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A Mortgage Industry Crisis?

What's going on in the world of mortgage financing? The media would have you think that the sky is falling, but let's review what is really happening and how it affects our lives and our future.



A few years back, Wall Street investors told the mortgage bankers, "Create new product switch higher returns and we will buy them." The industry responded with higher risk products that paid higher returns such as Stated Income loans and loans that didn't require verification of income or assets.

At first it all made sense; individuals with lower credit scores (typically 660 and below) were still required to have at least ten percent down and take on a much higher-than-market interest rate to compensate for the additional risk. Gradually, the underwriting guidelines became less restrictive until subprime investors were accepting borrowers with no money down, low credit scores of 580, and offering rates not much higher than that of a standard borrower.

Nationally, everyone was running along like there was no tomorrow – investors were happy with higher returns and homeowners were pleased to be in new homes. Then certain markets started to turn and instead of experiencing doubledigit appreciation they went flat or decreased in value (NV, MI, CA, MA, RI, AZ, FL). A big wake-up call came when homeowners with Adjustable Rate Mortgages (ARMs) went to refinance and couldn't because most of these loans were originated at 100% and due to the market being flat they had no equity. Adjusting interest rates drove monthly payments up and it led to a surge of foreclosures causing the number of homes in foreclosure as of July 2007 to be double what it was in July 2006. It didn't take long for the investors to determine which loans were defaulting at an alarming rate and pull the plug on that source of lending. The result is a major restructuring of the sub-prime lending market and its guidelines. Right now we are seeing the pendulum swing far in the direction of conservatism. Yes, sub-prime loans still exist, but not the "580 credit score, 100% loan-to-value loans" that were available a few months ago. Now a sub-prime loan requires a higher credit score and a small down payment.



So, is the sky really falling? No. The market is simply adjusting to match the true risk associated with real people living real life. In the end, we will see that it is a healthy adjustment that will help to maintain long-term property values and realistic investor rates of return.