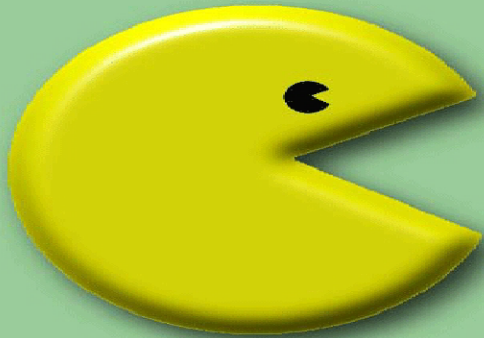

Newsletter - Vol. 7 Issue 2

February 2010

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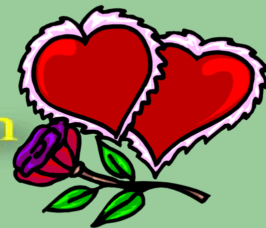

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THE MONTH IN REVIEW

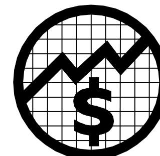
1/4-1/8 Both the market and oil rose considerably on the first trading day of the new year—the Dow was **up 155** and **oil climbed to $81.51** a barrel, it's highest level in 14 months. The National Association of Realtors said its index of **pending home sales declined 16 percent in November**, the first drop after nine months of gains. The index, which fell sharply, is considered a reliable indicator of where the market is headed. It was the clearest sign yet that predictions of another downturn in real estate may become a reality. Despite the loss of 85,000 jobs in December, the **unemployment rate stayed at 10%** in December, in line with economists' forecasts. It could have risen except for the fact that many people who want jobs stopped looking and were no longer counted as unemployed.

1/11-1/15 Treasury prices rallied in a classic flight-to-safety, lowering the yield on the 10-year note to 3.71% from 3.82% late Monday. Treasury prices and yields move in opposite directions. **MORTGAGE INTEREST RATES DO NOT CORRELATE PERFECTLY WITH TREASURY YIELDS, BUT THE YIELD ON 10 YEAR TREASURY NOTES INFLUENCE MORTGAGE RATES.** According to the Mortgage Bankers Association U.S. residential **mortgage originations are expected to plummet 40 percent in 2010** to their lowest level in a decade. Interest rates are expected to rise when the Federal Reserve completes its pledge to support the mortgage securities market with $1.25 trillion in purchases. Wednesday, the **Dow** close**d at** 10,681, a new **15 month high.** Retail sales figures for December appeared to be weaker than initially thought according to the Commerce Dept. **The Dow Jones industrial retreated 100 points** from market highs, Friday, as investors looked past better than expected earnings.

1/18-1/22 Tuesday, the **Dow** was **up**, gaining **115 points** as IBM led the charge of tech stocks. Wednesday, it was **down—stocks dropping 122 points**. Calling it the **"Volcker rule,"** the president proposed prohibiting commercial banks from making trades for their own accounts and from owning or investing in hedge funds. **Wall St**. reacted unfavorably to the proposed curbs resulting in a **474 point sell-off** during the last two trading sessions. The Labor Dept. reported that the rate of **unemployment in California is currently12.4%.**

125-1/29 Sales of existing home fell by 16.7% in December, their largest drop in more than 40 years. The Consumer Confidence index, from the Conference Board, rose to 55.9 in January from 53.6 in the previous month. As expected the **Fed opted to keep the fed funds rate,** a key short-term bank lending rate, at near zero percent. The stock market correction that was expected in October now appears underway, albeit 4 months late. The **DJIA dropped another 115 points Thursday and 6% in the past week.** The U.S. Gross Domestic Product, (GDP) grew at an annual rate of 5.7% in the fourth quarter, the fastest pace in more than six years, according to a government report Friday.

Two more lending casualties were racked up this month. This brings the running total to **379** 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.



RATE SUMMARY: Rates are much better than they were a month ago.

Conforming and High Balance Conforming are 0.125 to 0.375% better.

Jumbos, e.g. the 30-yr. fixed rate are 0.3% improved, all others are unchanged.

The governments, FHAs & VAs, are down between an 18th to 3/8ths.

FOR CURRENT INTEREST RATES FOR 10-15 OF THE MOST POPULAR PROGRAMS GO TO:

www.mortgagestraighttalk.com

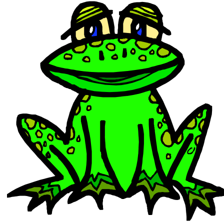
Then, click on the menu tab labeled "RATES". The rate sheets are updated every Friday.

"THE ROAD TO HELL IS PAVED WITH GOOD INTENTIONS --Anonymous

What called the proverb above to mind is that while many of you were watching 'Bowl' games, today, I was poring over roughly 100 pages of material that pertain to the new U. S. Housing & Urban Development (HUD) and RESPA (Real Estate Settlement Procedures Act) regulations that went into effect on 1/1/2010. In addition, there are new GFE forms to deal with also. When legislators and regulatory bodies attempt to curb past excesses their reforms frequently result in nostrums that are ill conceived and replete

with unintended consequences. The latest changes were implemented on the basis of consumer surveys conducted by HUD. It drafted changes to address what consumers found objectionable in shopping for a home loan. The resultant changes are reminiscent of another maxim: “A camel is a horse designed by a committee”. Unfortunately, the reason that legislation is so often wide of the mark is because it is drafted by people who have never been practitioners of business in the subject industry. At least, that’s the way it seems to those of us in the mortgage business because the latest changes appear rushed and not carefully thought through. Allow me to briefly point out the theoretical aims (pros) versus the defacto practice (cons).

Pros



The initiative from the Department of Housing and Urban Development (HUD) requires that a new "Good Faith Estimate" form be given to all applicants, one that makes it easier to compare true costs of loans from different lenders. All lenders must use a specific form and disclose fees in the same spots on the same forms. Until now, borrowers might have focused on interest rates or monthly payments to compare mortgages options. But fees play a big part in total cost.

There are generally two blocs of fees. One covers origination charges, what the lender receives for providing you with the loan. The second bloc consists of settlement fees, for say, title insurance or an appraisal.

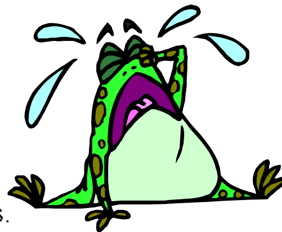
If borrowers accept the offers as outlined, lenders must issue the loans under the costs listed. If the mortgage originator provides services in the second bloc, the fees have a deviation allowance of 10%. The idea behind all these prescriptives is that borrowers should get what they have been promised from lenders and loan originators.

The estimate is not iron clad and can be altered, if there's a material change in circumstances. If the appraisal comes in lower than expected, for example, that could affect the mortgage rate, though the lender must quickly tell the borrower.

The new 3-page form has lines covering all the settlement fees, such as theorigination fee and discount points charged up-front to lower the interest rate. It also clearly lists the initial loan amount, the term length in years, the monthly payment, the initial interest rate, and whether that interest rate can rise, plus any prepayment penalties or balloon payments.

There's also a "shopping chart" on the third page in which up to four different deals can be placed side-by-side and their costs easily compared.

Cons



While making mortgage financing and its associated costs more comprehendible to consumers is a worthy goal, the latest RESPA mandates have resulted in considerable confusion among mortgage professionals. Under the new regs, the lender is bound by the Good Faith Estimate (GFE) provided to the consumer by the mortgage broker. And, because the regs regarding the new GFE are confusing to brokers, lenders and escrow agents, the number of declined submissions is up by 40% due to procedural errors. Nor do the new regs allow for corrections to the GFE and resubmitting an application to the same lender.

Except under a few “changed circumstances”, if the lender accepts the GFE prepared by the broker, there is no amending the GFE, even if the rate is not locked. Moreover, because closing costs overages have to be borne by the loan originator, submissions have waned. The present iteration is trebly punitive toward brokers: it not only requires yet more work of them while restricting their compensation it also

makes them responsible for closing cost overages (unforeseen and otherwise). Since brokers are required to generate a GFE within 3 days of taking an application, not surprisingly, brokers have deferred taking applications.

To offset this dismal state of affairs, many lenders have enacted their own version of a moratorium regarding the new GFE suggesting (but not saying in so many words) that brokers submit new loans using 2009’s GFEs, but to make sure they were dated prior to Jan. 1, 2010.

From the outset, it was readily apparent to many of us who originate loans, this was ill-conceived. Both loan originators and consumers merit financial instruments that are drafted better than this latest legislative boondoggle.

THIS ISSUE'S TOPIC: BUYING FORECLOSURES & SHORT SALES

Foreclosures dominate the housing market and to a lesser extent, short sales. At present, there are 1.5 million such homes for sale, and many more are expected to be available soon. This provides both opportunities and pitfalls for bargain hunters. The same applies to short sales—only to a somewhat lesser extent. There are a lot of great deals on the market, but buyers beware: purchasing a foreclosure is rife with pitfalls. Just because prices are low doesn't mean you should make snap decisions or buy something that isn't right. Here are 8 tips for making sure you don't get taken for a ride.

1. Don't get caught up in a feeding frenzy

Banks put repossessed homes back on the market at cut-rate prices because quick sales help avoid the expense of upkeep, such as property taxes, insurance, heat and electricity. Those lowball prices represent golden opportunities, but they also attract dozens of buyers who may bid up until homes are no longer bargains. Don't get caught up in a bidding war. Instead, carefully calculate what you want to spend and do not exceed that price.

2. Don't get greedy

On the other hand, very often bidders employ the opposite strategy. If you're one of those buyers that routinely offer 25% below the listing price you will find that your offer will not be accepted because by being a foreclosure sale it is already heavily discounted. Don't get greedy. At the listing price the deal is already apt to be a steal.

3. Contact lenders directly

Smart buyers establish relations with asset managers at banks. This may reward them with inside information or first crack at new foreclosures hitting the market. In the case of a short sale, for example, it can give the inside edge. If a buyer is pursuing a short sale—buying a home for less than what the current owner owes on the mortgage—you should talk directly to the property's asset manager. That way, if the short sale falls through and the bank repossesses the house, the asset manager knows you are still interested. It could lead to a quick sale without other bidders.

4. Get pre-approved from the lender you want to buy from

If you're trying to buy a property from, say ABC Bank, it can help if you or your mortgage broker gets you a pre-approved mortgage from ABC Bank. Doing so may cause lenders to look more favorably on your bid if it's similar to others. Plus, you're not locked in if other lenders offer you better terms. You can always change your mind and get your mortgage from another source.

5. Consider fix-ups

Most REOs, the industry term for bank owned properties, are sold as is. The conventional wisdom is that banks will do nothing to the houses before the sale. That can be problematic today because so many foreclosed homes are in less-than-mint conditions. Often, the former owners were struggling to pay their bills and may have neglected routine maintenance. Or, they may have trashed the properties before leaving

In 25% of cases, homebuyers persuade lenders to fix some of the problems before the sale closes or receive a seller's credit for the repairs. Most of the time, banks would rather sell the house to the next available bidder—one who doesn't ask the bank to pay for repairs. So be willing to consider a home that needs some work—but budget accordingly.

6. Hire a real estate attorney

Once banks agree to sales, they often want to move fast and load contracts up with legal mumbo jumbo. As a result, buyers often do not have the time or expertise to figure all the angles. The solution is to hire a real estate attorney—even in states where home sales are usually completed without one. Considering you're making a six-figure investment, the legal fees are cheap insurance against the risks.

7. Wait to make an offer

Homebuyers may be well served to wait before making an offer. Let the house sit on the market for a few days, giving others a chance to set the bidding tone. Then jump in. Talk to the agent selling the property. The agent may tip his hand. Call up and ask, "Should I make an offer? What should I come in at?" The agent may tell you he has offers at, say $300,000 and you should bid a bit higher, giving you an advantage over earlier bidders.

8. Tour properties with contractors

With so many REOs in seriously deficient shape, it's essential to go over every inch with someone who can spot problems and tell you how much it will cost to remedy them. A foundation crack can be a minor problem or a deal breaker, and most ordinary homebuyers have no way of telling the difference. Like an attorney, a contractor can be very worthwhile insurance.

NOTES REGARDING SHORT SALES

After three years of a prolonged U.S. housing slump that pushed the economy into a recession and cut resale values by 30 percent from the peak in July 2006, it's dawning on banks that they are better off with a short sale than a foreclosure. At last, they are beginning to listen to reason and go along with short sales in increasing numbers. Pressure has been building to approve short sales as the number of delinquent mortgages has grown to 3.2 million and an estimated 5 million foreclosures loom in the next two to three years. Also new Treasury Department guidelines for foreclosure alternatives taking effect in April 2010 require lenders to consider borrowers for a short sale on their primary residence 30 days after missing two consecutive payments on a modified loan or after the borrower requests a short sale.

Short sales benefit the bank because foreclosed properties lose even more value when they are vacant or in cases where a homeowner vandalizes a house before ceding it back to the bank. With a short sale lenders often see a loss severity of as little as 10 to 15 percent. Losses on prime loans going through the foreclosure process averaged 49% as compared to 34% for short sales. For sub-prime loans, losses averaged 73 percent for a foreclosure as compared to 59 percent for a short sale. In short, the loss severity for short sales is lower, but it's by no means low.

In the past, lenders have been reluctant to do such sales because they didn't have the procedures for employees to approve a financial loss for the company and a 'short' requires someone to make a command decision and there were not good structures in place to incentivize losses.

As regards a borrower's credit history, a short sale is typically reported as "settled" and the impact of a short sale on a credit score is similar to that of a foreclosure.

RISING RATES AND MAYBE A FED MBS REDUX

As you may recall from last month's annual forecast my biggest quandary was over the Federal Reserve's plans to curtail its purchase of Mortgage-Backed Securities (MBS). For the past 12 months, the Fed's purchases were responsible for mortgage rates being near record lows, dampening rate increases by providing a ready market for the securities. But things worsened in December. The recent rate increases were due, in part, because the Federal Reserve is winding down its MBS purchasing program...right at a time when there is an increased volume of MBS coming to market.

So why is there more coming to market right now? Because it takes about four months for home loan originations to become securities—and summer originations were light, allowing the decreased Fed purchases during the fall to still help handle the flow of MBS coming to market at that time. But loan origination volume increased in late summer and early fall, due to lower home loan rates as well as the anticipated expiration of the Home Buyer Tax Credit (which has since been extended). This increased volume of home loans is now securitized and hitting the markets, at a time when the Fed is buying less. The Fed (as previously announced) has nearly reached its $1.25 trillion target and aims to end its purchases by March 31st.

But, it's not just mortgage rates that have spiked upward. Treasury yields have as well, another indication that mortgage rates are headed skyward. The yield on the benchmark 10-year Treasury has grown steeply over the past few weeks. **Mortgage interest does not track treasury yields lockstep, but the two TEND TO MIRROR each other's movements.**

Mortgage securities rates are always higher than Treasury yields because investors demand a premium above practically risk-free Treasurys. The difference between mortgage rates and Treasury yields is usually somewhere near 1.7 percentage points. The current spread of about 1.2 percentage points is quite narrow. So, when the Fed relinquishes its current 80% market presence to private investors, they will almost surely demand higher rates.

[One wholly plausible possibility has rates remaining constant through the winter and gradually rising during the spring, the busiest time of year for home sales, and hitting about 5.5% by the end of June. After that, interest increases will slow, approaching 6% by year's end and capping at around 5.75%.]

Now, however, in minutes, newly-released from its Federal Open Market Committee meeting in December, officials say the Fed is prepared "to contemplate changes if need be, and it may re-enter the $5 trillion agency mortgage-backed securities (MBS) if its buying power is needed to hold down interest rates". A continued rise in long-term interest rates could derail a tentative housing recovery.

But with signs emerging that the economy is slowly recovering, pressure is building on policymakers to show that they are ready take away "the punchbowl [of low interest rates] at the party", lest all the Fed's actions result in an inflationary spike a few years down the road.

FHA MORTGAGES: SOON, MORE STRINGENT AND MORE COSTLY

After April 5th it's going to be harder to get an FHA mortgage because it will be raising its up-front mortgage insurance premium to 2.25%, from 1.75%. Looking to shore up its weakening finances, the Federal Housing Administration announced stricter standards this month. The agency, which insured nearly a third of new mortgages in 2009, will also require borrowers to have at least a credit score of 580 to qualify for the agency's 3.5% down payment program. Those with lower scores will have to pay at least 10%. In addition, the FHA will reduce the amount of money sellers can provide to homebuyers at closing to 3%, down from 6%, of the home's price. That change will bring the agency in line with industrystandards and remove the incentive to inflate appraisals.

One thing the agency did not do is increase the down payment requirement. Many industry observers said such a step is necessary to reduce FHA loans' high delinquency rates because borrowers with little equity in their homes are more likely to default or walk away.

But, housing experts are growing increasingly concerned about the agency's ability to handle rising numbers of defaults. In November, the agency reported that its reserve fund has dropped to .53% of its insurance guarantees, well below the 2% ratio mandated by Congress and the 3% ratio it had last fall. The fund covers losses on the mortgages the agency insures.

As banks have clamped down on mortgage lending, the FHA program has emerged as one of the few ways people can buy a home. As a result, demand for FHA loans has skyrocketed in popularity because banks are willing to make FHA loans because they come with a federal guarantee to cover losses if the borrower defaults. In the past two years the volume the agency guaranteed more than quadrupled to $360 billion. Nearly 50% of first-time homebuyers go through the agency.

THIS MONTH'S Best BUYS:

THE CONFORMING 5/1 ARM

at 3.5%

OR

THE JUMBO 3/1 ARM

at 3.7%

WHAT HAPPENED TO 'TOO BIG TO FAIL'?

"Those who do not remember the past
are condemned to repeat it." --George Santayana

As we are still recovering from the greatest financial meltdown in 80 years, it is almost inconceivable that on 12/11/2009 every single Republican and 27 Democrats in the House of Representatives voted against a modest reform of the financial excesses that led us to our present predicament. Can the collective memory of so many legislators be that short?

Let's review how we arrived at our present state of affairs. America emerged from the Great Depression with a tightly regulated banking system. The regulations worked: the nation was spared major financial crises for almost four decades after World War II. But as the memory of the Depression faded, bankers began to chafe at the restrictions they faced. And politicians, increasingly under the influence of free-market ideology, showed a growing willingness to give bankers what they wanted.

The first big wave of deregulation took place under Ronald Reagan—and quickly led to disaster, in the form of the savings-and-loan crisis of the 1980s. Taxpayers ended up paying more than 2 percent of G.D.P., the equivalent of around $300 billion today, to clean up the mess. But the proponents of deregulation seemed to have very short memories, and in the decade leading up to the current crisis politicians in both parties bought into the notion that New Deal-era restrictions on bankers were nothing but pointless red tape.

The result was a credit boom and a monstrous real estate bubble, followed by the worst economic slump since the Great Depression. Ironically, the effort to contain the crisis required government intervention on a much larger scale than would have been needed to prevent the crisis in the first place.

Financial giants like AIG, and mega-banks were provided with government bail-outs on the theory that these entities had grown too big to fail because if one did, the failure would trigger a domino-like effect throughout the system and the resultant effect would be catastrophic. Thus, the government provided TARP funds to lending

initutions enabling them to put their financial houses in order, to unthaw frozen credit markets and get them lending again. Ironically, instead, they used these tax-payer funds to expand their market share and go on buying sprees. Bank of America took over Countrywide and Merrill-Lynch, Wells Fargo acquired Wachovia and Chase scooped up Bear Sterns and Washington Mutual. The net result was that the big banks got even BIGGER.

Meanwhile, Republicans and conservative Democrats seem to be of the mind-set that Government Sponsored Enterprises (GSEs), not greedy bankers and lax regulatory enforcement caused the meltdown. Their perception is that GSEs triggered the crisis, even though private lenders actually made the vast majority of sub-prime loans. They argued Fannie Mae and Freddie Mac coerced bankers into making loans to unqualified borrowers, even though only one of the top 25 sub-prime lenders was subject to the regulations in question. In fact, it was the huge losses by banks in the trading of financial securities, especially mortgage-backed assets that precipitated the credit crisis in 2008 and the federal bailout. Also, it is evidently the view of these same legislators that the disastrous downturn in commercial real estate is attributable to loans made to poor people and members of minority groups and not to developers of shopping malls and office towers.

While Treasury Secretary Tim Geithner and Larry Summers, Director of the National Economic Council have seemed content to allow the banks "to conduct business as usual", former Federal Reserve Chairman Paul Volcker has been the lone voice in the administration insisting that financial reform be undertaken before the lessons of the recent crisis are forgotten. The Fed, he believes, should have the power to dismantle big banks that pose a systemic risk to the economy and to re-draw the line between commercial and investment banking. Since the repeal of the New Deal-era Glass-Steagall Act in 2000 banks have been allowed to make money not only by lending it out at interest, their core deposit-taking function, but also by running hedge funds and other speculative operations. Volcker argues that, since their deposits are federally insured, the big banks were enabled to take bigger risks for which the taxpayers bore the cost. He insists that this incentive structure was not only unfair but also at the root of the current crisis and maintains that enacting legislation that prevents the banking oligopoly from subjecting tax-payers once again to the "moral hazard" of

privatizing gains while socializing losses is the key to preventing future crises.

Late last month and none too soon, President Obama proposed the so-called Volcker Rule, in recognition of the former Federal Reserve chairman, prohibiting commercial banks from making trades for their own accounts and from owning or investing in hedge funds. It places new limits on the size and activities of big banks. Hopefully, it will be adopted.

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

The Categorical Imperative: A sadist is a masochist who follows the golden rule.

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

NEXT ISSUE'S TOPIC:

POWERS OF ATTORNEY AND LIVING TRUSTS