

Special Report

Update: Fannie Freddie Bailout *by Mitch Kossar, Broker, CIG Realty and Loans*



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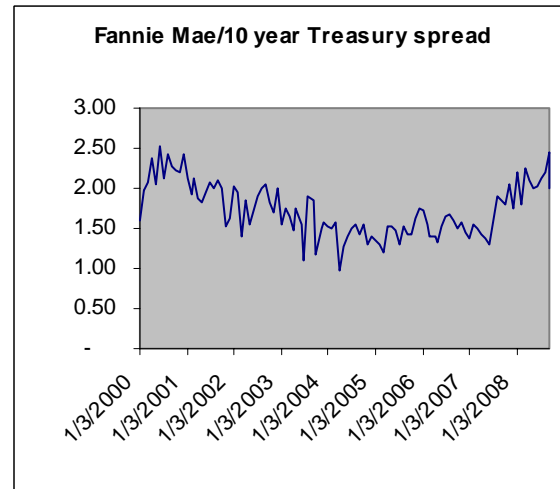
- As predicted by CIG in July, the collapse of Freddie and Fannie has helped good borrowers
- Rates may have gone down, but guidelines are still tight
- Rates may go down even more, but the long run for rates do not look so rosy
- It is unclear whether this government intervention will be enough
- The Fed may still have to chose between a looming ARM disaster and deep recession in the midst of rapid asset deflation.

Dear Friends and Past/Prospective Clients:

In mid-July we discussed the impact of Fannie Mae weakness on mortgage rates. In that newsletter we discussed how a bail out of Fannie and Freddie seemed likely and if that were to happen rates would fall. Well it happened, just about on schedule.

Good news for the best borrowers—for now

And its good news for borrowers who have strong enough credit to qualify for their types of loans. Why? As the agencies became weaker, it became more difficult to raise capital and more difficult to sell their loans, so they had to raise their interest rates to get buyers and capital. The spreads between the agency paper and the "risk free" 10 year treasury continued to widen as shown in the graph below.



This meant that even though long-term rates went down, mortgage rates stayed high. Now that the government has basically opened its wallet for lending, rates came crashing down over the weekend and the saving was immediately passed on to the consumers. As we can see from the graph, there is a lot more room for rate to fall, perhaps as much as 1 to 1.5% to go back to historical levels.

With treasuries at almost all time lows, does that mean another refi boom? Well not quite.

We are not out of the woods yet - not by a long shot

- First, the savings will not be passed down to anyone but the best borrowers with lots of equity (20% is enough).
- And even the best borrowers will have trouble if they are self employed, retired, have investment property, want cash out or want interest only loans.
- Finally the secondary market for private markets for loans above the new "agency Jumbo" is still non-existent.
- That means real estate markets will stay down as many borrowers have trouble getting loans and we are far from out of the woods yet.

Also, you may recall that in that July Newsletter our concern that this intervention may not be enough. Each time the government takes drastic action, the markets sigh but the underlying problem remains the same: The credit crunch does not abate. There are still more skeletons to come out of the closet. For example, the expiring ARMS have not hurt anyone yet because short term rates stay low—the weak dollar, government debt and inflation risks are putting great pressure on the Fed to increase rates, eventually the levee could break. The Fed may have to chose between runaway inflation or a recession not seen since the 1930s.

Worse yet, we see a vicious cycle; banks tighten credit to reduce their leverage. The shrinking credit reduces asset prices and their leverage remains the same and the cycle continues. It's a massive deflation of assets. The carnage first brought down the sub-prime players—the weakest players. Then the "alt a" players, liquidity in the private markets dried up and next Bear Stearns fell. In all these cases, these were institutions that made bad decisions. Although it is true Fannie and Freddie were highly leveraged, their portfolio was much more conservative than anyone else. They fell because the credit crunch destroyed their assets as well. Its like the good borrower who maintains his house, while all the other houses are foreclosed on and boarded up. Her house goes down with the rest of them. Fannie/Freddie are going down with the rest of them.

Although the general economy has been hit hard by the credit crunch, it is still far from collapsed. There is still a potentially long way to go, and the country has a bad balance sheet coming into this mess. Eventually the Government may run out of tricks...and money... and spreads can go up again.

So what do we do?

- If you are in a position to refinance, do so with minimal fees. The spreads can drop much more, but in that case refinance again. It is a good idea to lock in a favorable rate now as markets have proven to be unpredictable. Last March rates hit a 4 year low... that lasted 2 weeks.
- If you have a loan between \$625,000 and \$729,000 dollars and live in a high cost area, definitely refinance before the "Agency Jumbo" limit declines back down to \$625,000
- Lenders are more open to modifying troubled loans

Bay Area Residents only:

- The real estate market in the Bay Area is being driven by credit, not the economy. Therefore home prices are stronger the higher up you go but the weakness is creeping upward. What first hit Daly City, San Bruno and SSF is now hitting San Carlos and Belmont while Hillsborough homes get multiple offers. Similar patters are occurring in SF neighborhoods.
- The Bay Area population is growing and the economy is a bit off cycle to the rest of the country, so there is a chance that housing will hold beyond the first time buyer level, but if the financial crisis truly spreads to Main Street all bets are off.

These are exciting times and we at CIG will try to guide you as we have been.