

# the Mortgage Commentary

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## We can see clearly now

Ah, the clarity afforded by looking in the rear view (economic) mirror. A lot has happened to the mortgage business since July 2007. And much of it was unexpected. The mortgage market has not just shifted, it has experienced an earthquake of shattering magnitude with significant long term implications.

We looked back at the Mortgage Commentary for July 2007 to gain a bit of perspective. And here's what we found.

The FOMC had not changed short term rates since June of 2006. Inflation seemed to be contained with the PCE (personal consumption expenditures) showing a year over year inflation rate of 1.9%. The Fed likes to see this index below 2%.

What happened after July, 2007? The economy commenced to stagger, and with the threat of recession growing, the Federal Reserve started cutting short term rates.

Starting in August, 2007 the FOMC cut rates at each subsequent meeting, taking the federal funds rate from 5.25% all the way down to 2.00% by the end of April, 2008.

These rate reductions had little impact on mortgage rates, but did cause the bank prime rate to drop, thus taking pressure off of borrowers with balances on home equity lines of credit since they are tied to prime.

In August 2007 subprime mortgages imploded, foreclosures exploded, investors in mortgage backed securities lost billions of dollars, causing the secondary mortgage market to dry up, many lenders went out of business, and an rates went up for all loans, particularly jumbo mortgages.

Fearing for their political lives, congress passed and the president signed an economic stimulus package designed to keep the economy from falling into recession.

As part of the stimulus package, loan limits for conforming loans in high cost areas were increased temporarily. For the Bay Area, the increase was from \$417,000 to \$729,750, and the new limit lasts through

2008 unless extended.

This is a significant increase and while the rates on these new super conforming loans are not as low as they are for the old conforming loans, (\$417,000 and below) many borrowers have benefitted. At least the rates are below those for jumbo loans -- loans above \$729,750.

In a business inspired response to the subprime crisis, and in an effort restore confidence in the secondary mortgage market, lenders have significantly tightened guidelines.

Notably, lenders have stopped making equity lines in the high loan to value range. Several lenders have stopped making equity lines in connection with purchases, thus virtually eliminating the much used (and apparently abused) 80-10-10 purchase structure. So buyers with 10% down and purchases above \$1,000,000 are pretty much out of luck.

In a politically inspired reaction, politicians have introduced legislation at state and national levels, which sounds good but may have devastating unintended consequences. These consequences may damage not only lenders, particularly mortgage brokers, but also consumers. We won't go into details here, but call us and we'll fill you in.

In addition to all of the foregoing, the skyrocketing price for oil has everyone concerned and rightfully so. The rising cost for energy is flowing into everything we drive, heat, eat, and wear. There's a word for this: inflation.

It is interesting that CPI (consumer price index used to measure inflation) does not include food and energy. At the same time inflation is raging, after paying for food and fuel, consumers have less to spend for anything else. And a fall off of consumer spending can lead to recession.

What is the Federal Reserve likely to do? Best guess is they will increase short term rates as early as next month. If they do, it will be good for mortgage rates since it would be an anti-inflationary move.

"People are always blaming their circumstances for what they are. I don't believe in circumstances. The people who get on in this world are the people who get up and look for the circumstances they want, and if they can't find them, make them."  
- George Bernard Shaw

## Want to save on gas?

The high cost of gasoline these days has everybody thinking about how to save on the cost of driving. One way to save is to drive fewer miles. Another way is to trade for a car that gets better mileage than the one you have.

In considering a trade, be sure you make the right calculations. The objective is to use less gas for the same number of miles driven.

Assume you have two cars: a van for hauling kids and stuff, and a sedan for business or pleasure. You drive each car 15,000 miles per year and you want to exchange one of these vehicles for one with higher mileage to save on the cost of gasoline.

The van gets 15 miles per gallon and you can trade for a new one that gets 20 miles per gallon. The sedan gets 25 miles per gallon and you can trade for one that gets 30 miles per gallon.

Which trade saves the most gas? Trade the van for a new one that gets 5 miles more per gallon or the sedan for one that gets 10 miles more per gallon?

You'd trade the van. Here's why. Don't think miles per gallon, think gallons per mile.

Van savings as follows: divide 15,000 miles by 15 miles per gallon equals 1,000 gallons. Divide 15,000 miles by 20 miles per gallon equals 750 gallons. That trade saves 250 gallons.

Sedan savings as follows: divide 15,000 miles by 25 miles per gallon equals 600 gallons. Divide 15,000 miles by 35 miles per gallon equals 428.57 gallons. That trade saves 171.43 gallons.

At \$4.25 per gallon the yearly savings on the van trade is \$1,062.50 and \$728.58 on the sedan trade.

Or — do the math. You could trade the van for a sedan that gets 35 miles per gallon and save \$2,431 per year. And that's at \$4.25 per gallon!

## They're ba-a-a-ack!

They're like locusts that periodically come to destroy crops. You hope you've seen the last of them and here they come again.

Unsolicited mailers are back, offering savings on mortgages by signing borrowers up for bi-weekly payments — for a fee of course.

Their offer is this: make half of your normal monthly payment every two weeks, thus shaving several years off your mortgage. The inference is that these payments are credited by the lender when received.

Well, that's not the way it works.

Your money indeed goes to the lender but the lender credits them only at the end of the month. Only then is your principal balance reduced thus reducing interest on the remaining (smaller) balance.

Bi-weekly payments will save on your mortgage. By paying 1/2 of your regular payment every two weeks you make one extra payment each year. This reduces the principal faster, pays off the loan sooner and saves interest.

So the offer is not totally misleading.

But why pay someone a fee for what is only advice on how to save? You can get the same savings all by yourself and you don't need to make bi-weekly payments.

Say your payment is \$2,400 per month. 1/12th of that is \$200. Make monthly payments of \$2,600 per month. That's one extra payment per year. You'll pay off your 30 year loan in about 25 years, saving interest all the way.

Or, if your income is irregular, when some extra money comes in, make an extra payment right then. That reduces principal and saves interest.

**BUT - YOU DO NOT NEED TO PAY SOMEONE A FEE TO GET THESE SAVINGS. SAVE EVEN MORE MONEY — DO IT YOURSELF.**

You can get the same savings all by yourself and you don't need to make bi-weekly payments.

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