

Special Report



Update: The Fed and Me: The meaning of Zero: *by Mitch Kossar, Broker, CIG Realty and Loans*

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Dear Friends, Colleagues and Clients:

What is the meaning of zero percent? Readers of this newsletter know that the low federal funds rates do not necessarily mean loan mortgage rates. However, this time around we have seen all rates coming down with the fed funds rate. The 10 year treasury is currently around 2.7%, the Fannie Mae secondary market rate is 4.5% and mortgages have come down accordingly. However anyone with a mortgage that is slightly off the basic product will see a big hit to their interest rate, so not everyone benefits.

You may not be able to lower your rate if you...

- have less than 20% equity in their home because of recent declines
- own investment property and want to refinance
- cannot document income or assets and do not have at least 40% equity in your property
- have a loan is over \$625,000 (the new agency jumbo limit in high cost areas)
- have a credit score below 720.

The following borrowers can likely lower their rate dramatically (low 5s/upper 4s)

- People who can document their income and assets, have at least 25% equity in their home, whose mortgage is under \$417,000 and have a strong credit score.

People with HELOCS (home equity lines of credit) will benefit as well, as the fed funds rate is tied to the prime rate, the main interest rate for most HELOCS.

The following borrowers will likely benefit soon, but not now:

- Borrowers with good credit, documentable income and assets, and loan amounts between 417,000 and 625,000 dollars.
- The same borrowers as well as borrowers will loan amounts below \$417,000 who have between 20 and 25% equity behind their first mortgage.

There are two reasons these borrowers will have to wait. First, Fannie Mae is still coming out with new rules on buying the new "high balance" agency jumbo mortgages between \$417,000 and \$625,000 and many lenders have artificially high prices until the uncertainty is settled. Secondly, recently banks have charged more interest

for loans with less than 25% equity in the homes so those loans sometimes cost more than people's current rates. There are ways around this, but it depends on the individual borrower's situation. These borrowers should look into refinancing, but may have to wait until January.

Clients are also asking about this 4.5% interest rate coming up in the news. Four things to note:

1. It's under discussion. It is not going to happen yet. It probably will not happen until first quarter next year or early second quarter
2. It only applies to purchases, not refinances.
3. There will almost certainly be loan amount limitations, expect limits of \$417k and below
4. There may be other restrictions, i.e. first time buyers, etc. Chances are the guidelines will be strict. Full documentation, 20% down, etc.

CIG will track this development as it continues, but it will not likely impact most people in the California area, and likely not those who are already home owners.

The next year or two should show ample opportunity to refinance. Even with conventional mortgage rates coming down, there is still a 200 basis point spread between basic mortgages and the 10 year treasury, and there are still big "hits" to interest rates for slightly more risky loans. There is a lot of room for these spreads to shrink and rates to continue to come down, and we have a democratic loaded Congress and executive branch determined to make housing more affordable and to shrink these spreads.

All that can stop this trend is inflation and flight from the US dollar. In today's deflationary environment where the rest of the world is bed-ridden by the US flu, this is unlikely to happen. We have a pretty long run of low interest rates ahead of us. CIG's recommendation is to do a no-cost refinance at a slightly higher rate and refinance continually as spreads narrow and rates come down. Because of uncertainty in the markets we recommend a 30 year fixed mortgage, because after this deflationary environment is over, the risk of massive inflation and double digit interest rates is considerable. When this trend reverses itself, it will do so with a vengeance.

