

What's happening with the mortgage crisis and how it affects you

By Cheri Nunez

We all know the mortgage crisis was not created overnight. Over the past year, there have been many articles written about this topic. It emerged in early 2007 as a subprime mortgage problem, and by midyear had escalated to an overall financial market crisis.

A low interest rate environment coupled with sustained high levels of housing appreciation was exploited by investor greed all the way to Wall Street. Driven by increasing appetites for higher investment returns, investors assumed more risk in expectation of real estate prices continuing to soar. The risk involved lowering credit standards to increase volume and also not pricing to this risk. Financial markets then began to operate on fear when the real estate and mortgage sectors began to slide.

I have been in the mortgage lending industry almost 30 years, and have been through many market cycles. Three to four years ago, lending standards deteriorated to the point of being irresponsible. The secondary market, where loans are packaged and resold as mortgage-backed securities, is what drives liquidity for continued lending. This market is void of trust and will take time to rebuild. The pool of available lending sources,

especially for jumbo nonconforming loans has narrowed significantly. Many are out of business and the majority of new sources will wait on the sidelines for stability in the credit and housing markets. Meanwhile, as in past market shifts, the lending community has somewhat over-corrected, making it difficult to borrow money. What was most surprising in this market shift was the ripple effect the mortgage crisis had on prime jumbo nonconforming conventional loans that exceed the Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) traditional conforming limits of \$417,000.

So what has been done to ease the credit crunch? The Federal Reserve lowered their benchmark fed funds rate seven times since last September. This is the rate at which depository institutions borrow from one another, usually overnight. Contrary to what most think, this does not directly correlate to a reduction in mortgage rates. It does, for example, affect the prime rate, which can benefit consumers by lowering home equity loans tied to prime. The Federal Reserve's job is to provide price stability to control inflation and help maintain moderate growth. In addition to the Fed action, Congress passed the stimulus

package several months ago allowing, FNMA and FHLMC to temporarily increase their conventional conforming limits from \$417,000 to \$729,750 in San Francisco and the majority of the Bay Area. To date, the stimulus package has not helped the Bay Area as much as has been publicized.

The intent was to help moderate interest rates in higher cost areas, and to stimulate home purchase activity by opening up a secondary market with FNMA and FHLMC for the increased loan amounts. Unfortunately, it wasn't until just recently that we have seen these rates decrease to reasonable levels above the traditional conforming \$417,000 limits. Loans above the new conforming jumbo limit of \$729,750 are still considered the nonconforming jumbo or super jumbo sector of the market.

The stimulus package also allowed for the Federal Housing Administration (FHA) loan limits to increase to the same maximum levels as mentioned for conventional financing. FHA is historically known as the government subprime lender and allows borrowers with lesser credit scores and down payments to qualify for loans. These loans are generally higher priced and are government insured, which minimizes lender risks.

Where are lending guidelines and requirements today? Packaging, underwriting and qualifying for loans has returned to basics, and is reminiscent of what responsible lending used to be 15 years ago. There is still an over-correction in the guidelines due to fear and the resultant lack of trust in the secondary mortgage markets.

Full income documentation and a strong credit history are guiding the lending standard now. Purchase loans must have adequate down payments. It is difficult to get financing with less than 20 percent down. It is available on a limited basis, but only to those with higher credit scores, job stability and verifiable income. Also, purchase second mortgages are difficult to obtain when the lender's exposure exceeds 80 percent. Home equity lines have tightened as well. Some lenders have frozen existing lines of credit in markets with declining property values, or simply because they do not want the potential of draws being made when credit markets have retracted. Home equity lines are still available to those who have maintained a larger equity position and have a strong credit score. Guidelines for cash-out refinancing, loans on second and investment home purchases have also tightened.

My advice to anyone looking to

obtain mortgage financing today is to consult with an experienced mortgage professional who has an updated, broad perspective of the marketplace encompassing many lenders. We continue to see frequent changes in the lending world that can impact qualifying and your ability to obtain competitive pricing and programs. It is more important than ever to be educated in the mortgage and financial markets so you can make better, well-informed decisions.

Expect volatility to continue as the financial markets attempt to find equilibrium. The lending industry will rebalance itself once the overall housing market begins to stabilize and the secondary markets regain their trust. We will see guidelines begin to expand where it makes sense to do so. Liquidity will return to the jumbo and super jumbo sector of the market. As they say, this too shall pass. The lending industry continues to serve a vital purpose, and it is our job as professionals to help clients navigate through difficult times to deliver successful results and meet their financial goals!

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