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Fed Clarifies MBS Purchase Policy

As the pressure for higher mortgage rates has increased in recent weeks, investors have speculated that the Fed would step in to "defend" certain interest rate levels, but that hasn't happened. This week, Fed officials explained that their mortgage-backed securities (MBS) purchases are designed to support the mortgage market and not to set rates. The Fed's MBS purchases of \$25.5 billion this week were similar to levels seen in recent weeks. Disappointed that the Fed hasn't increased its quantity of asset purchases, investors sold MBS this week, and mortgage rates moved higher.

A number of factors have been developing which typically push interest rates higher. The coming supply of debt needed to pay for government programs will compete for investor funds. Despite strong demand for this week's large Treasury auctions, investors are concerned that higher rates will be required in the future. In addition, an improved economic outlook has made investors more willing to move funds to riskier assets and away from safer assets such as bonds. It also means that higher inflation may be a concern sooner than previously expected.

The difference between short-term and long-term rates reached record spreads during the week. With the Fed-controlled fed funds rate close to zero, short-term rates remained low. Long-term rates, which are market-controlled and influenced by investor expectations, rose significantly. A wide yield curve spread is often found during periods when the economy is strengthening.

HUD Clarifies Use of \$8,000 Purchase Tax Credit

New guidelines were issued today for the monetizing of the \$8,000 first-time homebuyer tax credit that can be used as a down payment on FHA loans that was announced by HUD and then delayed by HUD. The primary change is that the money cannot be applied toward the 3.5% minimum down payment. It can be used for a larger down payment or applied toward closing costs.

Borrowers Finding It Tough Going In "Making Home Affordable"

Two major hurdles have dashed many prospective borrowers' hopes when applying for The President's mortgage initiative, also known as the Making Home Affordable Program. The two snags are for those with Mortgage Insurance, and the second is for those with a 2nd mortgage.

MI Issues

Under the Fannie/Freddie plan, those with MI are allowed to refinance up to 105% of their appraised value and either transfer their MI certificate or have a new one issued at the same rate, even though the loan-to-value has gone up. MI rates are based on brackets of 80%-85% LTV, 85%-90% LTV, and 90%-95% LTV. The program is supposed to allow someone who originally had an MI rate based on 83% LTV to get the same rate, even if the new loan is at 103% LTV. This is a great plan, except that most lenders do not have their loan underwriting systems updated to accommodate this program. The result – borrowers with MI can not get their loans. Most lenders claim they will have the "glitches" fixed shortly.

2nd Mortgage Issues

Under the Fannie/Freddie plan, those with a 2nd mortgages are not allowed to consolidate those junior loans with their 1st mortgage if they want to take advantage of the 105% LTV program. An example: In 2007 a borrower bought his new home using the 80-10-10 1st / 2nd mortgage piggyback program. Today, due to falling values, the loans are now a 95% LTV 1st mortgage and combined with the 2nd mortgage for a total of 105% Combined Loan To Value. The only option under the federal program is for the 1st mortgage to be refinanced, and the borrower is to obtain a subordination agreement from the holder of the 2nd mortgage. In theory, if the 1st mortgage rate is reduced, it will make it easier for the homeowner to keep his home and continue to make his payments on time. This should be a good thing for everyone, right?

Lenders who gave those 2nd mortgages just a couple of years ago to 90% or even 100% LTV are either not providing 2nd mortgages at all, or have scaled back their lending to a maximum of 75% LTV. Since the borrower in the example above no longer has a 2nd mortgage that fits the lender's guidelines, the holder of the 2nd mortgage will not allow the refinance to take place (by not agreeing to a subordination agreement). This problem has surfaced for many borrowers trying to take advantage of the Making Home Affordable Program. During the boom years most home purchasers used a 1st / 2nd mortgage combination instead of taking MI. The government would double the amount of homeowners that could refinance if they were to come up with a program to service the needs of this large group of homeowners. Until then, this group of homeowners will just have to continue with their existing mortgage rates and payments.

Events This Week:

Durable Orders Up

Sentiment Rose

Housing Mixed

Manufacturing Fell

Events Next Week:

Mon 6/1
ISM Manuf.
Income

Tues 6/2
Pending Sales

Wed 6/3
ISM Services
Factory Orders

Fri 6/5
Employment

Also Notable:

- April Existing Home Sales increased 3% from March
- May Consumer Confidence rose to the highest level in eight months
- Continuing Jobless Claims climbed to a new record high
- Oil prices rose to \$66 per barrel, the highest level of the year

DAILY RATES FROM HAWAII'S TOP LENDERS:

Average 30 yr fixed rate:	
Last week:	+0.15%
This week:	+0.35%

investment properties are then added to that rate. Borrowers can also “buy down” these rates by paying additional points.

Each color on the graph represents a different lender.

Week Ahead

Next week, the important Employment report will come out on Friday. As usual, this data on the number of jobs, the Unemployment Rate, and wage inflation will be the most highly anticipated economic data of the month. Early estimates are for a loss of about 550K jobs in May. Before the Employment Data, the ISM index, Personal Income, and Construction Spending will come out on Monday. Pending Home Sales, a leading indicator for the housing market, will be released on Tuesday. ISM Services will be released on Wednesday, and Productivity is scheduled for Thursday. Fed Chief Bernanke will be testifying on Wednesday.

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