



Randy Johnson, president/Independence Mortgage Company

## THE MORTGAGE CRACKDOWN

### HOW IT AFFECTS US ALL

If you think the soaring level of foreclosures doesn't affect you or your neighbors—you're wrong.

Many lenders are tightening requirements for mortgages even for people with good credit. Such a climate affects not just buyers and sellers of homes but also creditworthy home owners seeking to refinance as their once attractive adjustable-rate mortgages become much more costly. The effects threaten to ripple through the economy as debt-burdened consumers pull back on spending and watch home prices continue to slump.

Although the new environment creates opportunities for some, such as those seeking to buy foreclosed homes at bargain prices (see *Bottom Line/Personal*, May 1, 2007, page 5), for many others, it casts a new cloud on the real estate outlook.

Ways it affects you...

• **IF you're seeking a mortgage.** Expect greater scrutiny and more challenges from lenders worried about flaws on your application, such as high credit card balances or missed payments on any bills...inability to document your income...and any doubt about the appraised value of the home. A lender also is less likely to approve a new mortgage if your monthly payments would consume more than 28% of your monthly gross income...or if you can't come up with a down payment of at least 5%.

**Strategy:** Raising your credit score even a small amount can make a big difference in getting a better mortgage rate. To do so quickly, reduce credit card debt...and fix any errors in your credit

report. (Go to [www.credit.com](http://www.credit.com) for strategies on how to do this.)

At today's interest rates, a "FICO" credit score of 630—based on your credit history—might push your rate for a \$300,000, 30-year fixed-rate mortgage above 7%, even though your credit score is higher than the scores received by "subprime" risky borrowers. A better score of 720 might lower the rate all the way to 6%.

• **IF you are seeking a bargain in buying a home.** You will find the best buying opportunities over the next two years in markets with high mortgage default rates and where many home owners have loans that require only interest payments for the first several years. (After an initial period, required payments often soar on interest-only loans, leading to a high default rate.) These include areas within several states where real estate prices had a huge run-up in recent years—Arizona (Phoenix)...California (Santa Cruz-Watsonville, Santa Barbara, Santa Maria-Lompoc)...Colorado (Boulder and Denver)...Florida (Naples)...and Nevada (Las Vegas). Home bargains also can be found in areas that have endured heavy job losses—Michigan (Detroit and Flint)...Ohio (Cleveland and Youngstown)...Tennessee (Memphis)...and Texas (McAllen).

• **IF you want to sell your home.** As foreclosures grow, a steady stream of homes priced for quick sale are hitting the market in the most affected areas of the country—depressing prices overall. Home owners wishing to upgrade from starter homes will find it harder to find buyers for their old homes. That's because

first-time buyers—who often have weaker credit and less cash for down payments than move-up buyers—will have the most trouble meeting mortgage requirements.

This real estate demand-supply imbalance could linger for another year or two, keeping prices weak. Citing stiffer lending standards, the National Association of Realtors forecasts that home prices nationwide will drop this year for the first time since the Great Depression.

**Strategy:** If you're planning to sell soon, be prepared to make concessions—including lowering the price sharply and even offering to personally lend part of the purchase price to the buyer (consult a real estate attorney about how to do this). Realize that you may still own your old home for a while if you plan to buy a new one quickly. Consider renting a home temporarily instead of buying immediately.

• **IF you want to refinance.** Seek a fixed-rate mortgage, not an adjustable rate. If possible, refinance before you get a notice that your adjustable rate is about to jump.

**Example:** One of my clients had taken out a mortgage with an adjustable rate that would reset in five years. That was the maximum amount of time he planned to live in the house. It turned out that he and his family loved living there and wanted to stay, but their mortgage rate was going to rise to 7.5%. Because he had a strong credit history and a FICO score above 720, I advised him to jump into the safety of a 30-year fixed-rate mortgage

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with a rate of about 6%. That provides great stability for virtually the same cost of riskier mortgages. *Careful:* If you refinance an adjustable-rate mortgage within the first two or three years, there may be a prepayment penalty equal to six months' worth of interest payments.

• **IF you are about to fall behind on payments.** If you can't refinance or sell your home, contact your mortgage lender right away. Don't let the customer service people tell you that there's no help available until your payment is past due. Ask to speak with the loss mitigation department. Mortgage lenders often will work with you at this point because they don't want the complication of a default either.

*Options include...*

**Loan modification.** At least one term in the mortgage agreement is changed to avoid default. For instance, the lender might extend the introductory rate period on an adjustable-rate loan.

**Reinstatement plan.** You sign a written agreement pledging to bring the loan up-to-date within a limited amount of time, usually less than 18 months. This is especially helpful for borrowers who have had onetime serious setbacks, such as illness, injury or a temporary layoff.

**Forbearance agreement.** The lender reduces or suspends payments for a specific period of time, usually no more than three months. This is useful for people

who have experienced some sort of catastrophe. The suspended payments are added to the loan.

• **IF you already have a 30-year fixed-rate mortgage.** The interest-rate premium you paid for stability and peace of mind when you took out the mortgage is paying off. Even so, keep in mind that the price appreciation of your home may be sluggish or flat for several years, given the current environment, especially if you paid top dollar. In particular, new subdivisions and condos in Florida and the Washington, DC, area may see declines. Over the long run, expect your home to revert to historical price growth of 3% to 7% annually.