1234 Mill Road, Suite 100
Harper Village, CA 92345

Direct: 800-555-1234
Cell: 800-555-4321
david@mortgageloans.com

DAVID BROWN
Loan Consultant
NMLS #123456

Dear Friends

For exceptional service and for answers to today's real estate financing questions, please call today!

Your referrals are greatly appreciated and always treated with the utmost of care.

About this time last year, a number of economic prognosticators began to say the real estate market had reached the bottom for this recessionary cycle and would begin moving up. It hadn't. Indeed, it may not move north in a noticeable way for a few more months.

Meantime, we face a schedule of changes—some made already, others waiting in the wings. You will be wise to remain aware of the changes to the way loans are written and to plan very carefully with your mortgage loan officer, real estate professional and tax advisor to make sure you minimize financing expenses. In this issue, we look at several easily-misunderstood changes that evolving and fading government involvement in the recovery and in the real estate market could bring, and also note how easily economic statistics can be misread. Very few things are extremely clear in today's economy—except, perhaps, this: Misreading today's economic data could cost us a lot of money, both individually and as a society. It is best, in the midst of confusion, not to jump to conclusions about anything, especially our real estate market.

David Brown

DAVID BROWN'S MORTGAGE UPDATE

Direct: 800-555-1234 • Cell: 800-555-4321 • david@mortgageloans.com

July 2011

% interest rate market ANALYSIS

"Mortgage interest rates should rise gradually to 5.5 percent by the end of the year and average 6.0 percent in 2012 – still relatively affordable by historic standards." [National Association of Realtors®]

The Sun Also Rises

It probably shouldn't surprise us that the real estate sector is moving carefully through great changes. It has become inevitable that guidelines and regulations governing the writing of mortgages be revised, for example, given the problems that still weigh down the mortgage finance sector and, by extension, the entire real estate market. Further, as government programs wind down, the markets they affected must adjust to a lack of governmental support. And as the agencies that have handled the packaging of mortgages come under scrutiny, the likelihood of change in their operations—perhaps even in their continued existence—grows stronger.

There are several changes, therefore, that have either already begun, or are about to occur, or are being contemplated. One is the end of the Federal Reserve's second program of "Quantitative Easing" (QE2), in which the Fed bought billions of dollars' worth of U.S. Treasury securities. How will this play out? Will it affect the future rates on home mortgages?

Another—a seemingly simple readjustment of the maximum amount of a home mortgage that can be backed by the government-related credit provided by Fannie Mae or Freddie Mac—may have more dramatic effects than are first apparent to the naked eye. You will want the guidance of your real estate professional and mortgage loan officer to help minimize likely increases in the expense of the financing of a high-cost home.

Third, there is an on-going discussion about the very existence of government-backed secondary market agencies like Fannie Mae and Freddie Mac. We will look briefly at the possible decisions that may be reached and how such a likely compromise in the way real estate loans are backed might affect you. The government may still play a limited part in the backing of mortgage loans. What might the changes mean to the availability and cost of financing to you in the future?

FIRST, THE DRY-DOCKING OF QE2

During the time of Quantitative Easing, the Fed made certain that the demand for Treasury securities was very high by buying billions of dollars' worth of the securities over time. Thus, it was impossible for the securities to languish on the market. Instead, their value soared—which, in the weird workings of Treasury bonds, meant their yields remained low. And low rates for Treasury securities usually translate into low rates in general. For example, 30-year fixed-rate mortgages track the 10-year Treasury note very closely, so the Fed's QE2 program was most likely partially responsible for today's low mortgage rates.

However, the program's effects have not always been clear. For example, if the program has helped keep rates low, and the program is to be abandoned, investors might be expected to push mortgage yields a bit higher NOW—in anticipation

© Copyright 2011. Every effort has been made to verify the information herein, but it cannot be guaranteed, nor should it be used as a substitute for professional advice. For further specifics, or to answer any questions, feel free to call. Printed on recycled paper made in the USA and harvested from sustainably managed forests.

of the program's end. After all, that's the way our markets usually work: If investors foresee rising rates, they often begin immediately to bid rates higher.

Soon, in any case, we will have sent QE2 into the dry docks, perhaps for repair, and started to move toward a market that is moved more by investor perceptions than by the machinations of the Federal Reserve. Many investors look upon this both with concern, because they aren't certain how well the economy can walk on its own at this point without governmental crutches…and also with pleasure, because the economy becomes so unpredictable when it is being manipulated by governmental programs. If the manipulations are minimized, perhaps we can get a real handle on where the economy is truly headed, though we may lose some of the benefit of governmental support.

SECOND, THE LOAN CEILING CHANGE

The effects of another change may be somewhat easier to predict, and generally less welcome—specifically in high-cost real estate markets. On September 30, unless Congress votes to extend them, the temporary higher limits on the mortgage amounts for loans to be purchased by Fannie Mae and Freddie Mac are set to expire.

For quite some time, the largest mortgage that could be written in a qualifying (high-cost) real estate market climbed from $417,000 to $729,750 in an effort to support the nation's higher-value real estate markets. Now, borrowers who need more than a $625,500 loan—the new maximum for conforming loans in high-cost areas— will have to find and use a more expensive "jumbo" loan.

WHY THE ADDED EXPENSE?

Why is a jumbo loan more expensive than a Fannie Mae or Freddie Mac loan? Because a Fannie or Freddie loan has the backing of the federal government. Thus, lenders and their investors feel very comfortable writing huge loans that are so solidly backed. Keep this in mind.

In a recent *New York Times* report on how the change to $625,000 could affect many homeowners, writer Ann Carrns posits a buyer who is taking out a $700,000 purchase money mortgage. Under pre-October 1 rules, his loan would be called a "conforming jumbo" loan, and would carry a mild premium of about 0.10% over the going interest rate for loans of $417,000 or below. If mortgage rates were about 4.75%—for the purposes of our example—the rate would become 4.85%, taking the borrower's payment about $42 higher each month.

Three Stages of Foreclosure Crisis

"In the first stage, problems were created by subprime and low-documentation mortgages, particularly in certain states…. Then, it became more of a national problem with the recession, as unemployment rose.

Now we've entered the third stage, in which we have spotty recovery. Some of the national numbers continue to be dominated by problem areas. [For example], twenty-four percent of all mortgages in the country that are in foreclosure are in Florida…. Yet 38 states have foreclosure rates that are below the national average. We have areas of recovery but those numbers are often overwhelmed by the bad numbers still coming out of a few large states."' [Jay Brinkmann, chief economist, Mortgage Bankers Association, quoted by *MarketWatch*]

However, after October 1, this $700,000 loan would no longer qualify for such light treatment. Indeed, it would be considered a "true jumbo" loan, and it would therefore no longer be eligible for the government backing available through Fannie or Freddie. Because it's larger than a $625,500 loan, it would require a premium of about 0.60%, rather than 0.10%. The interest rate would thus climb to 5.35%, and the monthly payment would thus be jacked up to $215 a month more than if the loan had been written and closed before October 1. What a difference a day makes!

The matter is even more complex, in fact. The rate lenders are charging borrowers depends on still more factors—credit scores and debt-to-income ratio among them. But the fact remains: This seemingly benign deadline could have a profound effect on many homebuyers and refinancers.

Let's talk about how best to approach high-cost financing, especially while the higher-cost home markets offer such attractive prices. The rules and procedures and guidelines will continue to change as the market readjusts to the new loan limits and, we believe, to recovery. We will want to review what you hope to accomplish, to look at today's options, and in the future, to stay on top of the coming changes as they affect you.

ON THE WAY, A THIRD CHANGE

There is a debate in Washington today over how to restructure the ailing Fannie Mae and Freddie Mac. Both agencies require infusions of federal cash in order to continue offering the backing of mortgages that is factored into the way real estate is bought and sold today.

People with widely varying views of how homes should be financed have entered the argument—including those who don't think the government should play any part in real estate financing and those who (like the National Association of Realtors®) definitely do.

Difficult Investment Decisions

"The *Wall Street Journal* reported that such financial heavyweights as Pimco's Bill Gross and major hedge funds are stocking up on [Treasury] securities that they think will perform best in a deflationary environment…. Over half of Gross's Pimco Total Return fund, for example, now consists of U.S. Treasury bonds, up from less than 33 percent at the end of March, according to the Journal. The bet seems to be that if economic demand slumps and profits tank, Treasury bonds will lose less than just about everything else." [Mortgage Bankers Association]

It is difficult to predict what is truly at stake. We know that the government has been involved in the writing of mortgages since the middle of the Great Depression. Arguably, its presence in mortgage writing helped make possible the abundant growth of homeownership after World War II, particularly among returning veterans.

We also know that before the government began to influence the writing of mortgages, it was difficult to obtain a loan that covered more than abut 50% of the home's purchase price, and the available loans generally had 5-year terms, at which point a substantial balloon payment became due. But this doesn't necessarily tell us what to expect from a mortgage system from which the government has been eliminated. Still, such a radical change remains unlikely.

A COMPROMISE PROPOSAL

At present, there is a proposal to replace Fannie and Freddie with five or more private companies. The companies would sell mortgage-backed securities that would be explicitly guaranteed by the federal government. This appears to be a compromise in the battle between those who demand a fully private mortgage system and those who seek to retain government participation in the process.

This is fascinating to watch, especially given the massive size of the mortgage debt overseen currently by Fannie Mae and Freddie Mac. The proposal suggests spreading the responsibility over five or more companies, but doesn't really create a system that differs greatly from the one we now have. This newsletter will endeavor to keep you informed about any changes that take effect in the future.

THE BEST CHANGE

Of course, the major changes to our financing practices being discussed today would probably be more easily agreed upon if our markets were working efficiently and more purchase money loans were being written. The best change, therefore, is recovery. It would doubtless help us create revised systems that incorporate what has worked in the past with creative ideas for the future.

Changing Rental Market

"Twice as many renters had enough income to buy a home in 2010 in comparison with 2005, so we have a much larger pool of financially qualified renters. Rising rents and excellent housing affordability conditions will encourage potential buyers who've been on the sidelines." [Lawrence Yun, chief economist, National Association of Realtors®]

The good news, as London's esteemed newsweekly, *The Economist*, recently suggested, is that the American housing market—despite recent sales and home value indices—is on the edge of mending itself. "There are signs," the editors intone, "this may be the darkest hour just before the dawn."

STATISTICAL CONFUSION

As an economist noted recently (see accompanying quotation from Jay Brinkmann), it is easy to be confused by data collected and computed for the entire nation or even for large areas—whether it be estimates of how much home prices have fallen or risen, of the number of foreclosures the nation may be facing, or of the number of workers who have recently lost work. The possibility of confusion rises when the up- or downticks are particularly small, as they have been for declining home prices. As we've seen over the course of the economic downturn, home prices—once they have begun to fall—are very slow to turn around. They gain a statistical intertia that keeps them from changing their direction.

Mortgage Bankers Association chief economist recently pointed out an even trickier problem. We read reports that the percentage of homeowners facing probable foreclosure is extremely high. Left unmentioned in these reports is the fact that 24% of the foreclosures faced by our nation currently are located in Florida. This changes the picture dramatically, and suggests that whenever we read any statistical analyses that seem to overwhelm any hope we have for recovery—we should look