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The Legends Letter

Issues in the Mortgage Market

Oh, how things have changed. Over the past eight months, not a single day has gone by without a front page story about the mortgage issues de jour. However, contrary to what the sensational media is reporting, the mortgage market is going through the process of taking on a new look.

In a nutshell, there is no one specific event that triggered the financial crisis in the mortgage and real estate industries. Economists, and experts who follow the financial markets, mostly believe that many distinct factors contributed to the situation we are currently dealing with. The most important factors, in no specific order of impact, are:

- Sub-prime loans to borrowers who were either not qualified or possessed serious credit issues.
- Poor performing loans in the Alternate "A" and Prime Mortgage market which resulted in a rise in loan delinquencies and notice of defaults.
- Relaxed underwriting guidelines which have allowed for "creative" financing that has led to rising defaults and subsequent foreclosures.
- Increasing concern that home values may have hit a plateau, and in some areas, property values have declined.
- The impending financial issue that will affect millions of Americans over the next 12 months is their scheduled interest rate adjustment. It is estimated that 2,000,000 homeowners will receive notices of interest adjustments to their current loan. Many homeowners may find that their current house payment will double and in some cases triple in amount. This issue is one that is not being taken lightly.
- The rising number of foreclosures nationwide. In California alone there were more than 17,000 homes that lenders foreclosed upon between April and June of this year.

These and other factors lead to a severe tightening in the secondary mortgage market. This particularly occurred in the non-conforming "Jumbo" market. The secondary mortgage market is where existing mortgages and mortgage-backed securities are turned into commodities, such as bonds, and then traded. This conduit is the lifeline that provides liquidity for entire mortgage industry.

Only one thing is certain: the causes of the current financial crisis are much deeper and complex than most people were willing to imagine. It will take some time for it to work itself out. There has been a number of ideas and proposals put forth which may assist in bringing back the mortgage credit markets. Time will tell how quickly these markets rebound.

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- Archived editions of the Legends Letter
- Our highly successful online Rapid Loan Application
- A listing of all of our financial products and services
- Easy to understand glossary of typical mortgage-related terms and phrases.

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Looking Forward: The Mortgage Industry will Survive

It may not look or operate like it has over the past seven years, but people will always need mortgages, and lenders will always be there to satisfy that need. The days when lenders make loans simply on the criteria of “stated income-stated assets” with little or no money down for the most part are unavailable. Those types of loans have become too risky. There are stated loans available for those who have 700 plus credit scores and a down payment. Mortgages will once again be issued on the important, though recently overlooked, criteria of verifiable income, assets, property values, and other factors that insure that a lender will be repaid instead of being forced to fore-close.

We have already begun to see a major shift with regard to the types and styles of loans available. Financial instruments that allowed for little or no down payment, and no income verification, have been eliminated. The use of and reliance on Automated Underwriting Systems (AUS) such as Fannie Mae’s Desktop underwriter is becoming far more prevalent. These systems tend to take a more conservative approach when evaluating a mortgage credit file. Driven by the secondary mortgage market the lending industry is in the process of re-pricing their willingness to take on risk. We are informed of underwriting guideline changes almost daily. Many of the larger lenders have overhauled their respective loan programs, giving much more weight to credit score, down-payment, and income verification than they did in recent years. Unfortunately, many of the smaller or niche lenders have had to close their doors due to inability to sell their loans on the secondary market. These recently enacted changes are allowing lenders to reposition themselves in the market and to focus on their best products.

The recent increase in interest rates for non-conforming “Jumbo” loans (loans greater than \$417,000) was the first of many changes. For the time being, many lenders have priced out many of the popular loan programs which they been utilizing over the past few years. The 30 year fixed rate mortgage is once again becoming very popular, not only for conforming but also for non-conforming loan amounts.

The next few weeks will give us a glimpse at what the near term future holds. The Federal Reserve is meeting on September 18th. It is widely anticipated that they will cut the Federal Funds rate in a move to provide liquidity to the credit markets. Though it is not directly connected to mortgage interest rates, the general consensus is that long term (mortgage) rates will decline. In anticipation we have seen a small decline in rates across the board on literally every loan type. We believe that the Jumbo market will be the indirect beneficiary of the Federal Reserve’s actions.

The conforming loan market is moving along quite well, due to the existence of Fannie Mae and Freddie Mac, the congressionally chartered corporations which buy mortgages on the secondary market, pool them together, and sell them to investors as on the open market. These governmental corporations guarantee the monthly principal and interest payments on conforming loans only. Since these government-backed corporations guarantee to bail out conforming lenders, the liquidity for these loans never posed much an issue.

We at Legends Financial feel very fortunate that the relationships we have built up over the years continue to allow us access to the highest quality lenders with the very best mortgage terms. The horror stories of lenders reneging the day “the file was supposed to close” simply never happened with us. There will be some ups and downs, given not only the state of the mortgage market but of the economy in general, but that must be expected considering the circumstances. Although the road will be bumpy, the opportunities going forward are quite promising.
