

Mortgage Meltdown FAQs

What is the Mortgage Market Meltdown?

This refers to a culmination of factors that has led to massive tightening in credit standards among lenders. This tightening is due to an excessive number of mortgages that are both delinquent and in default. As a result of tighter credit standards and the devaluation of mortgage-backed securities, global investors are shying away from purchasing additional pools of loans, causing over 100 lenders to close and leaving many homebuyers and homeowners unable to locate financing alternatives.

Why should a real estate SELLER be concerned?

The pool of potential buyers will shrink as many individuals find it difficult, if not impossible, to obtain mortgage financing. Experts have speculated that the number of potential buyers will contract anywhere from 15%-30%. Sellers should also be aware that increased foreclosures can depress community values and result in a glut of local inventories, which could further drive down home prices.

So how many foreclosures are there?

According to www.foreclosures.com, there are currently 1,447,451 homes in pre-foreclosure; 832,281 homes are currently set to go to auction; and 1,217,885 homes have already been taken back by the lender. The number of homes in the foreclosure process as of July 2007 is double what it was as of July 2006.

What types of loans have been most impacted by credit tightening?

Subprime and Alt-A have suffered the greatest setback because these borrowers are at greater risk for defaulting. Subprime loans are those loans which have typically been taken by borrowers with poor credit. Alt-A type loans are for borrowers that typically have good or excellent credit but are unable or unwilling to provide documentation for income and/or assets.

What is the impact on the real estate market?

The National Association of Realtors estimates that home sales nationally will decline by nearly 13% in 2007. Median home prices nationally are projected to fall by 1.2% in 2007. According to the PMI Group, Inc., however, many local markets are experiencing price declines well in excess of that, up to a high of 11.44% in Miami. States that have experienced and will continue to face the greatest declines are California, Florida, Arizona and Nevada.

What should sellers and buyers do now?

Sellers should be realistic about home prices – the high prices of 2004 and 2005 are a distant memory. Home prices have taken a fall, and for those with houses currently available for sale, reductions may be in order to generate activity and offers. Sellers should demand that any offer from a buyer be accompanied by a pre-approval from a local mortgage professional.

Buyers need to be pre-approved – and frequently – as mortgage availability can change drastically, in some cases even daily. This is particularly true for those borrowers who have poor credit or are unable to provide income and/or asset documentation. Buyers should meet with a mortgage professional today to seek a pre-approval. They should be prepared to provide income and asset information including: two years of tax returns, including all schedules, W-2s, 1099s, up to three month's worth of liquid asset statements, and their most recent pay stubs.

What types of loans are NOT being impacted by this crisis?

Loans that are offered and treated as conforming type loans, traditionally under \$417,000 in most states, although that number may be higher in some states. In addition, government loans including those offered by FHA and VA have not been impacted to date. For these loans, it is typically a requirement that a borrower provide full income and asset documentation.

Current State of Mortgage Financing...What's Going On?

Anyone watching or reading the financial news over the last few weeks has seen a lot of angst and consternation over the state of the mortgage industry. In fact, one of the larger lenders in the US, American Home Mortgage, was forced to shut down operations recently. But why? What is happening, what does all this mean to you and most importantly... what should you be doing do right now to make sure you are protected?

Here's the scoop.

Over the past several years, many loans were made to homeowners with somewhat non-traditional or "non-conforming" situations, be it a poor credit history, inability to document income, or any number of factors that do not fit within the traditional "box" for home loans. These loans are often called "Sub-Prime", or "Alt-A", meaning that they were somewhat riskier in nature than A credit, prime, or traditional loans. Another type of "non-conforming" home loan is one where the credit and income might be perfectly fine, but the loan amount is higher than \$417K, which is the current maximum loan that can be done using pools of money from mortgage giants Fannie Mae (FNMA) and Freddie Mac (FHLMC). If the loan amount is higher, it can certainly be done - it's called a "jumbo loan" - but the end money comes from private institutions, not from the large government sponsored entities of Fannie and Freddie.

Most non-conforming loan product rates popped significantly higher recently. Here's what happened.

The end investor for Subprime or Alt-A loans will charge a premium for taking on a pool of these loans, because they know that traditionally, they might have a higher rate of default and delinquent payments within that risky pool. But lately, default and foreclosure has been on the rise - partly due to the fact that with credit tightening and a soft real estate market, many troubled homeowners are unable to refinance or sell in order to get out of trouble. So now, these end institutions are demanding a much higher "**risk premium**" for taking on these pools of loans, as they see the rates of default are climbing higher.

But since these institutions are purchasing these pools of loans sometimes months after the borrower has actually closed at a given rate, this increase to the risk premium means that instead of paying \$101K for a \$100K loan that will bear interest, they may only be willing to pay \$95K for that \$100K mortgage to account for the risk. Multiply that times thousands upon thousands of loans...and you have millions upon millions of dollars in loss for the company trying to sell the pool at a much lower price than they were expecting. This is called a "**liquidity crisis**", and is exactly what happened to American Home Mortgage - there was no mismanagement, but they simply got caught holding too many "hot potato" loans, forced to sell them at massive losses...and eventually they had to make the decision to close the doors and stop the bleeding.

Further, even when a lender is able to take some losses, they may be subject to a "**margin call**". This means that as their losses and risk premiums increase, the value of their loan portfolio decreases. As the value decreases, the credit lines that are secured by those portfolios begin to issue margin calls as the value of the asset that they are secured on is now diminished. This is exactly like margin calls in the Stock market. If you have a loan against a Stock that is losing value, you will get a "margin call" and need to pay down the loan, as the underlying Stock is losing too much value to be considered adequate collateral any longer. So for the big lenders, as their portfolio is losing value due to increased risk premiums and losses...the margin calls start coming in, and they are required to pay down their balances. In turn, this means that they have less availability to fund their new loans, which then exacerbates the problem.

In response to seeing this situation play out in the demise of American Home Mortgage, lenders of other non-conforming loan products increased their interest rates dramatically almost overnight to be better

prepared - and likely over-prepared - for increased risk premiums down the road. Even though loans above \$417K are not presently suffering from increased delinquencies like the Subprime and Alt-A loans are, these rates popped higher as well, because they are being purchased by smaller private entities that can't afford to take on any margin of risk.

What happens next? The major damage is probably already done, and the present situation will likely settle out over the coming year. Lenders will stop pulling products off the shelf, and the rates on products that have moved so significantly higher now should trend lower down the road as delinquency rates stabilize.

But here are a few important things YOU should do right now:

ONE: Even if you are not presently in the market for a home loan of any type, make sure that your credit standing is as solid as possible. Many people in the market for a home loan didn't expect they would have a need, and didn't plan in advance to ensure their credit would qualify them for the best possible financing. With no immediate need for a home loan, time is on your side... why don't we take a few minutes together and just make sure you are prepared, should a need arise down the road? Call or email me right away.

TWO: If you are in the market for a home loan, or know someone who is - understand that now is the time to be working with a real qualified professional who can keep you informed of changes in the market and get your loan funded quickly. Now is NOT the time to be playing the risky game of trying to scour the entire nation to find someone who promises to save you a paltry amount on costs, or deliver a rate that seems too good to be true.

Your home and your financing are just too important, and times have changed. I am here to help and advise during these volatile times - and would welcome calls from you, your friends, family, neighbors or coworkers.