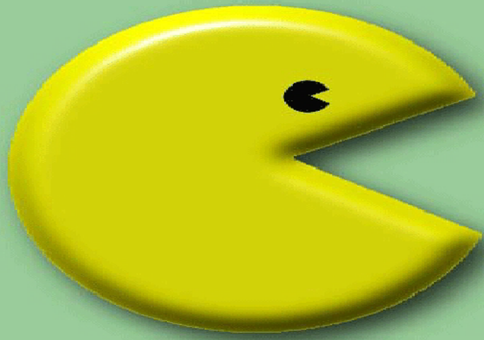


# Newsletter - Vol. 8 Issue 6

**June 2011**

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## THE MONTH IN REVIEW

**5/2-5/6 The Institute for Supply Management said its April manufacturing index fell to a reading of 60.4%, better than the reading of 58.5% economists had expected. The price on the benchmark 10-year U.S. Treasury edged higher, pushing the yield down to 3.29%. Businesses increased factory orders in March for the fifth consecutive month, according to the Commerce Dept. The broad-based 140-point sell-off in the Dow, Thursday, was sparked by a strong retreat in the energy sector as oil fell $9 and on worries about Friday's jobs report. The price on the benchmark 10-year U.S. Treasury rose Friday, pushing the yield down to 3.14% (mortgage rates are heavily influenced by the yield on the 10-year bond).**

**5/9-5/13 Stocks slid 130 points, Wednesday, as energy and materials stocks were particularly hard hit by a sell-off** in oil and gasoline futures. **The Producer Price Index for finished goods rose 0.8% in April,** seasonally adjusted, according to the government. That followed a 0.7% increase in March. The Commerce Department said **business inventories rose 1% in March**. Economists were expecting inventories to rise 0.9% during the month, after a 0.7% increase in February.

**5/16-5/20 The number of new homes being built fell 10.6% in April**, the Commerce Department said. **Home sales in Southern California fell 5.5% to 18,344 units in April, the median price paid for a home in So. Calif. Was $280,000.** So-called distressed property—**foreclosures and short sales—made up more than half April's sales of previously owned homes last month** with foreclosures constituting 36.6% and short sales 17.6% of this market. Short sales are those transactions in which a lender allows a home to be sold for less than the outstanding debt on the property.

5/23-5/27 **The Dow Jones slumped 130 points**, Monday, on concerns over Europe's simmering debt problems. A government report showed that **NEW home sales rose 7.3% to an annual rate of 323,000 units in April**. Housing starts fell 11 percent in April, according to figures released from the Commerce Department last week. The National Association of Realtors reported that **PREVIOUSLY OWNED homes inched down 0.8 percent from the prior month. The Labor Department Thursday reported an unexpected jump in initial jobless claims to 424,000,** marking the seventh straight week that closely-watched reading has been above the 400,000.

5/30-5/31 The markets were closed for Memorial Day. According to the S&P/Case-Shiller national home price index, which was released Tuesday, **home prices hit another new low in the first quarter, down 5.1% from a year ago** to levels not reached since 2002 .

Occasionally, I think that I have covered every imaginable real estate related topic. After 8 years of writing this newsletter, I seem to have reached that point. So, what does one do under the circumstances? One possibility, of course, is to update previous topics. Rewriting and re-editing to enhance clarity and flow are other worthwhile goals. Hence, what I am about to embark here is version 2.0 of MST's Talking Points. As the vast majority of readers were not with me at the inception of the newsletter, like the old joke, if you've never heard it before—it's new to you. So, I believe that by covering anew some of the more prosaic topics, there's worth for new readers while reinforcing an understanding of the mortgage process for the veteran readers. Because the lending universe is ever-changing, updating previous material has obvious merit. Since I had already planned to run a piece for this issue titled "Why Mortgages Are Denied as Never Before," I thought where better to start than with its necessary antecedent—qualifying.

# Qualifying

It's been said that the three most important things in real estate are location, location, location. Whether you are a first-time homebuyer or refinancing for the nth time, for a borrower the three most important steps in obtaining a loan are Qualifying, Approval and Funding. In one sense, it's Qualifying, Qualifying, and Qualifying because if you don't qualify, you'll never reach the other two. Because we are a full-service lender (offering both conventional loans and hard money loans) I've only occasionally found this to be a problem for my clients.

When it comes to qualifying, the triumvirate that underwriters focus on is **credit, assets and income.** Obviously, if a lender is going to extend credit to a borrower, it wants the loan to be repaid. One of the best ways to determine whether a borrower is worthy of granting credit is to look at their credit history. Your credit report is essentially a **PERMANENT RECORD** of your borrowing history and your FICO score is partially based on it. The **FICO** scoring process is a computation derived from an algorithmic formula for credit risk assessment that was devised by the FAIR ISAAC COMPANY. It is used by lenders because it is highly predictive of future payment risk. It was not (as most people mistakenly believe) designed to measure your credit worthiness, instead it is a mathematical model specifically designed **TO PREDICT THE LIKELIHOOD THAT A BORROWER WILL HAVE A 90-DAY LATE PAYMENT WITHIN THE NEXT 24 MONTHS ON ANY CREDIT ACCOUNT** and for this reason it's not as intuitive as one might surmise.

Not so long ago it was possible to obtain a loan if your FICO (credit) score was over 500. But lenders have tightened their guidelines in recent years. Today, that number is 620. Borrowers with a 620 FICO are in the lowest quintile of the general population (or bottom 20 percent) and as such they are viewed as risky or "C" grade borrowers. Below 620, you will qualify for little other than a hard money loan, though there are a few sub prime lenders that will go down to a 580. The current threshold for FHAs and VAs also is a minimum of 620, although most lenders have raised the qualifying score to 640. The Web site myFICO.com reports the breakdown of the general population's FICO scores as:

- 20 percent below 620
- 20 percent between 620 and 690
- 20 percent between 690 and 745
- 20 percent between 745 and 780
- 20 percent above 780

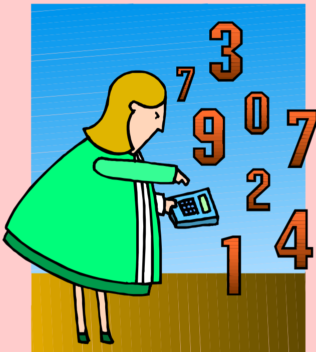
The second area that underwriters pore over is **ASSETS.** The more you have of these the more secure an underwriter feels about a file. Good credit is an indication of your aptitude to repay a loan. Income is an indication of your ability to repay it and assets are reserves that may be tapped in the event that something interrupts your income, like a lay-off, an accident or illness. If you have ample assets you can usually weather a business reversal or minor health issue.

One's **INCOME** is the area that warrants the most scrutiny because it determines one's ability to service the debt and how much of a loan one can reasonably afford. To assess this, underwriters look at one's gross monthly income and they use this number to calculate a borrower's Debt-To-Income ratios or DTIs.

Now is as good a time as any to discuss ratios. What conventional lenders consider ideal are ratios of 28% on the Front End (**FE**) and 36% on the Back End (**BE**). What this means is your **HOUSING EXPENSE SHOULD NOT EXCEED 28% OF YOUR GROSS MONTHLY INCOME AND WHEN ADDED TO YOUR LONG-TERM DEBT** (any account with more than 10 months of payments remaining) **SHOULD NOT EXCEED 36%.** Some lenders will allow HIGHER ratios like 33% and 38%.

**Others will go as high as 36% ON THE FRONT END (FE) RATIO AND 45% ON THE BACK END.** In years gone by, sub-prime lenders would allow BE ratios as high as 50 to 55%. Regardless of what the ratios are for a particular lender, a broker can always lobby on your behalf with that lender's underwriter by presenting what are known as compensating factors. It may work, it may not. Nevertheless, here is a partial list of them:

## COMPENSATING FACTORS



1. No debt or little debt.

2. Excellent long term credit, including previous mortgage and/or rent payments and high credit scores.

3. Proven ability to pay debt in excess of allowable ratios.

4. Large amount of liquid assets left after closing.

5. Proven ability to save.

6. Good potential for increase in income.

7. Long term stability.

8. Possessing an advanced degree or is working toward one.

9. Large down payment, low LTV loan.

10. Ability of nonworking co-borrower to obtain a job in which he or she has a background.

11. Potential for a large amount of overtime or a bonus.

12. Shorter loan term.

13. Little or no increase in housing expense.

14. Other income not used in qualifying.

Computer underwriting through proprietary software programs like Fannie Mae's Desktop Underwriting (DU) or Freddie Mac's Loan Prospector (LP) skip the human element of an underwriter and can significantly improve on even the most liberal qualifying ratios. I have seen approvals on loans with LTVs of 90% and FE ratios of 45% and BE's of 70% and LTVs of 95% with FE and a BE of 38% and 65%, respectively. THESE ARE NOT THE NORM, however.

A major sub-prime lender I spoke with said that only 19.6% of the applications they receive result in loan closings. I suggested that the low percentage might have more to do with the fact that they were a sub-prime lender. He replied, "Not really the industry average is about 1 in 5 or 20%". My success rate is over 95% because I thoroughly pre-qualify borrowers by taking a complete 1003 (Uniform Residential Loan Application) and by sending an accompanying Letter of Explanation to the underwriter as to what the borrower is attempting to accomplish. It sounds elementary, but you would be surprised at how many loan officers omit this often times critical step that results in their file being denied.

## OTHER STRATEGIES FOR QUALIFYING

If you're a first-time home buyer that's a bit short of the needed down payment or the cash reserves that most lenders require borrowers to have (in the event that one loses one's job or has an accident that temporarily keeps them from working), what follows are some "thinking outside the box" strategies worth considering:

**1. EMPLOYER.** If you're relocating at your employer's request, your company may pay some or all of your down payment and home purchase costs as an employee benefit.

**2. LIFE INSURANCE.** You may be able to tap the cash value of your policy if it's a whole life or universal life policy.

**3. TAX REFUND.** It may be enough for your down payment or the cash reserves that a lender requires.

**4. RETIREMENT PLANS.** The government allows first-time home buyers to access up to $10,000 from heir IRAs and 401(k)s prior to age 59½ (without a penalty for early withdrawal). So, a couple could obtain as much as $20,000 here alone.

**5. GIFTS.** Some parents or generous in-laws help their off-spring with their starter home by gifting them some amount toward that all too critical down payment. The current tax law permits tax-free gifts of up to $13,000 per calendar year.

**6. EQUITY SHARING.** This situation allows two or more people to buy a house that one or more of them occupies as a primary residence. For example, a non-occupant investor might make the down payment and closing costs in return for a specified interest in the property, while the actual occupant(s) would have a greater or lesser interest in the property in exchange for making the monthly mortgage payments, taxes, insurance and maintenance.

**7. CARRY-BACK FINANCING.** This situation involves having the seller carry a 10 or 20% second mortgage or some variation of this. If for example, one had only 10% for a down payment, have the seller carry back a 10% second mortgage and obtain an 80% first mortgage via a conventional lender, thereby precluding the need for an outside 2nd or HELOC (Home Equity Line Of Credit).

SUMMARY

**The three areas that underwriters primarily focus on when it comes to qualifying a borrower are income, assets and credit score**. Should a borrower be deficient in one area, various strategies and/or compensating factors may yet enable them to qualify.

## WHY MORTGAGES ARE DENIED

## (as never before)

Getting a mortgage just keeps getting tougher, and many homebuyers are getting rejected for loans they could easily afford. The issue: Tighter standards from Fannie Mae and Freddie Mac, the government entities that back mortgages made by banks. Banks are reluctant to make loans without the Fannie and Freddie guarantee, and loans backed by them account for just about every mortgage written these days. In 2009, the agencies raised the minimum credit score that borrowers must have from 580 to 620. That's probably for the best. But they've pushed through a host of other requirements as well, and that means real estate deals don't get done, even for some relatively low-risk borrowers. A quarter of all mortgage loan applicants get denied for loans, according to the Federal Reserve.

Here are some of the reasons that banks must turn down borrowers for mortgages:

### Too few of the condos in your association have been sold

For Fannie/Freddie lenders to approve a mortgage to finance the purchase of a condo a large majority of the units—70%—have to be already sold or under contract to individuals. Before 2009, the threshold was 51%. If more than 30% are still owned by the company that built the complex or sponsored its conversion from rental units, the mortgage will be denied, no matter how qualified the buyer is.

### Vulture investors flipping their way to big profits

The reasoning is that condo developments where the builders or sponsors still own a large share of the units are more likely to get into financial difficulty. If the builder or sponsor runs out of funds before it can sell off the units, it may stop paying the common charges and property taxes. Struggling sponsors have also lost unsold units to creditors, who resold them at underwater prices, making them more likely to default. The agencies also refuse to fund condo loans if buildings face some pending legal liability, if more than 15% of owners are behind on homeowner dues or if more than 10% of units are owned by a single entity.

## Your debt is too high

Fannie and Freddie have also increased their emphasis on income relative to debt. If someone's total debt payments exceed 45% of income, the mortgage will be denied. In 2009, the limit was 55%. Using that as a hard and fast rule can penalize very qualified buyers, ones who should be able to meet their debt obligations. Take, for example, a couple that wants to buy a second home as a rental. Two mortgage payments could easily push them past the 45% threshold, even though they'll have rental income and home equity. The 45% rule can also hurt small business owners who have had a couple of bad years. Their incomes may be down relative to their debt, but they may have plenty of cash to keep from defaulting on a mortgage.

## The wait after foreclosure is extended to seven years from five

Some borrowers lost homes to foreclosure but then diligently rebuilt their financial health. Despite high credit scores, ample assets and income and steady employment, lenders are not allowed to finance their Fannie/Freddie mortgages if their foreclosures happened any time within the past seven years. Before spring last year, the wait time was five years.

## Missed payments on credit card debt

Fannie and Freddie also have gotten stricter in how they factor in missed payments on credit cards, auto loans and other debts in which the balances do not have to be paid off every month. They used to be okay with a missed payment or two.

Now, one missed payment will hit your debt-to-income ratio, because banks will add 5% of your outstanding loan balance to the debt part of the calculation. That would be an extra $1,000 on a $20,000 student loan balance, for example.

## Where to go

Portfolio lenders will look at the entire credit history and see a blemish and say, “This has no impact on credit worthiness.” They may offer rates and terms competitive with agency loans but if there are serious risk factors, loans can be more expensive. It's a tough environment, for people like the self-employed, mortgages can get pricey.

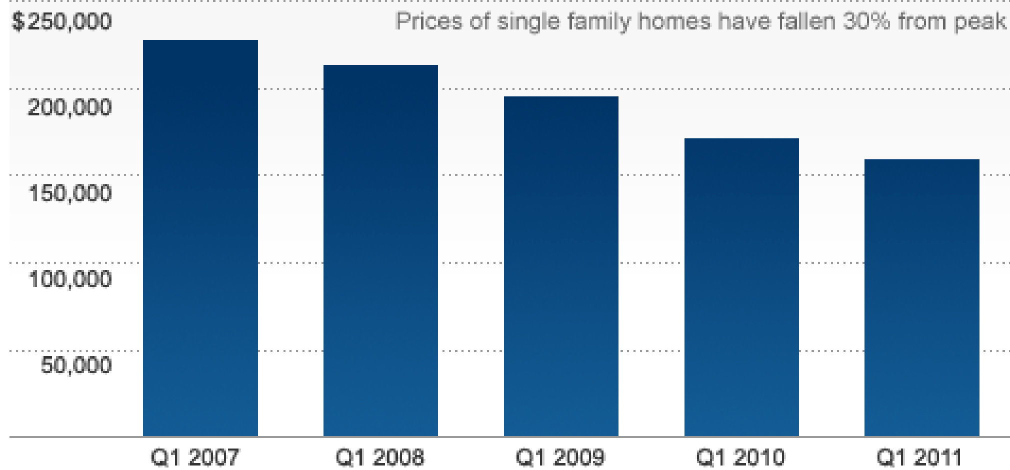
## SAN DIEGO—TOPS AMONG TURNAROUND TOWNS

As I pointed out in the March newsletter, San Diego is one of the first of the top 10 housing markets to experience a recovery. Move.com, which runs the Realtor.com website, has recognized that trend, as well. Move.com, with a data base of homes for sale all over the United States, looked at several factors: One is changes in asking prices, which reveals seller confidence (or lack thereof); Two is the length of time on market, which shows how fast homes are selling.

San Diego, like the rest of coastal California’s housing markets, went through some post-bubble hard times, with high foreclosure rates and a big dip in home prices. They fell about 40% from their boom highs. Now with mortgage related foreclosures largely purged from the system, the city has begun a recovery. It has been on the comeback trail for more than a year; its prices rose 1.6% in 2010, according to Fiserv. Move.com sees the recovery as building up a head of steam. Sales have gotten brisker and inventory is on the market only a median of 79 days, about half the national median. Sellers have also noticed the improvement and raised their asking prices 1.4% in March, compared with a month earlier.

# FORECLOSURES FACTS AND FICTIONS

Nationally, home prices continued to plummet during the first three months of 2011, falling 4.6% from a year earlier. The U.S. median price, according to the National Association of Realtors (NAR), dropped to $158,700 for a single family house. Condo prices fell even harder—10.4% to $152,900. The median home price has now slumped 30% from its 2006 high of $227,100, and prices have fallen nearly 7% so far this year. Falling home prices precipitated the recession and are slowing the recovery.




The NAR blamed much of the latest price drop on sales of foreclosed properties. These "distressed" property sales accounted for 39% of the market, up from 36% from a year earlier. Distressed properties, often in poor condition and are priced to move, sell for about 20% less than conventional home sales. Those sales attract speculators, investors and cash buyers who gravitate toward lower priced homes. The market for distressed properties may further expand over the next few months. Falling prices have sent more mortgage borrowers underwater, owing more on their mortgage balances than their homes are worth. That makes them more likely to default on loans.

Realty Trac, like the NAR, is widely regarded as an authority on foreclosures because it publishes the largest database of foreclosure, auction and bank-owned homes in the country. So when it (or the NAR) states that: "the average discount for REO [bank-owned] properties is 20%" it is generally accepted that foreclosures sell at a discount when compared with conventional home sales. But this is not so. **The prices paid for foreclosed properties in various U.S. housing markets, do not represent the "discount price" in a particular market, but simply the new price (for all homes in that market)**. Foreclosures, however, may be selling at 40% or 50% discount from their peak market value.

In fact, it is a matter of basic economic theory that the prices paid for these "marginal purchases" tend to set the prices for the entire market. Put another way, when a potential buyer is looking at homes (and home prices), that buyer is not going to base what he/she is willing to pay based upon the highest prices paid in a particular market, but rather on the ***lowest*** purchase prices and appraisers abide by this dictum also.

If one were to accept that foreclosures sold at a discount of a 20 percent, or put another way—4/5ths of the price of a non-foreclosed home, then by the same reasoning and reversing the arithmetic, the average non-foreclosed property is selling at a 25% premium above the real price. This is equally untenable. **The reality is that the prices of the foreclosed properties become the new normal for that area.** The true unfortunates are those homeowners that already lost their homes to the foreclosure process and their neighboring homeowners that have had their equity eroded to zero, or worse yet, now have a negative equity.

Today, close to 30% of all U.S. homeowners have negative equity, i.e., they owe more than their home is valued at. It is the highest level in history, and worse than at the (supposed) "bottom" that this market hit at the beginning of 2009. Meanwhile, long-term unemployment in the U.S. also remains at the highest level in history. On top of this, the average wage of U.S. workers (i.e. homeowners) continues to fall, while the "cost of living" continues to rise. What remains a fact is that:

**The #1 cause of foreclosures is negative equity.**

**The #2 cause of foreclosures is unemployment/job-loss.**

**The #3 leading cause of foreclosures is debt-bloated households being 'squeezed' by falling wages and rising costs.**

Consider what this means to a retired state worker who has their pension stripped from them: it likely means one more home dumped onto the U.S. market—at "fire sale" prices. The Tea-Party types who have been cheering-on the foreclosures of "deadbeat homeowners" and the slashing of billions in state pensions are seemingly unaware that they're *slitting their own throats*. The prices paid for the foreclosed homes will represent *the NEW real value of not just their neighbors' homes, but their own homes as well.*

In the meantime, misguided factions continue to insist on government tax-cuts for the rich and the corporations. These policies are economic suicide. Plutarch wrote nearly 2,000 years ago that *"an imbalance between rich and poor is the oldest and most fatal ailment of all Republics."* When we allow the wealthy to amass all of the wealth of an economy—and thus totally hollow-out that economy—-such economies inevitably implode.

With the erosion of the middle class, there are far too few workers working. After forty solid years of slashing their wages (in real dollars) means that even those who *do* have jobs can't be 'squeezed' for enough tax dollars to support *shrinking levels of government services*.

The obvious solution is a jobs creation program and a revenue increase in the form of higher taxes.

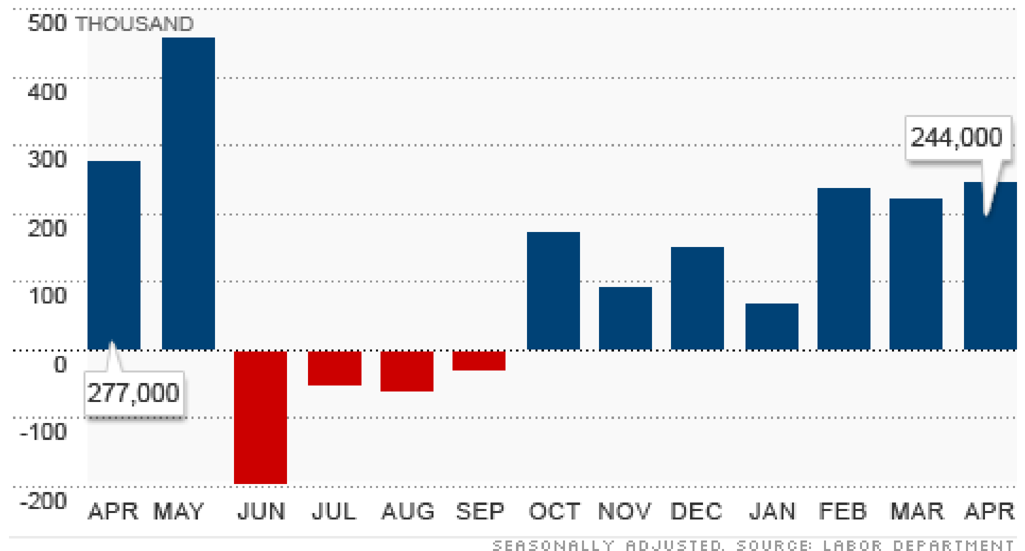
# PRIVATE SECTOR YEA, PUBLIC SECTOR NAY

The jobs recovery picked up speed in April, as business payrolls swelled and the unemployment rate rose as more people returned to the workforce. The economy added 244,000 jobs in the month, the Labor Department reported. That's up from the 221,000 jobs gained in March. Job growth has been strong since the beginning of the year, with 768,000 jobs added since January. And Friday's report also showed that 46,000 more jobs were added in February and March than previously thought. Yet the unemployment rate edged up from 8.8% to 9.0%.

## WHY THE DISPARITY?

Employers claim they added 244,000 jobs in April, but workers say they lost 190,000, pushing the unemployment rate up to 9%, from 8.8%. Why the disparity? The Labor Department compiles the jobs report based on two separate surveys. The first survey collects business and government payroll data. The second, used to calculate the unemployment rate, surveys American households. Economists, on the other hand, prefer to focus on the payrolls data because it's less volatile and has a larger sample size. The rate often increases as the job market improves and previously discouraged workers return to the labor force. An additional 113,000 people who were not previously counted among the unemployed, reentered the labor force in April. Thus, the government's highly anticipated April jobs report showed somewhat of a paradox.

Two major trends were at work in April. The good news was that 113,000 people who had previously given up hope, started looking for jobs again, a signal of growing confidence in the economy since the unemployment rate only counts people who are actively searching for jobs. It was these new applicants that helped push the unemployment rate higher. The bad news is that another 190,000 Americans also claimed they lost their jobs and economists are generally unclear of why this happened. Other than month-to-month volatility, there are no underlying economic fundamentals that would explain that big of a drop. So while employers said that they hired in April, workers reported that they still lost jobs.



## GOVERNMENTS CUT BACK

Still, the unemployment rate is down significantly from its 9.8% level in November, and that's a sign of gradual improvement. While most businesses continued to hire, government staffing fell by 24,000 jobs in the month. Most of the cuts were at the state and local level, with public schools cutting almost 5,000 jobs. That means the private sector has to be that much stronger to offset the drag from the public sector. There was more good news in the unemployment survey, as the number of people who had been out of work more than six months fell by 283,000. Long-term unemployment is widely considered one of the most serious problems with the battered labor market because of the difficulty those job seekers have getting their careers back on track. While unemployment has fallen nearly a full percentage point since November, part of that drop has been the result of a decline of people in the labor force. Only 58.4% of the overall population had a job in April. For all the growth so far this year, job gains are only slightly ahead of the 150,000 new jobs that are needed to keep pace with population growth.

## RATE SUMMARY:

**Rates IMPROVED, this month.**

* **Conventional conformings—DOWN by an 1/8TH**
* **Jumbos—DOWN by an 1/4TH**
* **Governments (FHA/VA)—LARGELY UNCHANGED**

**FOR CURRENT INTEREST RATES FOR THE 16 MOST POPULAR PROGRAMS GO TO:**
**www.mortgagestraighttalk.com** Then, click on the menu tab labeled "RATES". The rate sheets are updated every Friday.

**SPECIALS OF THE MONTH**

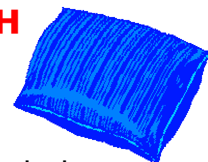
**Conf. 15-yr. fixed @ 3.625%**
**Conf. 5/1 ARM @ 3.000%**
**High Balance Conf. 30 yr. fixed @ 4.375%**
**Home Ownership Accelerator @ 3.310%**
**JUMBO 5/1 ARM @ 3.625%**
**JUMBO 30 yr. fixed @ 5.00%**

## 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



Corduroy pillows are making headlines.

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

**NEXT ISSUE'S TOPIC:**
**YOUR HOME—HOW TO HELP IT SELL IN TOUGH TIMES**