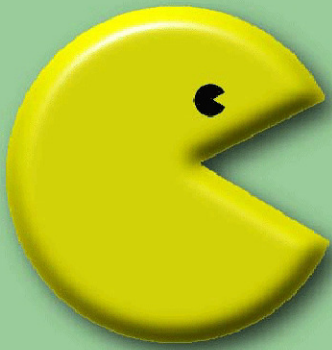


Newsletter - Vol. 3 Issue 10

October 2006

mortgagestraightTalk.com

Tel: 760-726-4600 Cel: 760-717-8584

Fax: 760-639-0785

Rod@MortgageStraightTalk.com

30 Yr. Fixed Conform. & Jumbo	6 & 6.375%
5/1 ARM Conform. & Jumbo	5.625 & 6%
Prime Rate	8.25%
MTA Index	4.664%
COFI Index	4.177%
Home Ownership Accelerator Index	5.323%

Morty's Bench Marks - 9/29/06

Above rates assume 30 day locks priced at par, that is, at wholesale with no rebate.

CURRENT EVENTS

The Federal Open Market Committee (FOMC) met on Sept. 20. and voted to keep interest rates unchanged for the second time in more than two years. The FOMC has acknowledged that while its past 17 interest rate hikes seem to be having the desired effect of slowing economic growth, reflected by a cooling housing market, it is still not sanguine about the current rate of inflation at 2.8% as it is well above its comfort zone of 1%-2%. Some people say, "What's the big deal with 2.8%? It's not that much different than 2.0%, right?" Wrong! At an inflation rate of 2.8% the $30,000 car of today would cost you $93,000 forty years from now.

In trying to stem inflation the Fed is trying to preserve the purchasing power of the dollar and maintain the value of consumers' savings. Inflation can be especially pernicious over time. Over the past 40 years the U.S. rate of inflation has been about 4.5%, a number that would not raise too many people's eyebrows but over time translates into a 1000% mark-up. In 1965, you could buy a first class stamp for 4 cents, a half-gallon of milk for about 45 cents, a loaf of bread for 19 cents, a gallon of gas for 22 9/10 cents, a new Ford Mustang for $2368 and a very nice new home for $25,000. Today, these same items will cost you tenfold more because of inflation. As a result many would-be retirees find that they cannot afford to do so because the purchasing power of their savings has been seriously eroded by inflation.

Conversely, some people have used this to their advantage by borrowing money today and paying back with even cheaper dollars (those with diminished purchasing power) in the future, to wit note the phenomenal growth in the use of option ARM and Interest Only mortgages during the past 10 years. Admittedly, inflationary expectations is not the only reason for the burgeoning growth of these programs.

Oil prices have momentarily receded to below $62 per barrel and across most of the nation gasoline prices have followed suit which has helped to moderate inflation. Nothing, however, lasts forever. As long as much of the rest of the world is paying $6 a gallon for gas, it's only a matter of time before they begin their inexorable creep back upward.

UCLA Anderson
School of Management

My old alma mater, the Anderson School of Management (UCLA), forecasts that the

slowdown in the housing market will end sometime next year. By slowdown, they're referencing sales volume as the number of homes sold will drop as owners decline to sell in a weak housing market. Prices, however, should hold. The real decline in the housing market, the forecast says, will come in "residential investment," which includes construction of new homes, repair and remodeling, and brokerage commissions on the sale of new and existing homes. My guess is that we'll see prices start to improve in late May and early June.

With housing and inflation slowing, the futures market "thinks" that there's a 90% chance that the Fed will keep rates at their current levels at its next two meetings in October and December, according to the Chicago Board of Trade. Moreover, the market thinks there is a 36% chance of a cut by April and a 90% chance of one by July.

THIS ISSUE'S TOPIC:

Private Mortgage Insurance (PMI)

Most budding mortgage brokers are told that nowadays one is far less apt to use Private Mortgage Insurance than in the past because it is not tax-deductible, unlike the interest one pays on a second mortgage or a Home Equity Line of Credit (HELOC). Hence, PMI has gotten a bad rap among most mortgage brokers and realtors. The purpose of today's discussion is to provide an overview of what Private Mortgage Insurance is and disabuse readers of some of the misunderstandings that pertain to it.

PMI: What It Is

Private Mortgage Insurance (PMI) is an indemnification policy paid for by the borrower that protects lenders interests when a property's Loan To Value (LTV) is in a range of 80.1-100% (foreclosure risk). Because they're insured against this loss, lenders are willing to accept lower down payments (a standard down payment used to be 20% of the purchase price). In a corollary fashion borrowers benefit in that it permits the buyer to buy a more expensive home with a smaller down payment than might otherwise have been the case.

With 2nd mortgages and HELOCs now topping 9-12%, it is actually cheaper for borrowers to go with PMI than a HELOC or fixed rate 2nd, particularly for those with low credit scores and where the Combined Loan To Value (CLTV) of a 1st and 2nd is 90% or less. Among the primary disadvantages of adjustable rate 2nds or Home Equity Lines of Credit (HELOCs) are the lack of interest rate and payment caps. Put another way, PMI is immune to rising interest rates and unlike HELOCs, it is cancelable whereas 2nds must be paid back in full and many of them like a 30/15 (a 2nd with payment amortized over 30 years but due in 15) have balloon payments to contend with, as well.

Canceling MI

Homeowners with PMI may request to cancel it when their equity reaches 80% and is automatically cancelled when the original LTV is paid down to 78%.

Tax Advantages

Choosing PMI may result in substantial tax advantages because with PMI you may have a larger 1st mortgage loan amount at a lower interest rate as compared to a 1st and a piggyback 2nd with an even higher interest rate and higher combined interest payments. Also, the interest on the MI premium that is financed into the loan amount may also be tax-deductible.

How does PMI Work?

Lenders usually take care of arranging for private mortgage insurance after discussing with you the kind of mortgage insurance plan you can afford and that fits your needs. Usually the mortgage insurance premium is added to your monthly principal and interest payment (along with your property taxes and hazard insurance) and in turn, the lender pays the mortgage insurance premium to the mortgage insurer. You can also opt for a single financed premium plan in which your mortgage insurance is factored into the loan balance.

Various Payment Options

As payment options go, there's pretty much something for everyone. Here's a sampling of the various plans and their corresponding benefits:

Monthly Premium — the mortgage insurance premium is incorporated into your overall loan payment. With this plan you can minimize the closing costs.

Annual Plan — you pay an initial premium at closing and a renewal premium each year that follows. The initial premium can be financed.

One-Time Premium — an up-front payment with lower monthly premium payments—reduced by as much as 40%. The up-front portion may be financed into the loan.

Single Premiums — the mortgage insurance premium is a one-time charge financed into your loan. This option minimizes the closing costs and monthly loan payments for the borrower. In addition, the interest on this single financed premium may be tax-deductible.

Super Single -- finances the premium into the loan amount and depending on the borrower's circumstances, the interest paid on the MI premium may be tax-deductible.

Split Premium — combines an initial, one time premium payment with lower recurring monthly payments. There are two initial premium options: full payment by the borrower at loan closing, or the financing of the initial payment into the loan. The borrower may receive a refund of the financed portion of premium if MI is cancelled in the first two years.

Lender Paid Mortgage Insurance — the lender pays for the mortgage insurance and passes the cost of it on to the borrower in the form of a higher interest rate on the loan. While this approach may result in reduced closing costs and a lower monthly payment for some homebuyers, lender paid mortgage insurance may not be canceled at any time.

How Small Can Your Down Payment Be and What Are the Costs?

Generally speaking, you're going to need 3-5% as a minimum and the higher the LTV, the higher the factor and consequently the higher the cost will be. Because of the variety of programs, variables, and lenders it's necessary to contact a mortgage lender like myself for actual pricing.

MORTY'S MAILBAG

Q. What's the deal with stated income loans? If I can't qualify for a full-doc loan (the cheapest) how am I supposedly qualified for a more expensive stated income loan? It makes no sense to me. Specifically, we were interested in a option ARM loan because of the low monthly payments and the 1.45% interest rate. Even though our income is about 4 times as much as what the proposed minimum payments would be, we were told that our income was insufficient because to qualify for such a loan, we were told that our P.I.T.I. (principal, interest, taxes & insurance) and consumer debt needed to be less than 38% of our income. It was suggested that we go stated income which is more expensive. If the solution is all that simple, why doesn't everyone who can't qualify for the cheaper loan go this route? Are there limits as to the income that one can "state" and what lenders will accept as fact?

A. The purpose of stated income loans is to provide loan programs for those individuals who can't easily document their income e.g., cash operations like "the mom and pop" stores, or occupations heavily dependent on tips like waiters, cab drivers, exotic dancers, and other self - employed individuals with irregular cash flows where bank statements, tax returns, and W-2's don't accurately reflect one's income. These programs, also, make it possible for individuals to "fudge" their income (within certain parameters) to get a loan that might otherwise have been beyond their ability to qualify for if they were to go full-doc. Because they are riskier for the lender, since there is less in the way of proof that the person actually makes what they purport to earn, the lender charges more to off-set the added risk. As was suggested, the solution for you may well lie with going "stated income".

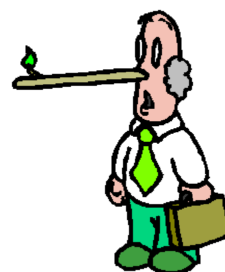
Another alternative may be in going from a 30 year term to a 40 year. This would lower your minimum payments and also the qualifying amount at the fully-indexed rate.

Finally, yes there are limits as to what lenders will accept as plausible regarding one's income. Stated income loans are rife with conflicts of interest for loan officers and borrowers, alike. If asked, the lenders' reps (many of whom are former Underwriters) are willing to suggest to Loan Officers what is likely" to fly under the underwriter's radar"

with regard to stating income for a given occupation. For example, if you work as a crossing guard for an elementary school, they are not apt to believe that you have a six-figure income. Underwriters use compensation guides to ascertain a range of income norms based on occupation and zip codes. With both reps and underwriters working for the same firm, it is an uniquely schizophrenic situation wherein both sides are working at cross purposes and conflicts of interest abound.

In part, this duality stems from the fact that the reps work on commission, whereas the underwriters are usually salaried. Yet it is critical that the underwriters strictly observe these guidelines because most loans need to conform to Fannie Mae and Freddie Mac regulations so that they can be resold in the secondary market. If the lender is audited and there are serious discrepancies, the lender is required to buy these questionable loans back, something lenders are loath to do.

Coincidentally, your question has a special relevance for me because of a recent situation with a couple of buyers. It is a particularly cautionary tale. The borrower wanted to buy a home with his fiancé. The problem was that while he was employed, she was not; she had assets, but he did not. The first broker they contacted wasn't very savvy about loans and futilely tried to get them approved by going full-doc. I explained to the borrower that the solution to his problem was a stated income loan and having her add him as a signer on her bank accounts. In order to qualify for a stated income loan of "x" amount, however, his stated income (gross) would need to be "y" amount of dollars. I explained that while the lender would verify employment they would not verify income.

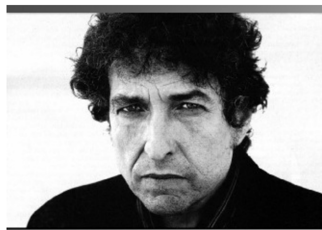


He affirmed the requisite income amount to be the truth over the phone and I got him pre-approved.

Greed in people is a truly astonishing thing to behold. People who would ordinarily act completely above board, turn larcenous often for a very few dollars. This truly turned out to be one of those situations wherein “no good deed went unpunished”.

A long story made short: four days before the borrower was to sign docs, I was informed by his realtor that my borrower had gone with his previous broker, the one that didn’t know how to do the loan. When I asked the borrower why he had decided to switch brokers at this late date, when I had gotten him approved with two different lenders, for three different amounts, that I had spent three weeks working on his file, etc. He told me that they (he and his fiancé) had decided to go with another broker because they “got a better deal and you can’t win them all.” (I would later find out that the difference was 5/100 of 1 percent). Not often enough, but occasionally justice is served. The very next afternoon the borrower’s Verification of Deposit (VOD) came in the mail along with his bank statements showing his actual payroll deposits. They revealed the borrower had lied and overstated his income by 100%, a not insignificant discrepancy between what he affirmed on the application and what he genuinely earned. In light of this, we were compelled to withdraw the application and the earlier approval we had received. Nonetheless, because the rate that I had found for the borrower was the best to be had, he had his new broker apply to the same lender with whom I had already had him approved. Even though I admonished him not to submit this loan to the same lender as it would arouse suspicion, he went ahead. Because his fiancé wanted to be on title and on the loan and because she had additional consumer debt, it necessitated stating his income higher still, such that their debt to income ratios would be under the requisite 38% (in this case) to qualify.

Just as I have a fiduciary duty to my borrowers I also have one to my lenders: it is that I will not conspire to defraud them. If found out, both they and their broker will be charged with perpetrating a fraud on a lender which is a felony. At the very least, the loan becomes callable, with the full amount due. Ironically, while these two former high school sweethearts had wanted the purchase of their new home to close on Valentine’s Day, because of their stupidity and cupidity they had placed themselves in harm’s way for all of $15/month. As Bob Dylan once observed, “When you live outside the law you’ve got to be honest.”



Recipients of the newsletter are invited to Ask Morty any real estate or financing questions. The answer to the question will be answered in the next issue for the benefit of all. Questions may be forwarded via mail phone or fax. (See front of issue for phone and fax numbers). Morty’s email address is Morty@MortgageStraightTalk.com

NEXT ISSUE’S TOPIC: BUYDOWNS