



Mortgage Insight: 2007 - The Year of the Refi?

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Is 2007 shaping up to be the year of the Refi? Merely posing such a question makes me sound as though I'm living in the past – three years in the past. We all know that 2003 was the year of the refi, right? And with the 10 Year Treasury note currently at 5% or higher and fixed rates well into the sixes, why would anyone think another refi wave is on the horizon?

When you consider recent market developments, the reasons become clearer. The close of 2006 presented enormous potential for refinancing – not in spite of rising interest rates, but in large measure because of them, and their impact on the huge volume of mortgages made in recent years, especially adjustable rate mortgages (ARMs).

Although there are many reasons for home owners to consider refinancing into fixed rate loans in upcoming months, I've included seven of the most significant reasons to do so:

1. Every index except for the MTA and COFI is at or above 5.00%, and according to industry experts, **interest rates on a quarter of all outstanding mortgage loans (\$2 trillion) are scheduled to reset in 2007 and 2008.**

Most of the ARMs written in

past years have a 2.75% margin, which means that they will be adjusting to close to 8.00%. In addition, the COFI and MTA levels are now at 4.00% and seem primed to rise at 20 to 25 basis points a month, so these borrowers will also want to fix their rate if they have not already. Borrowers who are currently financing their homes with Payment Option ARMs or MTA ARMs will find it an appealing proposition to fix their rate and at the same time eliminate negative amortization.

2. Over the past five years the conforming loan amount has increased significantly to its current level of \$417,000. This means that borrowers who previously had to pay the Jumbo premium are now eligible for a conforming loan amount.

This is also significant for ARM loans that have a conforming loan amount. In the past, more borrowers that previously had Jumbo loan balances chose ARMs because the rates were so much lower than a Jumbo fixed rate. Now, they will find that with the conforming loan amount being where it is, a refinance to a fixed-rate loan makes perfect sense.

3. A significant event occurred on January 1, 2006, when the minimum payment on credit cards was raised from 2% to 4%. The math is easy. If borrowers have \$10,000 of credit card debt outstanding, this means their payments went up by \$200 a month to \$400. Yikes! If they were able to obtain a 6.5% 30 year

amortizing loan of the same amount, the payment would be \$63, and, even better, if they could get an interest-only loan, the payment would drop to \$54.

With the appreciation that home owners have enjoyed over the past few years, there may be significant opportunities for refinancing for the purpose of debt consolidation, simply because of the increase in the minimum payment on credit cards.

4. Home owners who have children going off to college are finding that tuition is at an all-time high, as is the number of students. The one piggy bank parents could use in the past was their home, usually in the form of a home equity loan. With short-term rates heading toward 9.0%, it probably makes sense to refinance your home and take cash-out to pay the tuition even though you might be raising the rate on your existing loan.

As an example, borrowers who previously financed their house three years ago with a \$300,000 fixed rate loan at 5.5% could now refinance, taking \$80,000 out (to cover tuition for four years), with a \$380,000 fixed rate loan at 6.50%. Their payment on their new loan will be \$2,401 on a 30-year fully amortizing loan and \$2,058 for an interest-only payment. If they instead financed the tuition with a home equity loan, their rate would be 8.50% or higher.

The combined weighted average rate for two loans would be much

higher than 6.5%, and the home owners would still be subject to additional increases on the second mortgage if rates continue to rise.

5. Piggy back or combination loans that were originated in past years for the purpose of avoiding mortgage insurance can probably now be consolidated into one mortgage, enabling home owners to continue avoiding mortgage insurance and eliminating a high rate second mortgage.

Combo or piggy back loans account for the vast majority of Zero Down or 100% financing loans that drove the housing market to record heights over the last few years.

This makes particular sense for home owners whose current first mortgage is an adjustable rate mortgage, or their second is a home equity loan. The appreciation in house values over the last three years, coupled with the relative bargain of fixed-rate loans, not only makes refinancing a piggy back possible, but it also, in all likelihood, makes it a necessity.

6. The advent of Alt-A lending has created several opportunities for home owners to improve on their mortgage terms. Borrowers who in the last three years were recipients of No Doc loans can now potentially

qualify for a Full Doc, or Alt-A expanded criteria loan.

In addition, the price appreciation of the last few years alone may make it a compelling proposition to refinance. The differential in price for an 80% LTV to a 95% LTV for a No Doc loan ranges from 2 to 3 points, which translates into as much as 2.00% in rate. This means that with simple price appreciation, it probably makes sense for previous No Doc borrowers to refinance even if they have to remain as No Doc borrowers.

In fact, in studying risk-based pricing in general for Alt-A loans, it makes sense for a borrower of any previous high LTV loan that was originated as a No Income/No Asset or No Doc loan (*even if the borrower used the same doc type*) to refinance.

7. Credit score grids have become much narrower, and, as a result, the risk-based price adjustments have become tighter. Borrowers who financed their house with a sub-prime loan may now qualify for a prime loan or lower rate Alt-A loan simply because their credit score has risen above that magic number of 620.

Add an improved credit score to a lower loan-to-value, due to recent appreciation, and you've got a recipe for significant improvement in mort-

gage terms.

IN SUMMARY:

It way be well worth every home owner's time and effort to compare their current mortgage terms to what may now be available to them.

Because mortgage classifications are so much more detailed than the average home owners realizes, their current qualifications may be significantly different and better, than what they were only one, two or three years ago. And best of all, it doesn't cost anything to speak with a mortgage consultant to determine if refinancing would be beneficial.

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