Open House: Slowing market weeds out subprime lenders

by Jim Woodard

It's tough to survive in today's mortgage lending industry. Many originators, particularly those that have been specializing in the subprime niche of the market, are folding their tents and silently leaving the business. However, there's a bright side to the current trend.

"We're seeing 40 or 50 subprime companies a day throughout the country going down in one form or another," said Angelo Mozilo, chief executive of Countrywide Financial. About two dozen large subprime mortgage lenders nationwide have gone under or stopped making loans, according to Implode-O-Meter, a Web site that tracks closures in the subprime lending industry.

The failure of so many subprime lenders is symptomatic of a larger trend - Wall Street's loss of appetite for risk, the site reported. With so many mortgages going bad, investment banks have quit backing subprime mortgages and are actually kicking bad loans back to some originating lenders, forcing some of them to close their business.

One of the first mortgage products expected to disappear are zero-down mortgages, sometimes known as 80-20s. These are often structured without verification of income to borrowers with impaired credit ratings.

There will be about 30,000 loan originators going out of business during the first quarter of this year, it was estimated by the For Benefit of the Originator association. This could be a positive development for the business generally, they point out.

"The skilled mortgage pro does not lose when the market gets worse because the unreliable lenders go out of business or are acquired by others, and the unreliable loan officers go back to doing whatever they were doing before," it was noted in a FBO report.

"The slowing market fits well in a trend of expansion and consolidation. The market expands until it's white hot, then cools and consolidates before the next expansion period. It's in this period that mortgage loan originators can begin to exert influence in a way they have never been able to before. If they play it smart, today's slow-down can be the catalyst for a new glory day to come for the loan originator."

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Freddie Mac, one of the nation's leading government-sponsored buyers of existing home mortgages,

announced it will cease buying subprime mortgages that have a high likelihood of excessive payment shock and possible foreclosure. It will only buy subprime adjustable-rate mortgages (ARMs) that qualify borrowers at the fully indexed and fully amortizing rate.

The objective of Freddie Mac's action is to protect future borrowers from the payment shock that could occur when their adjustment rate mortgages increase. It will also limit the use of low-documentation underwriting for these types of mortgages to help ensure that future borrowers have the income necessary to afford their homes.

Also, it will strongly recommend that mortgage lenders collect escrow accounts for borrowers' taxes and insurance payments. The new policies will take effect on all mortgages originated on or after Sept. 1 of this year.

Freddie Mac also announced their development of fixed-rate and hybrid ARM products that will provide lenders with more choices to offer subprime borrowers. For example, in contrast to the payment structure of many of today's "2/28" ARMs, the new hybrid ARMs will limit payment shock by offering reduced adjustable rate margins, longer fixed-rate terms, and longer reset periods.

However, it will require originators to underwrite these products at the fully indexed and amortizing rate. The company plans to commit significant capital to purchasing these loans into its portfolio.

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Q: Are illegal immigrants allowed to obtain a mortgage using an ITIN?

A: Currently, yes. But newly proposed federal legislation would put the brakes on the growing trend of providing home loans to mortgage applicants using an individual taxpayer identification number (ITIN) instead of a Social Security number. ITINs are normally issued by the Internal Revenue Service to help immigrant workers who don't qualify for a Social Security number to report their income and pay federal taxes.

An increasing number of banks and other lenders have been offering home mortgages to undocumented immigrants using ITINs. The proposed bill, introduced by Rep. John Doolittle, would amend the Truth in Lending Act to make ITIN mortgage lending illegal.

Q: Are home sales increasing or decreasing in today's market?

A. The number of home sales in January rose significantly, reaching the highest level in seven months, according to a report from the National Association of Realtors. The increasing sales include single-family homes, town homes, condominiums and co-ops.

The sales volume rose by 3 percent from the previous month, to a seasonally adjusted annual rate of 6.46 million units.

"Although we're expecting existing-home sales to gradually rise this year, and buyers are responding to the price correction, some unusually warm weather helped boost sales in January," said David Lereah, NAR's chief economist. "On the flip side, the winter storms that disrupted so much of the country in February could negatively impact the housing market. These weather events are unusually large. Many transaction closings were postponed in February and home shopping was essentially shut down for about a week in many areas. We shouldn't be surprised to see a near-term sales dip, but that will be followed by a continuing recovery in home sales."

Despite today's sluggish market generally, existing-home sales are on the increase, along with the number of mortgage applications. And, at this writing, mortgage interest rates are edging downward. Market factors are looking more favorable for home buyers and sellers.

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