government Sponsored Entities (GSEs) mortgage securities essentially maintained their value throughout the crisis and did not contribute to the significant financial firm losses, that were central to the financial crisis. The GSEs participated in the expansion of subprime and other risky mortgages, but they followed rather than led Wall Street and other lenders into subprime lending. So, no, the reason behind the mortgage melt down was not due to liberal Fannie and Freddie home purchase programs, but to too lenient cash-out refinancings.

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

MORTGAGE MIRTH





RATE SUMMARY

As the economy improved, this month, mortgage rates increased modestly.

*Conforming programs—an 1/8th to 1/4th worse ↑
*Jumbos—a ¼ higher ↑
*Governments—an 1/8th worse ↑