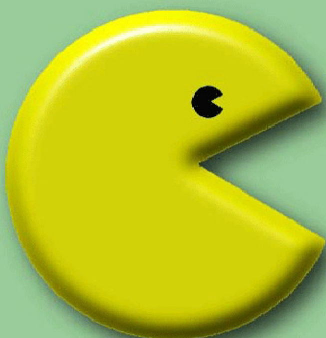


Newsletter - Vol. 5 Issue 9

September 2008

mortgagestraightTalk.com
Tel: 760-726-4600 Cel: 760-717-8584
Fax: 760-639-0785
Rod@MortgageStraightTalk.com

30 Yr. Fixed Conform. & Jumbo	6.125 & 6.25%
5/1 ARM Conform. & Jumbo	5.75 & 6.625%
Prime Rate	5.00%
MTA Index	2.855%
COFI Index	2.829%
Home Ownership Accelerator Index	NA

Morty's Bench Marks - 8/29/2008

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

An unprecedented development is occurring in California. In this issue "AS FORECLOSURES ESCALATE, EQUITIES EVAPORATE" lays out how and why many (if not most) California home owners are apt to be adversely impacted.

8/1-8/8 On 8/1 the unemployment rate rose from 5.5% 5.7%, the worst reading in 4 years. As widely expected, Fed left its key short-term interest rate, the Fed Funds unchanged at 2%. The DJIA soared 331 points in response reduction in the price of oil (8/5). The dollar hit a seven-month high against the yen Wednesday and gained against the euro after the Federal Reserve eased some concerns about the U.S. economy. Across the board, conforming rates rose .125% and jumbos bumped up .25% this week

8/11-8/15 More write-downs and deteriorating conditions in the financial sector caused the market to decline 139 points and 109 points, respectively, Tuesday & Wednesday. The innumerable headlines in recent months of "Oil's Up, the Market's Down" and "Oil's Down, the Market's Up" were a common banner, this week. Normally, Thursday's 82-point rise in the Dow wouldn't have merited much comment. But, given that it rose largely because oil dropped $1/barrel and in spite of the July Consumer Price Index jumping up to an annualized rate of 5.6%, a 17-year high, is another instance of the market's misplaced irrational exuberance. The wide erratic swings we've seen this week indicate investors' uncertainty with regard to the economy. The dollar hit a nearly 2-year high against the British pound and gained nearly 9% in the past month against the Euro, since its low of $1.6038 on July 15th.

8/18-8/22 Stocks tumbled 180-points, Monday, as Fannie Mae and Freddie Mac lost 22% and 25% of their values, respectively, after a Barron's report came out suggesting that a government takeover of the troubled mortgage finance giants was inevitable. The Dow slid another 130 amid a weaker dollar and more problems in the financial sector on Tuesday. The market moved largely sideways Wednesday and Thursday. On Friday, once again, "As oil slumped, the market jumped". The $6.59 drop in the price of oil was the biggest single-day fall in dollar terms since Jan. 17, 1991, when oil fell by $10.56. The market rise was not good news for mortgage rates.

8/25-29 Monday, the Dow fell 241 on credit market problems and higher oil prices. Investors discounted a report showing that existing home sales rose to a five-month high in July, topping forecasts, while home prices fell. The following day, despite grim readings in the housing markets and a hike in oil prices, the market reacted only slightly because as one pundit put it, "while things are bad, they are not as bad as expected". Mid-week, the government released the gross domestic product (GDP) report showing an annual growth rate of 2.7% in the 2nd quarter. Most economists attributed this anomalous rise to the $90 billion in economic stimulus checks that reached consumers in the second quarter. Nevertheless, the market rallied up strongly 212 points. The Commerce Department said Friday that individual income decreased by 0.7% in July, the biggest drop in 3 years. The market reacted apprehensively and sold off 171.

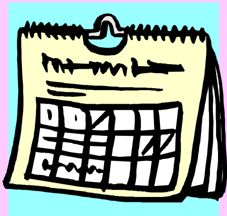
Five more lending casualties were racked up this month, bringing the running total to 276 mortgage lenders that have "imploded" since the beginning of 2007. This means that they have halted major operations, filed for bankruptcy or become a "fire sale" acquisition of another lender.

THIS ISSUE'S TOPIC:
FIXED RATE MORTGAGES

I'm not sure how such an obvious topic eluded me for so long, but perhaps because it was so obvious is why I overlooked it. Nevertheless, while this month's topic may seem like a ho-hum one, I promise that even for readers that are "old pros" there are a few nuggets of info contained herein that will make it worth your time.

Fixed rate mortgages are the most popular financing instruments because they combine the safety of fixed payments with affordable amortization for the term of the loan. The interest rate cannot change and because of their wide availability, rates offered by various lenders are extremely comparable and competitive.

TERMS



One area in which fixed rate mortgages vary is their term, the length of time over which the payments are due. The two most common terms are the 30 year term (360 payments) and the 15 year term (180 payments). The trade-off between the two is that while the latter has payments that are roughly 50% higher the total interest paid over the life of the loan is hundreds of thousands less because the money being lent is for half the time of the former. The other obvious benefit is that one's debt is being retired in half the time. These loans also have a lower interest rate because of the diminished inflation risk due to the shorter term. The downside is that most borrowers cannot afford the increased payments that go with a 15 year term unless the loan amount is rather small. Thus, most people opt for a 30 year term. The other advantage of the 30 year term is that it provides more tax shelter for borrowers because of the higher total interest payments associated with the longer term loan.

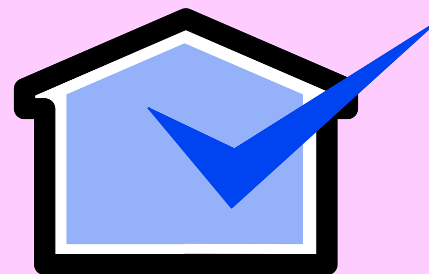
CUSTOMIZED TERMS

Most of you know the foregoing but did you know that the 30 year and 15 year terms are by no means the only term options open to a borrower? Loan terms can be customized to the borrowers needs. For instance, 25, 20 and 10 year loans are available, as well, or even 22 or 27 year terms. While some lenders place restrictions on the terms offered, these loans are sold in the secondary market just like most other loans. One restriction is that the interest rate for such a loan is likely to be determined by the next longest loan term. Therefore, a 25 year loan is apt to have the same rate as 30 year loan and a 10 year term may have the same rate as a 15 year loan. Currently, Fannie Mae offers 10, 20, & 30-year pricing.

BALLOONS

As fixed rate mortgages go, they're pretty straightforward—"what you see is what you get". But there are borrowers whose needs are not met by a fixed rate loan. A "hybrid" fixed rate loan addresses the needs of this community in the form of a balloon mortgage. The payments are fixed for essentially the life of the loan with the exception of a much larger final payment or balloon payment at the end of year 5, 10, or 15. This final payment may also be referred to as a "call" or "demand" payment. A very common example of just such a loan is a 30 due in 15 which means that the amortization is based on 30 years but the balloon payment falls due at the end of 15 years. The advantage of these loans is that the payments are generally amortized over a long amortization schedule, like a 30 year time frame, so the payments are lower (with the exception of the balloon) than they would be for a loan with a shorter term.

Some of these loans have a feature that converts the loan to a fixed rate loan after the balloon; this is called a "conditional refinance". It is important that borrowers understand that a balloon is not an ARM (adjustable rate mortgage) and that a conditional offer to refinance at maturity does not guarantee financing. To be eligible for a conditional refinance, most loan programs require the following:



- Must be owner occupied property
- No 2nd mortgages or liens
- Must be current/No late payments in the past 12 months
- New rate cannot be more than 5% above the note rate
- Borrower must pay refinance fees/sign documents

TWO STEP ARM

The Two Step ARM is a hybrid that combines fixed rates and the lower rates of ARMs into one. These loans are often referred to by the length of their fixed rate periods, e.g., 3/1s, 5/1s, 7/1s, and 10/1s. Like a balloon, this loan offers a fixed rate for a fixed period that is lower than comparable 30 year fixed rate loans. This loan has no balloon feature, instead there is a rate adjustment at the end of the fixed rate period converting the loan to an ARM instrument.

The terms of the adjustment may vary, but the margin is generally 2.5% over the prevailing rate on the 10 year Treasury Bill or an index like the CMT (constant maturity index) with a maximum change or rate cap of 5%. Because the Balloon and the Two Step are similar, people often get them confused. The Two Step is actually a 30 year ARM loan whereas the Balloon expires on the loan's call date. Because there is no protection for the borrower after the "call" or "demand" payment the lender's risk of future interest rate changes is diminished, hence in this rare instance fixed-rate balloons offer much lower interest rates than a Two Step ARM.

SPECIAL OF THE MONTH: 5/1 INTEREST ONLY CONFORMING ARM @5.75%

ABOVE RATE PRICED AT PAR WITH A 30 DAY LOCK. RATE VALID 8/29/2008, RATES CHANGE DAILY.

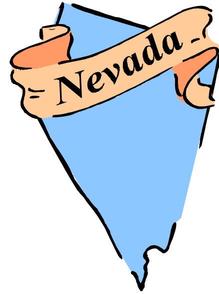
AS FORECLOSURES ESCALATE, EQUITIES EVAPORATE

It's not been reported in the mainstream press, but something unprecedented is occurring in the housing markets these days that will affect the average homeowner. Everyone knows that in terms of home prices it's very much a buyers market. But recent sales numbers, however, reveal something much more troubling. In California, **the foreclosures market or REO [real estate owned (by lenders)] market has become the de facto real estate market. FOR THE FIRST TIME IN HISTORY, THE PRICE OF REAL ESTATE IS NOT CONTROLLED BY THE BUYERS OR THE SELLERS, BUT BY THE BANKS**. The significance of this may elude some of you, but as we shall see the effects are manifold and should be a real eye opener.

To grasp the magnitude of what's occurring and the repercussions it's worthwhile to look at some real world numbers. In May, California broke a major foreclosure record with $10.4 billion in loans going back to lenders' balance sheets.In June, there were $10.2 billion in loans taken back by the banks, a slight drop. This was mildly encouraging until July's figures revealed **another record-shattering month for foreclosures in California with the banks taking back roughly 26,500 homes for $12.55 billion.**A 25% increase in foreclosures is not a good thing in the real estate universe!

DataQuick, a company that provides real property and land data, reported that in California, as of **May, the most recent month for which complete numbers are available, foreclosures constituted 40.1% oftotal housing sales, June's foreclosure numbers were 41.9% and July's, 43.6%**. It also indicates that **the foreclosure crisis is worsening** because even if the banks are fortunate to sell the properties for 60 cents on the dollar of the NEW appraised value, which could be as little as 30-40% of the value ($12.55 billion) at the time they initially lent on the property, **this then could represent another $7.5+ billion in losses for the nation's largest lenders in one state for one month.** In case you were wondering, **California represents roughly 30-35% of the total foreclosure count and 40-45% of the total foreclosure volume of the entire nation.**

And, this is being repeated, not just in California, but in most parts of the country. Although California's Central Valley remains ground zero for foreclosure filings, Stockton, which is just east of San Francisco, had the highest rate of foreclosure filings of any metro area, one for every 25 homes. That's seven times the national average. Riverside/San Bernardino, which is east of Los Angeles, had the second highest rate in the nation with one filing for every 32 households. Las Vegas, Bakersfield and Sacramento rounded out the top five.



Nation-wide, Nevada had the highest rate with one filing for every 43 households, while California had the highest total number of filings—202,599 filings. According to RealtyTrac, an online marketer of foreclosed homes, forty-eight of 50 states and 95 out of the nation's 100 largest metro areas experienced year-over-year increases in foreclosure activity.

The reason that I'm calling attention to this is because foreclosures have supplanted "organic sales" in the normal real estate hierarchy. In the past, organic sales have always made up most of the market with new home sales and foreclosure sales a distant second and third. (An organic sale is a transaction between two private parties and not from the foreclosure stock). **Weak "organic sales" are especially significant because they are a leading indicator of mortgage loan defaults.** Their presence is a primary indicator that individuals can't sell their homes and are stuck, perhaps with an exotic and/or unaffordable mortgage or in a negative equity position. And, their pain is apt to be your pain, too.

For those unfamiliar with **the foreclosure process in California, it is a three step process. A Notice of Default (NOD) is the first step and takes 3 months. If the NOD has not been cured in that time frame the next step is the Notice of Trustee Sale (NTS) which is posted on the property and at a Public Place (City Hall or Courthouse). This can take as little as 21 days. The final step is the actual auction of the property whereby the foreclosure trustee makes an opening bid for what is owed on the property which includes principal, interest, advances, interest on advances, and all foreclosure costs, on behalf of the beneficiary (the Lender). If there are no higher bids, the property becomes the possession of the Lender and it goes into their REO inventory of foreclosed properties.**

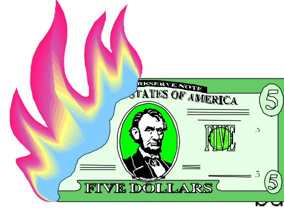
California intrastate filings for June averaged 2,009 per day and nation-wide there were approximately 8,000 NOD's filed daily. High numbers of NODs indicate that people are missing payments due to the lack of financing options, drop in property value, job loss, tightened lending guidelines, etc. Although July's NODs leveled-off at over 40,000 per month, a historic high, it has led a lot of people to incorrectly believe that the market is bottoming out. [What is more likely is that the leveling in July's NODs is attributable to the seasonality of summer real estate sales and the integration of operations of mortgage giant Countrywide with banking giant B of A rather than a fundamental shift in foreclosure activity].

The vast majority of NOD's are first mortgages because second mortgage holders quit filing NOD's months ago (which may also account for the leveling-off of NODs), due to values falling to levels that make it futile. If you are a second mortgage holder and the value has dropped below 80% (in most cases) there is no reason to foreclose because only the first mortgage holder will be repaid. For this reason alone, second mortgage loan defaults are soaring and the loans are essentially worthless. Historically, roughly 75% of NOD's pass through the foreclosure auction process to end up as lender REOs.

Only about 25% of NOD's are cured by refinancing, borrowing money, selling their home etc. by the auction date. Because it takes 4-5 months to reach the auction phase, if you combine the past 3 months' NOD's of 125,350, at a cure rate of 25%, this means that 94,013 homes will be auctioned and most taken back by banks from Oct. through Dec, historically poor sales months, during what will be for a great many individuals the not-so-happy holidays.

Notice of Trustee Sales (NTS) for June 2008 were up 215% over June 2007 and July's NTS were 9.6% above this past June's record. This is not only sizable**: it also means fewer people are curing their NOD's than in the past.** By law a trustee sale can be filed 90-days after the NOD. Yet, due to the volume, the average time to file an NTS for July was 105-days. Lenders can take a home to auction in as little as 21-days following the NTS. On top of this, none of these figures include For Sale By Owners (FSBOs) or home builder inventory.

Furthermore, **the total number of homes in California for July thatwent toauction, surged nearly 20% to a total of 28,795 properties ($12.55 billion)**. Of these, 27,817 or **96.6% received no bid higher than the lenders opening bid and became lender owned (REO).** This number is much higher than expectedand comes despite **a) banks delaying foreclosure auctions longer than the typical 21- 35 days,** which has been the typical time frame in the past several months, **b) short-sale approvals taking so long it has stretched out the final leg of the foreclosure process.**



Despite what you may have read, **the overall California housing market is stagnant and has been all year.** According to DataQuick, June's Home Sales report for California states that sales are "up for a second straight month," but considering how meager they were in April and May, that's not saying much.

Moreover, this is the time of the year that they're expected to be up, the summer months are the season when homeowners typically move. In addition, this was the first Spring/Summer selling season in five years without a full menu of "exotic and/or affordable" loans programs to drive affordability. There is a real disconnect when the headlines tout that sales numbers are growing, while values are falling and[according to the Multiple Listing Service (MLS)] the supply is shrinking, but in reality the actual inventory is not falling due to the bank REO inventory surging and sales stagnating. Both June's overall and organic sales were at the slowest pace since DataQuick began reporting in 1988. The inventory of MLS homes and bank REOs continues to grow. **Bank REO sales are counted in the monthly Existing Home Sales report, but these homes come from largely "shadow inventory", homes typically not listed in the inventory estimates. They are sold mostly through real estate agents or large auction aggregators such as the Real Estate Disposition Corp. (REDC).** When you compare year-over-year sales, last year foreclosure sales were only about 5% of the total. Yet, this year, as previously mentioned, **for the month of July**, alone, **foreclosures were 43.6% of total sales.**

HOUSING PRICES ARE NOT STABILIZING BECAUSE THE RATE OF FORECLOSURES IS FAR OUTSTRIPPING THE INCREASE IN TOTAL SALES. Almost overnight, California real estate is being marked-to-market by the lenders' shadow inventory, accelerating a natural process that should take years. Similar stats can be found in other foreclosure-heavy states and across the nation; the numbers are not good. **THE AMOUNT OF 'NON-LISTED' BANK REO SHADOW INVENTORY IS STAGGERING—ESTIMATES RUN AS HIGH AS A 3.75 YEARS SUPPLY IN CALIFORNIA!**

And this situation is only likely to grow worse with banks anxious to liquidate the billions of dollars in non-performing assets on their balance sheets that this REO inventory represents. As we come to the end of the Spring/Summer selling season and the attendant drop in values that it signifies there is even further impetus to dump their REOs. The last thing this market needs is more inventory.

Zillow.com, an online real estate service that provides estimates of home values, reported the following sober statistics: nearly one-third of all US homeowners who bought in the past 5-years are in a negative equity position, of those who bought at the 2006 peak of the housing market, 45 percent are now upside-down (owing more than their home is worth) and almost one-quarter of U.S. homes sold in the past year were for a loss. Worse, Zillow's figures only take into consideration what people originally paid for their home, not if they refinanced at a higher loan amount or added a second mortgage after the initial purchase. Just the addition of a second mortgage could push this 'one-third' figure up considerably. Other estimates that factor in the latter variables put the estimates closer to 55-60% that are technically 'underwater'.

In May, **the median home price in California dropped, once again, to $328k, down 3.25% in a single month.** Housing prices have fallen off of a cliff in the past year, especially in CA where according to DataQuick the median price is off 32% since last summer. DataQuick also reports that home prices have dropped 29.7% in the past year for San Diego. Many people erroneously think that as prices drop, more homes will sell and the increase will solve the inventory problem. But this is deceptive because **as prices fall, more homes will sell, but then too, more homeowners will also be thrown into a negative equity position which in turn will lead to more defaults and more foreclosures**. **NEGATIVE-EQUITY IS NOW THE PRIMARY CAUSE OF LOAN DEFAULT.**

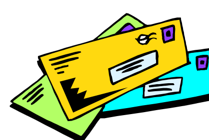
What is most frightening now is how quickly values are dropping as a result of so much shadow inventory entering the system and

discounts deepening each month. **We have never before seen a real estate market in which sellers (lenders) controlled so much available inventory and have the ability to sell it for whatever it takes to move it quickly. ACROSS THE NATION, NEIGHBORHOODS ARE BEING MARKED TO MARKET LITERALLY OVERNIGHT.** The result is an immediate and swift reduction in price as **ONE FAMILY GETS A 'GREAT DEAL', 100 HAVE MORE EQUITY STRIPPED AWAY, 50 ARE THROWN INTO AN INCURABLE NEGATIVE-EQUITY SITUATION AND 25 DEFAULT AS A RESULT, LEADING TO MORE SURPLUS INVENTORY**.

RealtyTrac forecasted that foreclosures were expected to be between 1.9 million to 2 million this year, but inasmuch as we're only midway through the year and already at 1.4 million, the projections will need to be revised—considerably. Mortgage rates will be heading higher, not only because of continued risk aversion by lenders, but due to rising price inflation and a weak dollar. The Fed and its foreign central bank partners have had zero impact on bringing down mortgage rates. If anything, it's been the reverse. As we've seen during the past 6 months, as mortgage rates rise, lower home prices are a given.

Traditionally job loss has been the number one reason that causes people to lose homes to foreclosure. Currently, we're in the midst of the biggest housing collapse in this country's history, and it's happened before widespread job losses have impacted the economy. We're already experiencing a housing depression without even a recession. Seven straight months of job loss reports have bumped the unemployment levels to 5.7%. Consider the impact on the housing market as the job losses mount. **Foreclosures won't go down until we start to see employment move up again**. Think 2010.

Typically, housing busts are about rising unemployment and falling incomes. As the demand decreases it results in the supply of homes increasing with the net being lower home prices. While a recession is now a forgone conclusion, what drove our recent economic expansion, housing, is also what is bringing it down: we bailed out an equity bubble with a real-estate bubble. The bulk of Gross Domestic Product growth in the 2003-2007 "up cycle" was a function of mortgage-equity extraction, and 30-40% of jobs were created in real-estate related industries. The ongoing problems in the housing market are being exacerbated by inflation, an anemic economy, lack of affordable financing, and declining property values and we will have to work through all of these problems before normalcy is restored.



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 identified as "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

You Might Be a Lawyer if...

- you are charging someone for reading these jokes.
- you believe that a forty word sentence is a short one.
- you have a daughter named Sue and a son named Bill.
- you can look at a contract and instantly tell whether it's verbal or written.
- your other car is a BMW.
- when you look in a mirror, you see a lawyer.
- when your wife says "I love you," you cross-examine her.

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

NEXT ISSUE'S TOPIC: WHAT TO KNOW ABOUT ESCROW