

Lincoln Trust Mortgage News - Vol. 1. No. 2

Hello again to everyone! Happy New Year to all!

INTRODUCTION

Thank you to all for the nice comments about the first newsletter that went out in July! No one has asked to be removed from the list as yet, so that must be a good sign as well. I also meant to mention in the first newsletter, if you want me to use a different (or additional) email name(s) please reply with that information.

I have continued to add more detail to my website at www.lincoln-trust.com so please visit it if you have a chance.

I am using this newsletter to stay in touch with my clients and business partners. As always, if you feel I am cluttering up your mailbox, just reply with a "please remove me from your mailing list".

MARKET NEWS

Well as the New Year rings in we have a new Fed chairman in Ben Bernanke to replace the irreplaceable Alan Greenspan. Short-term rates have continued to be pushed higher with the Prime Rate at 7.25%, but indications from the Fed are that the raising of rates will be stopped soon. So as the market sits right now, shorter-term (ARM) rates are right at the surprisingly stable longer-term rates (fixed 15, 20, and 30 year). Conventional 3/1 and 5/1 ARMs are now at the same prices as 15 and 30 year fixed (5.625 to 6.125%). To show you how things have inverted, the 5/1 ARM has a lower rate than the 3/1 ARM. With the Prime Rate well over long-term rates, there is constant pressure for those longer-term rates to creep up. So far it hasn't happened.

PAY-OPTION ARM explained

With conventional ARM and fixed rates running neck and neck, the only other program that is getting a lot of press lately is the Pay-Option ARM. This program can have a starting rate as low as 1.00% which means you could borrow \$500,000 for \$1,608.20 per month!! Sounds GREAT! And it is.....BUT....there is high potential for negative amortization if you only make that minimum payment due each month. This means the minimum payment doesn't cover the actual accrued interest and the principal of the loan can rise month after month. Scary right? Not necessarily. This program can be perfect for self-employed people as well as folks that have investment property. You have to have excellent credit in order to qualify for a pay-option ARM simply because of the potential for negative amortization and the Feds want to insure you know what you are getting into.

It gets its name from the 4 options you get to choose from at payment time each month. These are:

- 1) the minimum payment is the low 1% rate payment. You can pay this and stay current on the loan.
- 2) Interest only payment on the **fully-indexed** rate.
- 3) 30-year amortized fully-indexed rate
- 4) 15-year amortized fully-indexed rate

Of course the **fully-indexed** rate is variable and it is comprised of 2 components that are added together. These are the **margin** and **index** that you sign up for with the loan. The margin is the bank's mark-up in the rate and the index is typically the MTA which is 12-month rolling average of the 1-year maturity monthly T-bill rate. A typical margin for the bank is 2.75% (this is negotiable so obviously try and get the lowest margin possible). Right now the MTA index is about 3.6%. So the fully-indexed rate this month would be 6.35% and it moves every month with movement of the MTA index. The rate can't move fast since it is the 12-month rolling average of the 1-year T-bill.

Now if you were to borrow \$250,000. the 4 option payments would be as follows:

- 1) 1% - \$804.10
- 2) interest-only fully-indexed - \$1,322.92
- 3) 30-year - \$1,555.59
- 4) 15-year - \$2,157.21

So you can see the flexibility. If cash flow is poor for the month, option #1 looks pretty good, and if you had a great month of income, #4 may be the way to go. The bad news (again) is that with option #1, the principal increases by \$518.81 (\$1,322.92 in accrued interest on the fully indexed rate minus the \$804.10 payment made). If the self-employed person has lots of income late in the year, he/she can allow the accrued interest to build all year long. Then at the end of the year he/she can pay the lump sum accrued interest and deduct the total from their income.

In recent years, investors could easily allow some principal increase because the property value was increasing even faster. The other reason this loan program is so attractive is that the minimum payment remains very stable even though it is an ARM. The most the minimum payment can rise on the 1st anniversary of the loan is 7.5% of the payment, so in our example the \$804.10 can only go up by \$60.31 or a new minimum payment of \$864.41

MORTGAGE ALPHABET SOUP explained

As with most professions these days, there is no shortage of acronyms in the mortgage industry. Here are a few of the more common ones you'll see:

PITI (commonly pronounced "pity", no pun intended) – Principal, Interest, Taxes, and Insurance – Your total housing monthly debt. This is your month mortgage payment (principal and interest) added to the monthly equivalent of your annual property tax bill and home owners insurance policy payments.

DTI – debt-to-income ratio. Your combined monthly debt payments (PITI, car payments, and credit cards) divided by your monthly income. In the "old" days we used to calculate both a "housing only" DTI and a "total" DTI and the Feds had limits for both ratios (remember numbers like 28% for a "lower DTI" and a maximum of 33% for the upper?). Now-a-days they have been forced to become much more lenient, and depending on the clients total credit history. i.e., ability to repay the forthcoming debt, I have seen a ratio in excess of 50% get approved through the Feds automated underwriting programs.

LTV – loan-to-value. The percentage of your proposed loan in relation to your homes market value (or purchase price, whichever is lowest). If you are putting 20% as a down-payment, your LTV is 80%. In general the higher the LTV, the higher the mortgage interest rate will be.

GFE – good faith estimate. One of the documents you sign at loan origination showing all the fees and costs associated with the proposed mortgage. This is meant to be very close to what the final numbers will be but it is still an estimate due to variations in closing dates (pre-paid interest variation) and escrow requirements at closing.

TIL – truth in lending. This is everyone's FAVORITE document that you have to look at while sitting down. This shows you the accrued interest payments over the life of the loan and typically on a 30 year mortgage you will pay 2 to 2.5 times the mortgage itself in interest. OUCH! But of course you have been allowed the "luxury?" of being able to deduct all that interest from your income.

FICO – credit score. A calculation developed by the Fair, Isaac, and Company utilized by each of the 3 credit reporting agencies (Transunion, Experian, and Equifax) to obtain an overall credit score. The score can be anywhere from 300 to 850 and it utilizes your total credit and payment history including the total amount of credit as it relates to the limits imposed by the creditors. Each agency has their own unique spin on the algorithm used which is why you rarely get the same score with any 2 agencies. The other main reason is that not all creditors report to all 3 agencies so the database is different. You will find however, as your history lengthens, the scores do tend to converge with reasonable accuracy. Most lenders use the mid-score as a basis for credit.

FREE CREDIT REPORT reminder

Now everyone can get free annual credit reports from all 3 agencies. Simply go to: www.annualcreditreport.com and that website will step you through the process.

Even if you don't plan to get more credit, you NEED to look over your report AT LEAST the free time once a year with each agency. This is the best way to insure your identity hasn't been stolen because if it has, the new credit lines will show up in the report. An excellent suggestion I read was to rotate your request to each agency every 4 months so they will always be free and you stay very current.

The agencies will require you to pay for your credit score (FICO) however.

IN CLOSING

ALL feedback is welcome! Suggestions for topics in future issues are welcome. Reply with any comments you'd like and remember there are no dumb questions.

warmest regards,

--Craig

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