the Mortgage Commentary

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Conforming Loans to $359,650

Type	Rate	APR	Trend
30 Yr FIX	5.875%	5.956%	➜
15 Yr FIX	5.625%	5.506%	➜
5/1	5.625%	6.293%	↑
3/1	5.500%	6.371%	↑
Jumbo Loans above $359,650			
30 Yr FIX	6.250%	6.311%	↑
15 Yr FIX	5.875%	5.973%	➜
10/1	6.000%	6.1293	➜
7/1	6.000%	6.359%	➜
5/1	5.750%	6.337%	➜
10 Yr Bond		4.361%	↑
Prime		6.750%	➜

Will Katrina raise mortgage rates?

This article is not to diminish or ignore the significance of the personal tragedies and devastation wreaked by the hurricane known as Katrina at the end of August. It is rather an interpretation of the potential impacts of this unforeseen event on our economy and mortgage interest rates in the short term and long term.

First, a brief description of the economic environment prior to Katrina.

As August drew to a close, and prior to this event, the belief shared by most economists and financial observers, and even more important, by the Federal Reserve was that the economy was chugging along just fine. In fact, it seemed a foregone conclusion that the Fed would take an additional .25% whack at short term rates in order to forestall inflation at each of the remaining three meetings of 2005.

The gap between long term fixed rate mortgages and intermediate (5/1, 7/1, 10/1) fixed rates had narrowed. The gap had narrowed by increases in the intermediate rates while long term rates remained fairly flat.

There was no evidence of inflationary pressure although oil prices were on the rise. However, the surge in oil prices, unless abated, could be a contributor to future inflation and a resultant rise in long term mortgage rates.

In this economic environment, the relative desirability of long term fixed rate mortgages compared to intermediate fixed rates generally favored the long term. Unless a buyer or borrower was clear that they would only need the loan for a short time, long term mortgages were well worth the slight difference in rate.

Then, on August 29th, Katrina hit the gulf coast. Fear of a further and dramatic spike in oil prices caused investors to move money from the stock market into the (safe haven) bond market, driving prices up and yields down.

Additionally, fear that rising oil and energy prices might drag the economy into a slowdown or worse, added to the perceived value of bonds, driving the price up and yields down.

The net result of these two fears was a decline in long term fixed mortgage rates. Our assessment is that this decline in rates will be short lived. In fact, by the time you get this, rates may have rebounded.

The initial shock of Katrina will fade. Historically high oil prices will create inflationary pressure as higher energy costs will permeate virtually all segments of the economy.

It will cost more to get to work and to heat and cool homes. It will cost growers more to produce food. Nearly everything we do and buy will cost more. Add to this a nearly structural federal deficit. And what do you get? You get inflation. And along with it, higher long term mortgage rates.

In view of these circumstances, borrowers with existing intermediate fixed rate loans may want to refinance into long term rates even though the rate will be higher.
And while it is not necessary to pay points to get a fixed rate loan, it could make sense for some to consider doing so today.

This loan deserves consideration, particularly if inflation sets in.

30 year fixed - interest only

As more borrowers take out interest only loans, the media increases it's warnings about the danger. They use the worst case scenario — borrowers making only the interest payments, the underlying index skyrocketing to the max, causing the monthly payments to double.

Although the likelihood of a worst case scenario is remote, if it did occur, the figures were right. But — the real danger posed by these loans is that the rate is fixed for a relatively short period of time and subject to increase.

Enter the thirty year fixed rate mortgage with interest only for up to fifteen years!

Certainly it is possible to abuse the interest only provision, but in contrast to the ARM interest only loans, the interest rate cannot increase — for 30 years.

The worst thing that could happen? At the end of 15 years, the original loan amount must be amortized over the remaining 15 years. How bad would that be?

A $500,000 loan at 6% monthly payments are $4,220 per month for the final 15 years compared to $2,998 for a normal 30 year amortizing loan. And for the first 15 years, interest only payments are $2,500.

This loan deserves consideration, particularly if inflation sets in. Your cash flow is improved for the first fifteen years and so you make the higher amortizing payments over the final fifteen (if you still have the loan) with cheaper dollars.

And the (dollar) price of your home would have increased due to inflation. The rewards might well justify the risks.

Whose best interests?

Banks want to engage in real estate brokerage, relocation, and property management services.

They are lobbying Washington for legislative action to gain this permission.

The real estate industry is lobbying against these same proposals.

And you can't blame the real estate industry for objecting to this intrusion into their business and their profits.

Even Alan Greenspan says it is not a good idea if "relationships between banks and commercial firms are too close."

We agree with Greenspan. It is not a good idea for either industry and it is not a good idea for the consumer.

But what about the growing tendency of real estate companies to provide mortgage services in addition to traditional real estate services?

Does this practice undercut the real estate industry's arguments against banks getting into real estate? Are the consumers' best interests being served?

Does the convenience of "one stop shopping" out weigh a potential conflict of interest?

Shopping at one place for both real estate and financing services raises a valid question about whose interest (pun intended) is being served.

Are potential buyer/borrowers exposed to the full market or just to the mortgage products of the in house lending partner?

Potential buyer/borrowers must satisfy themselves about these questions when dealing with a real estate firm offering both real estate and mortgage services.

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