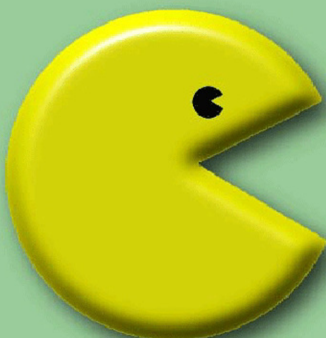

Newsletter - Vol. 5 Issue 2

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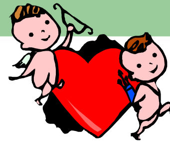
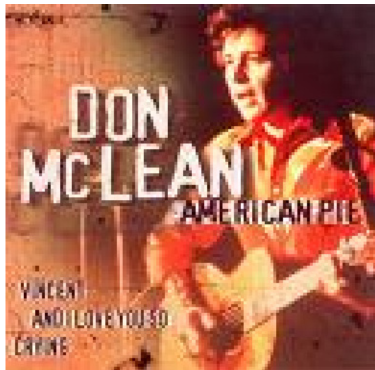
30 Yr. Fixed Conform. & Jumbo	5.375 & 6.625%
5/1 ARM Conform. & Jumbo	4.625 & 5.625%
Prime Rate	6.0%
MTA Index	4.788%
COFI Index	4.383%
Home Ownership Accelerator Index	3.264%

Morty's Bench Marks - 2/1/2008

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



CURRENT EVENTS



But February made me shiver

With every paper I'd deliver.

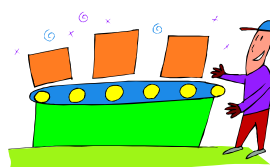
Bad news on the doorstep;

I couldn't take one more step.

-from Don McLean's "American Pie"

This year, the news, thus far, has been rather grim as the above song lyric suggests. On the other hand, mortgage rates have dropped. The first trading day of the New Year saw the price of oil breach the $100 a barrel mark, if only briefly, before slipping back to close at $99.62. This was a 97.32% price increase from its Jan. 18th low in 2007 of $50.48. (Incidentally, when the price of something doubles the increase is 100%, yet for some reason the financial writers at CNN and the N.Y. Times reported increases on the price of oil as 45% and 60%, respectively. Neither apparently knew how to accurately calculate the simple percentage increase (99.62/50.48)-1. Instances such this begs the question about the reliability of other data presented).

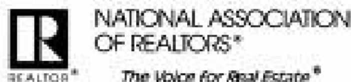
The Institute of Supply Management's (ISM) announcement that its manufacturing index dipped below the index's tipping point of 50 to 47.7, showing a sharp contraction of manufacturing activity. The question facing manufacturers is whether our strength in foreign markets (because our exports are cheaper due to the devalued dollar) will eclipse our growing economic problems at home. As I mentioned last month, most of what is made by U.S. factories is consumed domestically, so exports can only go so far in taking up slack.



In its release of the minutes of its Dec. 11th meeting on 1/2/08, the Federal Reserve acknowledged its willingness to cut interest rates further, if it saw further deterioration in the credit markets and the housing sector. But complicating this move was the warning by a top Chinese bank official, only the week before, that if the Fed continued to cut rates it might trigger a destabilizing sell-off in China's trillion dollar holdings of U.S. bonds.

As events unfolded in January, a debate of sorts raged among various economic pundits as to whether we were headed for a recession or not. If history is any indication, then the Labor Department's jobs report on Jan. 4 furnished an unequivocal answer. It reported that unemployment hit a 2-year high of 5% and that in December 2007 some 7,655,000 people were unemployed, a figure some 13.2

percent higher than the previous December. **In the past, a 13 percent annual rise has been THE SIGN OF A RECESSION EVERY TIME.**



According to the National Association of Realtors (NAR) the prices of homes sold in December registered the biggest year-over-year decline on record and 2007. It was also the first year on record that has seen a drop in 40 years. The three biggest declines in prices ever recorded have now come in the last 4 months. The pace of home sales plunged 12.8 percent for the year, the biggest drop on record. Single family home sales fell by 13 percent in 2007 which was the largest drop in 25 years. For builders it was even worse, new home sales at 774,000, were down 26 percent from the 1.05 million sales in 2006. This was the biggest drop since the government started tracking new home sales in 1963, surpassing the 23 percent decline posted in 1980. The NAR expects overall home prices to remain flat this year, retracting its previous forecast of a price rebound this year and pushing it back to 2009. Foreclosures, however, were up 51% in 2007 with 405,000 households losing their homes.

On the 9th of last month, stocks closed down 238 points, tumbling for fifth time in six sessions in 2008. This was good news of sorts for borrowers because ordinarily as stock prices decline, U.S. Treasury bond prices rise. Since a bond's interest rate is fixed, as the price of the bond rises, its yield decreases. **Mortgage lenders pay particular attention to the 10-year Treasury because its yield has an approximate correlation with the interest rate on mortgage-backed securities. So, with the Dow off 5.1% for the year and the recent run up in the price of bonds, the yield on the 10-year Treasury fell to 3.77%. Consequently interest rates (long-term) on home mortgages improved (dropped) about .25% during the week to their lowest levels in 2 years.**

On the tenth of January, Fed chairman, Ben Bernanke, announced in unusually blunt language that the Federal Reserve was willing to make "substantive additional" cuts in the Fed Funds Rate [to stave off a looming recession]. It doesn't want to cut rates too deeply, however, for fear of stoking the flames of future inflation. Though there were [at this point] few signs of rising inflation there is evidence is that American economic growth has slowed to a crawl. Because a cooling economy usually damps inflation by reducing demand for goods and services, Fed officials are now far more worried about a painful slowdown than about inflation.

1/11 After months of speculation about its financial viability and losing 79% of its market value, Countrywide Financial announced that it was being acquired by Bank of America for $4 billion in stock. (Later in the month Countrywide would report a $422 million loss for the 4th quarter and reveal that an astounding one-third of its investment portfolio's sub-prime mortgage loans were delinquent). Reports of surging credit card delinquencies among various credit issuers and Merrill Lynch's $15 billion write down revived recession worries. Investors headed for the exits with the Dow taking another 246 point drubbing.

Mid-month the bad news became a torrent: Citigroup revealed a $9.8 billion dollar quarterly loss—its worst ever. JP Morgan Chase & Co. reported a 34% decrease in quarterly profits in conjunction with a $1.3 billion hit related to its sub-prime exposure. Wells Fargo recorded a 38% decline in net income. These negative items along with retailers reporting that holiday sales figures were 25% less than expected and the Labor Dept.'s announcement that energy costs soared 6.3% fueled the Dow's 277-point drop.

Topping Citigroup's wretched excess of the day before, Merrill Lynch posted its worst performance in company history, a record $10.3 billion loss and a $17.78 billion dollar write down. Equally dismal were the slumps in December housing starts yielding the sharpest full-year drop in new home construction in 27 years and building permits hit a 33-year low. Altogether, they produced another triple-digit decline in the Dow of 307 points.

While America celebrated Martin Luther King's birthday the stock markets around the rest of the world were "tanking" on fears of America's pending recession spilling over into their economies. Various exchanges around the world appeared to be in freefall, recording losses of between 5-7% for the day (the equivalent of a 600-840 point drop for us).

Tuesday, sensing panic, the Fed stepped in before the opening bell and made an emergency cut of .75% to the Fed Funds Rate, reducing it to 3.5%. It was the steepest cut in 24 years and it marked the first time that the Fed had changed rates between meetings since the 9/11 disaster of 2001. Even so, when the NYSE opened, it was down 465 points within the first half hour of trading. Reports of Bank of America's and Wachovia's 4th quarter profits plunging by 95% & 98%, respectively, certainly didn't help matters. Nevertheless, the market managed to claw its way back up to finish off only 128 points at 11,971. **Rates for conforming mortgages dipped briefly with 30-year and 15-year fixed-rate mortgages hitting a 4 year low of 5% and 4.375%, respectively. In addition, the Fed reduced the Discount Rate by a similar ¾ of a percentage point, pushing this rate down to 4%. The Prime Rate was cut to 6.5%.**

Another tumultuous day followed on Wall St. as stocks climbed out of a 326-point hole early in the day and to finish up 298 points by session's end. Market volatility has been at its highest level in five years. In a three-hour span in the afternoon, the blue-chip index ricocheted by over 600 points. This "whiplash" rally on the 23rd was triggered by reports that insurance regulators moved to defuse another potential time bomb in the markets: the weakened condition of two large insurance companies that have guaranteed buyers against losses on more than $1 trillion of bonds. Undoubtedly, this was yet another factor in the Federal Reserve's decision for the previous day's rate cut.

The big news on the 24th was that Congress and the Administration had agreed to an economic stimulus package which would grant rebates of $300-$600 to most taxpayers in an effort to spur spending and head off a recession. Unfortunately, it will be June before recipients are likely to see these tax rebate checks and their impact is not likely to show up until the 3rd quarter of '08. Another case of too little, too late.

To address another critical issue affecting American homeowners, the Stimulus Package before Congress **proposes a one-year increase in Fannie Mae's and Freddie Mac's conforming loan limits (from $417,000 to $729,750)** to make it easier for buyers to get or refinance mortgages—especially in high-cost regions like California. These government sponsored enterprises currently guarantee a secondary market for loans of less than $417,000, which makes lenders more willing to issue them. Even so, conforming mortgage rates (less than $417,000) are lower now than this time last year.

Pricing has not been equally beneficial for the non-conforming loans (above $417,000), however. Homeowners with jumbo mortgages pay higher interest rates because, with no guaranteed secondary market for the loans, lenders take on more risk, and charge borrowers more for doing so. The spread, the differential between conforming and jumbo rates, is as high as it ever has been. With some lenders, I have seen the interest rate differential for a 30 year fixed rate non-conforming loan as much as 2% higher than for the same 30 year conforming fixed loan product, when in days gone by it has averaged only .25-.375% higher. If, as part of the Stimulus Package now before Congress, the Fannie Mae and Freddie Mac conforming limits are raised from the current $417,000 to the proposed $729,750 it will amount to a major rate decrease for many Americans. At this juncture it's hard to say what the spread for loans above $417,000 to the new limit will be but it should be an improvement. **Note:** these changes, if enacted, are not expected to be effective until late February or early March. **But again, the operative word is proposed; it has not been passed.**

FannieMae FreddieMac

1/30 Fourth-quarter growth in gross domestic product was lower than expected, rising only 0.6%, compared to forecasts of 1.2% growth and way below the 4.9% growth in the third quarter. The first quarter of declining GDP which is the hallmark of a recession appears underway.

As expected, the same day, the Federal Reserve cut the Fed Funds Rate (FFR), **a key short term interest rate,** by a half-percentage point today to 3.0%. It was the second significant cut in just over a week. **The Prime rate now stands at 6.00% and the Fed Discount Rate at 3.5%.**

On January 31, 2008 headlines in newspapers across the country read: **"Federal Reserve Cuts Interest Rates, Again".** Yet buyers and borrowers were confounded to hear that mortgage rates were worse when they had just read that the Fed had cut interest rates. When I asked a few individuals what it was that the Fed cut, "Well," they stammered, "the interest rate." Wrong! **What the Fed cut was the Fed Funds Rate (FFR) which is the overnight (very short-term) lending rate by which banks via the Federal Reserve lend to other banks.**

The purpose of the rate cut was to fend off a recession because of the dire state of the U.S. economy. Lower Fed Funds Rates mean lower short-term rates. The prime rate, the lowest commercial interest rate that banks will lend in the short-term to their most credit worthy borrowers is generally three percentage points higher than the FFR. If people can borrow money, whether it's businesses or individuals, everyone is going to find it easier to do business and the economy is more likely to expand. **Again, this is short-term money**. **Some mortgage loans,** however, **like Home Equity Lines of Credit (HELOCs)** and consumer loans such as credit cards **are variable rate short-term loans and are pegged to the Prime Rate.** Borrowers with home equity lines of credit tied to the Prime Rate will find that their debt has suddenly gotten a little more affordable.

But the Fed Funds Rate and the Prime Rate have little to do with mortgage rates. **Mortgage interest rates are for much longer-term fixed loans (10-30 years and more).** These loan rates tend to track with the interest rates of long-term debt instruments like the 10-year Treasury bond. As expected, following the rate cut of the Fed from the day before, investors shifted their money out of bonds to reap the better returns to be had in the stock market which sparked a stock market rally and it closed up some 207 points. As a consequence, mortgage rates worsened.

According to the Bureau of Labor Statistics core inflation (excluding food and energy prices) in the 4th quarter of '07 were 2.7 percent higher than a year ago and outside the Fed's so-called comfort zone of 1 to 2 percent.

There were fourteen more lending casualties this month, the most notable being CountryWide Financial and Aurora Loan Services. This brings the running total to 224 major mortgage lenders that have "imploded" since the beginning of 2007, meaning that they have halted major operations, filed for bankruptcy or become a "fire sale" acquisition of another lender.

MORTGAGE SPECIAL OF THE MONTH: THE 3/1 ARM

*Next to the newsletter header is Morty's Bench Marks which lists the prevailing rates for the most popular loan programs. Starting this month I'm instituting a new feature calling attention to the most attractively priced program(s) available. They (or it) may not necessarily be right for you but they are currently among the best deals to be had. Right now the **3/1 ARM** is the hands down winner. **The rate for a conforming loan < $417,000 was 4.25%, and a jumbo > $417,000 was at 5.125%** (on the morning of 1/23/08). A 3/1 has a rate that is fixed for 3 years and becomes adjustable in year 4 with an annual adjustment thereafter. The pricing for these programs has worsened slightly for the conforming and considerably for the jumbo since the Fed Funds Rate cuts (on 1/23 & 1/30). They now stand at **4.50% for the conforming** and **5.125% for the jumbo.***

THIS ISSUE'S TOPIC: ANNUAL PERCENTAGE RATE (APR)

Many borrowers are stunned when they receive what we in the business call the TIL. TIL stands for Truth-In-Lending disclosure and it is often the first time that borrowers come in contact with what is known as the **Annual Percentage Rate (APR)**. They mistakenly believe that the APR number referenced is their actual note rate; **IT IS NOT**! The APR does **NOT** affect your monthly payments. One's monthly payments are a function of the interest rate and the length of the loan.

APR is a confusing construct for many people. Most realtors, and I dare say many mortgage brokers, do not truly understand it, even thought its professed purpose is to clarify. **The APR was designed to allow borrowers to compare the various interest rates of different loans and the costs associated with obtaining those loans. The APR is a measure of the total cost of a loan transaction expressed as a yearly interest rate.**

It's often not easy to choose between a loan with a lower rate and higher fees and a loan with a higher rate and lower fees. For example, which lender is offering the better deal, Lender A with a loan of $100,000 at 8% with $3000 in fees or Lender B at 8.25% with no fees. On a 30-year note the payment with Lender A would be $733.76/month and with Lender B the payment would be $751.27/month. So, it looks like Lender A with both the lower interest rate and smaller payment would be the clear-cut winner. But when one takes the $3000 of lender fees (application fees, underwriting costs, points, etc.) into account on an annualized basis along with the payments one discovers that Lender B's program is the better deal because the APR is 8.25% vs. Lender A's 8.32%. (I have simplified the example here for purposes of illustration. There would undoubtedly be some fees with the Lender B). Thus, one can see that this may be a useful tool for comparing similar loan programs. In order to help borrowers make a more informed decision on their mortgage federal law mandates that the APR be disclosed along side the actual interest rate.

<u>**Note:**</u> Comparing APR's only works when comparing similar loan programs like a mortgage with a 15-year term with another one with a 15-year term or fixed rate loan with another fixed rate loan. Fifteen-year terms will have lower APRs because of their lower interest rates, but higher fees than a 30-year term because they are spread out over fewer years. ARM loans are apt to have lower interest rates than fixed rate loans but possibly more in fees.

In part, the reason why APRs are confusing is because the rules to compute APR are not clearly defined. APR is based on a rather complex mathematical formula. It reflects the amount being financed, the interest rate, the timing of the payments and any other cost that make up the finance charge, such as points, origination fees, processing, etc. The reason for APR variances between lenders is because different lenders include or exclude various costs.

When applicable, the following fees ARE generally included in the APR calculation:

- **Points-both discounts points and origination points**
- **Pre-paid interest**
- **Loan-processing fee**
- **Underwriting fee**
- **Document preparation fee**
- **Private mortgage insurance**

The following fees are SOMETIMES included in the APR:

- **Loan application fee**
- **Credit life insurance**

Because of the various charges made in connection with a loan, the APR is invariably higher than the rate of interest that the lender quotes for the mortgage.

Calculating APRs on adjustable and balloon loans is even more complex because future rates are unknown. Who knows what the index of the LIBOR will be at 15 years from now? So, the program necessarily makes certain assumptions, some of which are "guesstimates". "Point", the software program that we and a majority of lenders use, does these calculations internally.

Although it has obvious value, looking solely at the APR is a flawed way to comparison shop for a mortgage and can cause borrowers to make costly wrong decisions. The problem is that the APR calculation makes some very bad assumptions. First, APR assumes zero inflation and that the value or buying power of a dollar today will be exactly equal to the value of a dollar 10, 20, or even 30 years from now. Next, the APR calculation assumes that the mortgage will never be prepaid or paid off. That means no refinancing or selling the home...highly unlikely since the average life of a home mortgage loan is less than four years. It is rare to see the same loan in place for even 5 years—let alone 30 years. Also, the APR calculation does not consider the value of the money used for fees. So if you spent thousands of dollars in points or fees to get a lower rate, the APR calculation does not give any value to the money if it were not spent on closing costs. Nor does APR take tax consequences into consideration. This can be significant since higher fees on the mortgage may not be deductible while the higher interest rate is deductible. Finally, APR can be manipulated by assuming a closing on the last day instead of the first day of the month which would increase the amount financed and decrease the APR.

Based on the foregoing, one should never choose a loan based on APR alone. One would in all cases want to know: the interest rate, points, fees, PMI payments (if any) and then compare these numbers in conjunction with the APR to decide which is best.

READER FEEDBACK

A couple of reader/realtors had suggestions for the newsletter this past month that they thought might be of general interest to the readership. One suggested that I stress that 2008 was a great year to buy Real Estate Owned (by a lender) or as they're more commonly known REOs. Since I recently covered why this is a great time to buy in the November 2007 issue I won't repeat myself. But, it is true that many of these properties are selling at discounts of 20 to 40% of their earlier prices.

The other suggestion was with regard to borrowers who have jumbo adjustable rate mortgage (ARMs). The realtor I spoke with asked what advice I might have for borrowers who are facing interest rate resets. This is a tough one because when the current credit crunch began the default rate among borrowers with jumbo mortgages was not particularly high, yet the market for non-conforming loans dried up in short order as opposed to the conforming loans (amounts under $417,000) that were backed by government sponsored programs. The jumbo loans that are available are at spreads above what was formerly the norm. There are jumbo loans to be had but the number of variables that exist make it well-nigh impossible to offer any generalized advice because lenders' guidelines have tightened, LTVs and CLTVs cut and the fact that many lenders are further reducing their lending limits by 5% for San Diego (if not most all of California) as it is deemed a declining market. The parameters and programs available vary from lender to lender and are very much on a case by case basis. Now, more than ever before it is crucial for borrowers to be dealing with a mortgage professional.

MORTY'S MAILBAG

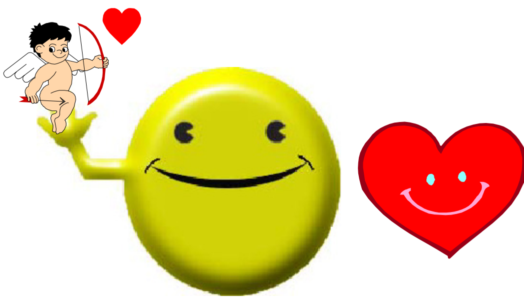
Q. Can you give me some information on the capital gains exemption for real estate?

A. Exemptions from capital gains taxes (CGT) on real estate are as follows: an individual can exclude up to $250,000 ($500,000 for a married couple filing jointly) of capital gains on the sale of real property if the owner used it as primary residence for two of the five years before the date of sale. The two years of residency do not have to be continuous. You can meet the ownership and use tests during different 2-year periods. However, you must meet both tests during the 5-year period ending on the date of the sale. There are allowances and exceptions for military service, disability, partial residence and other reasons. See IRS Publication 523.

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: TITLE INSURANCE



MORTGAGE MIRTH

When a mortgage broker met his untimely end, he was informed that he had a choice about where he would spend his eternity: Heaven or Hell. He was allowed to visit both places, and then make his decision afterwards.

"I'll see Heaven first," said the broker, and an angel led him through the gates on a private tour. Inside it was very pleasant and tranquil, and all the people there were playing harps and eating grapes. It looked very nice, but the salesman was not about to make a decision that could very well condemn him to a life of utter serenity.

"Can I see Hell now?" he asked. The angel pointed him to the elevator, and he went down to the Basement where he was greeted by one of Satan's loyal followers. For the next half hour, the salesman was led on a tour of what appeared to be the best night clubs filled with some of the most attractive women he'd ever seen. People were drinking, cavorting, and having a…(if you'll pardon the expression) Hell of a good time.

When the tour concluded, the angel asked him if he had reached a final decision.

"Yes, I have," he replied. "As pleasant as Heaven looks and all, I have to admit that Hell was more my kind of place. I've decided to spend my eternity down there."

The salesman was sent to hell, where he was immediately thrown into a dungeon, chained to a wall, and subjected to various fiery tortures. "When I came down here for the tour," he cried, "I was shown a whole bunch of bars and parties and other great stuff! What happened?! "The devil replied, "Oh, that! That was Sales, this is Processing."

If you'd care to share one that you've heard, please email it to me at **Rod@mortgagestraightTalk.com**