

the Mortgage Bulletin

Week of May 22nd, 2006

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Homer Simpson
Cartoon Character

Your Logo Goes Here

Conforming Loans to \$417,000

Type	Rate	APR	Trend
30 Yr FIX	6.500%	6.587%	↓
5/1	6.250%	7.462%	↓

Jumbo Loans over \$417,000

30 Yr FIX	6.750%	6.851%	↓
10/1	6.625%	7.430%	↓
5/1	6.375%	7.473%	↓
10 Yr Bond		5.020%	↓
Prime		8.000%	→



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Bursting Bubble? Dangerous loans?

The media are determined to implant two fears into the minds of home owners and home buyers: that the housing bubble WILL burst; and that interest only mortgage loans ARE bad loans, per se. Frankly it gets tiring to read about the dire consequences of these twin “dangers” day after week after month after year.

As regards the housing bubble, stories speak not of whether the bubble will burst, but of when. And as regards interest only loans, the focus is only on negative possibilities.

So what are home owners to think? Should they immediately put their homes on the market and sell them before the bubble bursts?

And what about home buyers? Should they avoid interest only loans altogether? Are there no instances when these loans can be advantageous and safe?

Let's take these horror stories one at a time: first the bursting bubble.

In the nine county Bay Area, 8,358 homes sold in April, 2006 compared to 11,158 in April 2005; a decline of 25%. However, home prices in the same nine counties increased nearly 7%.

So, while there is no evidence supporting a bursting housing bubble, there is evidence that the sharp rise in home prices is leveling off. That is not a bad thing and certainly not cause for home owners to panic and sell.

Available housing inventory has climbed. It takes longer for homes to sell than has been the case in the past. It took 1.8 months in February 2005 vs. 3.6 months in February 2006. This is good news for buyers. Buyer's choices have been limited and any increase in inventory helps buyers.

Growth in housing inventory not only broadens buyer choices but it also provides some much needed breathing room for such mundane things as property inspections and financing contingencies.

It's not really a bad thing for buyers to have

some time to carefully examine the house they are buying and the type of financing that works best for them.

And while multiple offers are still common for many listings, hopeful signs are emerging that the playing field of buyers and sellers is becoming more level.

Now let's discuss interest only loans, so consistently maligned by the media. Here's the deal.

INTEREST ONLY LOANS ARE NOT, IPSO FACTO, BAD OR DANGEROUS.

Interest only loans do not, by their terms, prohibit borrowers from making principle payments. This fact is rarely mentioned by the media.

Interest only loans are not limited to adjustable rate (ARM) mortgages. Borrowers can get 30 year fixed rate mortgages with an interest only option.

Media articles about interest only loans usually create a doomsday scenario in which: the borrower makes only interest payments; the interest rate increases to its lifetime cap at the end of the fixed period; and fully amortizing payments must be made. The article then concludes that the borrower's monthly payments double.

As George Gershwin's lyric proclaims, “it ain't necessarily so.”

What is so is that at the end of the interest only period, amortizing payments will be higher than interest only payments. But the loan could be a 30 year fixed rate, so the rate would not increase.

Even if it is an ARM loan, that fact does not mean the rate will increase (at all) at the end of the fixed period. Who knows? In 2011 we could be in a recession and the rate could go down.

And certainly there is no reason to conclude that the rate will go all the way to the lifetime cap at the end of the fixed period.

So – the housing bubble is not bursting and interest only loans are not bad. Don't let the media convince you otherwise.



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