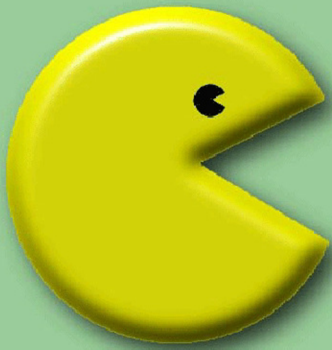

Newsletter - Vol. 3 Issue 9

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mortgagestraightTalk.com

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

Fax: 760-639-0785

Rod@MortgageStraightTalk.com

30 Yr. Fixed Conform. & Jumbo	6.25 & 6.375%
5/1 ARM Conform. & Jumbo	5.875 & 6.25%
Prime Rate	8.25%
MTA Index	4.563%
COFI Index	4.09%
Home Ownership Accelerator Index	6.155%

Morty's Bench Marks - 8/30/06

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

CURRENT EVENTS

Last month, I surmised that when the Federal Open Market Committee (FOMC) met on August 8th it would suspend its two year campaign of raising rates—and it did. The FOMC meets next on September 20th and the fed funds futures contracts are now only pricing in a 12% chance of a rate increase at this meeting. While the Fed acknowledged that inflation had accelerated, it predicted that slowing economic growth—led by the retreat of the housing market—would lead to smaller consumer price increases before long. One hopes that this occurs.

But more typically, what results when a government continues to spend far more than it takes in—is inflation. If it manages to curtail inflation, it does so at the expense of economic growth and straddles a fine line between a recession on the one hand, or "stagflation" - a stagnant economy with rising prices.

Most economists contend that the country is essentially at full-employment, meaning that additional demand for workers will tend to push up wages. Because wages account for three-quarters of total production costs, Fed officials view them as inflationary, if they rise significantly faster than productivity.

Economic researchers have analyzed the trade off between inflation and unemployment for the last several decades. Their findings show a grim but consistent trade-off: to reduce inflation by one percentage point, the unemployment rate has to rise by about two

percentage points for an entire year. To reduce inflation to the upper limits of what Mr. Bernanke (the Fed's chairman) and other Fed officials consider acceptable, more than three million jobs would be lost, a bigger drop than in the recession of 2001.

Recently, a reader took umbrage at my observation in my July newsletter that the Fed's efforts to combat inflation were being hampered by the current administration's fiscal policy. In view of the administration ringing up deficits for 2005 that ranged from an ultra-conservative low of $318 billion (the administration's numbers) to a more likely 760 billion (including the "off the books numbers"), all the way to 3.5 trillion if one were to include transfer payments from Social Security and Medicare, I did not think I was being impolitic when I merely referenced the recent tax cuts for the richest 1% of the nation as being "injudicious". In fact, I thought I was being understatedly diplomatic while the adjectives that sprang

most readily to mind were asinine and self-serving. Swelling these numbers further is an added $5 billion per month from our incursion into Iraq, not to mention Congress' decision in March to raise the national debt limit to $9 trillion. The reason I chose to revisit this matter here, and elaborate on my assertion is because for some, my explanation may have been too glib, but for this reader my use of the word "injudicious", seemed to bespeak a liberal bias.

With core inflation already at 2.9%, the instability in the Middle East serves to only hasten the likelihood of $80 oil and in turn raise the price of oil-based items as diverse as airfares to plastics. For these reasons I believe the surcease in rate hikes will be short-lived. Also, there is a worldwide-trend toward tighter a monetary policy by the central banks of various nations which I mentioned in my March and May newsletters. On August 4th, the European Central Bank (ECB) which is the equivalent of our Fed raised its rates for the fourth time in the previous eight months. It has been following the Fed's stair-step rate hikes since December. Similarly, the Bank of England followed suit, the next day, with a quarter point hike to its key rate. In both cases, the authorities cited rising oil prices and the attendant risk of inflation as the reasons for raising interest rates. Two weeks after this, China's central bank raised interest rates for bank loans and deposits by .27% to slow down a torrid 11.3% growth rate in the second quarter.

THIS ISSUE'S TOPIC: SECONDS

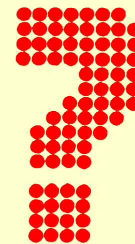
This issue's topic may be a yawner for some of my more experienced readership, but bear with me and I'll attempt to reward your attention and patience with some worthwhile nugget of information.

Nomenclature

Mortgages encumber real property by making it security for the repayment of a debt. A first mortgage is the first loan that's secured by a particular piece of property. Quite naturally, It follows that a second mortgage is a loan secured by the same property. The third loan on the same property would be a third mortgage on the same property, and so forth.

Risk vs. Reward

Statistically, people who have less of their own money in a property have a higher rate of default. In the event of a foreclosure (non-payment), mortgages are paid off in order of their numerical priority. Because of this, each successive loan on property is increasingly riskier for a lender. Thus a second mortgage is in second position (or junior) to the holder of the first mortgage which means the second mortgage lender won't see dollar one until the first mortgage lender has been paid in full. Because seconds are inherently riskier, lenders demand higher interest rates, typically 1-5% higher than first mortgages. Further, the higher the Combined Loan To Value (CLTV) of the first and second mortgage, the higher the rate one should expect to pay for the second. Reason: see the third sentence of this paragraph.



Terms

Again, because they're inherently riskier, they command a quicker pay off period, some as short as 3-10 years. It is not uncommon to have 30 year 2nds, but a 30 year amortization

with a balloon of 5-15 years is more common. (A balloon loan is any mortgage that comes due with an unpaid balance. Most second mortgages are balloon loans. Naturally, the final monthly installment that pays off a loan's entire remaining principal balance is called a balloon payment). The most common of these loans is known simply as a 30 due in 15 (commonly notated as 30/15). The benefit to borrower is that the monthly payments are lower because the payments are based on a 30 year amortization schedule, even though the actual term of the loan is only 15 years.

Amounts

The loan amounts for seconds depends on the number of units and its designation which begs the following questions: is the property a single family residence (SFR), a duplex, a triplex, planned unit development (PUD) or a condo? Is it owner occupied (o/o) or non-owner occupied (n/o/o) [also known as investor property]? Lenders will lend higher LTVs on first mortgages for S.F.R.s that are owner occupied as compared to other types of property, which in turn means, that seconds on these properties can be smaller and there is a larger number of lenders willing to write them. But with an investor properties, the LTVs are more restrictive for firsts dropping from 80% down to 75%, 70%, and 65% which often necessitates second mortgages in the range of 20 to 35% and the sources for them are considerably fewer.

Types

There are two basic second mortgage types: Fixed Rate Mortgages (FRMs) and Adjustable Rate Mortgages (ARMs) a.k.a., variables. Some second mortgages are fully amortized, like a 15/15 or a 25/25, i.e., a 25 year term due in 25 years. As the name implies, a fixed rate mortgage is one in which the rate is fixed for the term of the loan and merits little more elaboration.

The most common variable is the Home Equity Line of Credit (HELOC). It is a revolving line of credit linked to the Prime Rate that allows the borrower to borrow against it repeatedly, pay it down and then borrow again, if so desired. With the recent interest rate hikes HELOCs have become increasingly pricey of late. Most equity lines require monthly payments of 1.5% to 2% of the remaining principal balance. If your credit is good enough there are lenders that will provide HELOCs as much as .3% below the Prime Rate (currently it is 8.25%). Many institutional lenders will provide free HELOCs to borrowers through brokers, paying for both the closing costs and appraisal. A prepay term is typically required to allow the lender sufficient time to recoup their out-of-pocket expenses.

As second mortgages go, the rarity is the “silent” second. A silent second is a mortgage for owner occupieds wherein the mortgagor (the borrower) makes no mortgage payments, but when the owner sells the property they must pay off the new mortgage balance. I say new mortgage balance because this is not an interest-free loan. The mortgage is negatively amortizing such that the interest that one would normally pay monthly is deferred on the loan and added to the original loan balance to arrive at the newly accrued mortgage balance.

These seconds are available only to a limited degree to low-income, first-time buyers and special occupations like teachers, policemen and

firemen and often in amounts that exceed typical second mortgage LTV percentages. They are provided almost exclusively through the auspices of FHA lenders and certain municipalities.

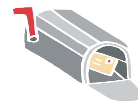
Sources

The lenders of second mortgages come from two sources: conventional lending institutions such as banks, savings and loans, insurance companies, credit unions and non-conventional, like seller financing (private party). In most situations the institutional lender that provides the financing for the 1st can also "piggyback" the 2nd with the 1st and usually provide the borrower with reduced underwriting fees and loan closing costs.

Another source of seconds is Seller Financing. It can facilitate a sale that would not otherwise happen, and benefit both the buyer and seller. With seller financing the seller will loan all (1st & 2nd) or a part of the sales price and take back a mortgage (usually a 2nd) on the property as security. This means that the buyer can come to closing with less cash, and promise to pay a certain amount to the seller over time, with interest. There are no lender fees, loan fees, or points charged for Seller Financing, so the buyer pays less in transaction costs. With no underwriting or appraisal, the seller can attract buyers that would otherwise not necessarily qualify to purchase the property. If the seller has made money on the property, under Seller Financing the seller may be able to defer the capital gains tax payable as the principal is repaid under the seller financed loan.

With seconds inching into the range of 10-13%, a more cost effective alternative for LTVs between 80% and 90% that is becoming increasingly attractive to borrowers is the much maligned Private Mortgage Insurance (PMI) and coincidentally, next month's topic.

MORTY'S MAILBAG



Q. We tried to do a For Sale By Owner (FSBO) a few months back, but found few buyers. Then we listed our home with one of these "Help You Sell" outfits to get it in the Multiple Listing Service but that hasn't proved very fruitful either. We keep hearing it's a buyer's market and properties aren't moving very well. Any thoughts as to what we might do? We bought in about 18 months ago and don't want to lose the small amount of equity we have which is another reason we chose not to list with a realtor that charges 3%.

A. A price reduction is the easy answer, but one that you may not want to entertain because of your small amount of equity. Something else you might want to consider is to offer a larger commission to the buyers'agent, perhaps 4% instead of the more typical 2½ to 3% or a bonus of $2500-3500 to the agent that brings you a buyer. All things being equal, realtors are much more motivated to show a property to a prospective buyer that has a 3 or 4% commission attached to it than one with a 2% or 2 ½%. This is one of the surest ways I know of to make agents aware of your property and shown to their buyers.

My other suggestion is to focus on seller concessions. With the 17 straight bumps to the Prime Rate in the past 26 months, even seasoned realtors are finding this market challenging. Buyers are in short supply and many are experiencing payment shock. Most buyers think in terms of payments and most sellers--sales price. It's been my

experience (in working with realtors) that a highly effective way to attract buyers is by placing the emphasis on affordability and sellers concessions as a means of shifting the focus away from the sale price, while managing to maintain it. One method is for the seller to pay the buyer's discount points. For example, on a $300,000 home, a motivated seller is likely to slash 3 percent, or $9,000, off the price to get his or her house sold quickly. By leaving the price unchanged, and instead using that money (or even less) to pay for mortgage points, you're helping the buyer secure a significantly lower interest rate and monthly payment which make your home more affordable. It becomes a win-win situation for buyer and seller alike. Further, the savings to the buyer can amount to hundreds of dollars a month and the buyer also gets the tax deduction on those points in April.

You can also sweeten the deal by offering to pay for some or all of the buyer's closing costs. Lenders generally limit seller concessions to non-recurring items like loan-origination fees, credit reports, appraisals, title, escrow and recording fees. Once you and the buyer settle on a purchase price, you agree to raise the price of your home by, say 5 percent, and give that money back to the buyer at the closing table. On a $250,000 home, that's $12,500 in the buyer's pocket—enough to cover all or most of the buyer's allowable closing costs. The buyer gets a loan for $262,500 and, in essence, gets to cover the closing costs through the mortgage.

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.

Curb Inflation,

Save Gas—Shop Online

I rarely do advertisements in the newsletter, but here's one worth mentioning for home buyers: my parent company, Associated Brokers MLI has a website that links to SANDICOR, San Diego's Multiple Listing Service, which allows prospective buyers to see all the listings currently on line with only a few mouse clicks. It allows you to search by region, price range, and other parameters. With some properties, virtual tours of the property are possible, as well. Associated Brokers MLI provides it absolutely free of charge in the hopes of attracting your business. The website address is www.associatedbrokersmli.com