The Rancho Report

ranchofinancial MORTGAGE CENTER

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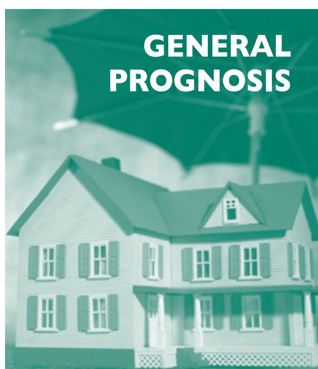
RECENT LEGISLATION

Three pieces of legislation are in the process of being passed, having worked their way through committee and full vote in the House of Representatives. They are now awaiting consideration of the Senate, where they will very likely be passed, though possibly in altered form. The House and Senate will then have to create and pass a reconciled version of each House's bill. They are all worthy of our careful attention and you may even wish to write your legislators about them.

GENERAL PROGNOSIS



"A trend away from subprime mortgages to FHA loans, which often carry much lower interest rates, is a positive development for consumers and the housing market going forward. Still, it will take some time for the change to yield a measurably higher closed sales volume." [Lawrence Yun, chief economist, *National Association of Realtors®*]

H.R. 1852

The "Expanding American Homeownership Act of 2007," sponsored by Congresswoman Maxine Waters (Democrat, California) and passed by the House on June 11, 2007, could elevate the FHA-insured loan ceiling as high in some cases as $729,750 (from its current $417,000 ceiling). Specifically, it would limit FHA loan size to 125% of an area's median home price, with an upper limit of $729,750, according to an amendment to the bill that was sponsored by Gary Miller (Republican of California), Dennis Cardoza (Democrat of California) and Barney Frank (Democrat of Massachusetts).

The bill would also extend the term of the FHA mortgage in some cases from 35 to 40 years and allow FHA to insure certain loans with no down payment. It would also allow FHA to use risk-based pricing when setting its mortgage insurance premiums, and it would increase the number of reverse mortgages that lenders may write.

A great deal of attention was paid to a provision that would require increased counseling for mortgage borrowers to make sure they know what they are getting into and how to get the most from their loan… and how to avoid foreclosure.

INSIDE

New Legislation That Will Bring Help

H.R. 3648

The "Mortgage Forgiveness Debt Relief Act of 2007," passed by the House Ways and Means Committee and then by the full House, would

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abandon taxation of debt relief in most "short sales" or foreclosures in which the existing indebtedness to the lender(s) is not fully paid off. Financial duress must be involved. Many in the real estate industry have long sought to change the tax practice of treating the "shortfall" as taxable income in a sale that doesn't cover the entire remaining mortgage debt. If a homeowner transacts to sell his home and $20,000, for example, of the remaining loan balance isn't paid off in the transaction (with the lender's agreement), the seller currently becomes responsible for taxes on that $20,000 of debt relief. This bill would change that.

The legislation would also extend the tax treatment of premiums paid on mortgage insurance to 2014; they are currently deductible, but only if paid in 2007. The change regarding taxation of shortfalls in repayment of existing mortgage debt would be permanent, though the Bush Administration is asking for the bill to expire within a few years.

Congress now, under its Pay-As-You-Go rules, stipulates that money needed for changes of this sort must be found before the bill can be passed. The House, which sought to pay for the bill with minor changes to corporate estimated tax rates and further changes to the tax treatment of houses converted into primary residences, is already out of synch with the likely wishes of the Senate. We will watch closely what develops in the course of reconciling House and Senate proposals.

DEDUCTING BUSINESS USE OF AUTOMOBILE

"The IRS standard mileage rate (48.5 cents per mile for 2007) allows you to claim a deduction for the car or truck expenses on business trips without regard to actual vehicle operating costs. However, the allowance does not do away with the need to keep records. In addition to keeping track of your mileage, you must also have records documenting the business purpose of the trips if the IRS questions your deduction." [*J.K.Lasser's™ Monthly Tax Letter*]

H.R. 3915

The"Mortgage Reform and Anti-Predatory Lending Act of 2007," sponsored by Barney Frank and others, stirred up a hornet's nest of opposition, not because every aspect of the bill was disliked, but because one aspect—the potential elimination of Yield Spread Premiums (YSPs) in transactions (more on this in a moment)—threatened much of the good that mortgage brokers can do for their clients and, crucially, also threatened their income.

Much of H.R. 3915 deals in ways the lending industry endorses regarding problems that haven't yet been resolved—the way in which mortgage lenders should be licensed, for example, with regulations and standards that are the same throughout the industry. The bill also normalizes and requires a set of disclosures to borrowers about fees and about the loans they are contemplating. As with H.R. 1852, the bill demands that classes or instruction be given to borrowers so that they will understand how their mortgage loans work and the obligations they may be taking on.

At issue was a provision which, through an amendment approved by Congressman Frank, eventually became acceptable to the mortgage industry, that would have eliminated the mortgage broker's ability to take fees not only at the "front end" of a transaction from the borrowers but also at the "back end" from the lender for whom the broker helps originate the loan. Specifically, the mortgage broker might be able to get a specific loan at, say, 6.25% (wholesale) whereas a private borrower could only obtain the loan at the retail rate of 6.5%. If the borrower accepts the loan from the mortgage broker at the retail 6.5%, the broker generally receives a fee (YSP) from the lender in question for the amount over 6.25%. That fee very often serves two crucial purposes—because the broker may use part of it to pay for some of the borrower's up-front origination fees, thus minimizing any out-of-pocket expense for the borrower, and part of it to add needed profit to the deal for the broker, who would make only minimal profit from a deal with little to no up-front payment from the borrower.

The Frank amendment restored YSP—except when

it is clearly the result of manipulative activity on the part of the mortgage broker, with the borrower gaining nothing, and possibly losing, because of agreeing to the broker's YSP when a less expensive or better loan could have been found. Note that the law already requires that the YSP, as with all fees, be disclosed to the borrower in full.

The FHASecure Program

This is not pending legislation. It is a current program created by the Federal Housing Authority. Unfortunately, as it is now written, the program helps precious few homeowners, but those who may face an impending rate hike on their ARM loan will still want to look at it closely.

The program allows a borrower with an ARM (usually subprime) that adjusts its rate between December 2005 and December 2009 to convert the ARM to a fixed-rate FHA loan—that is, a homeowner with a stable employment history and enough income to meet the payments if the loan is converted to a fixed-rate FHA loan, with at least 3% equity in the home, and a payment history without defaults or late payments.

The website for this loan (www.fhasecure-loan.com/) contains the following explanation from Assistant Secretary for Housing-FHA Commissioner Brian Montgomery: "FHASecure is designed for families who are good borrowers but were steered into high-cost loans with teaser rates. These homeowners, many of whom are minorities, need a safe, affordable mortgage product that will help build wealth. All FHA borrowers pay mortgage insurance premiums to offset claims to the FHA insurance fund and ultimately prevent risk to the taxpayer."

The problem, of course, is that—until H.R. 1852 is passed, the limits on the size of FHA loans will keep far too many borrowers from using this program to help them avoid the pitfalls of unexpectedly high adjustments to their subprime ARMs. But we are moving in the right direction here.

HOUSING MARKET OVERVIEW

"Total existing-home sales–including single-family, townhomes, condominiums and co-ops–eased by 1.2 percent to a seasonally adjusted annual rate of 4.97 million units in October from a downwardly revised level of 5.03 million in September, and are 20.7 percent below the 6.27 million-unit pace in September 2006.5.48 million in August, and are 19.1 percent below the 6.23 million-unit level in September 2006." [National Association of Realtors®]

What Is The Importance Of All This?

We can follow as Congress makes its earliest attempts at eliminating the possibility of future problems from subprime-type loans and ameliorating the problems already created. The bad news is that these pieces of legislation tend to find someone or some group to pin the blame for today's problems on, and this is nearly always a gross overgeneralization that backfires in the face of reality. The problems are complex and not available to simplified solutions that often hurt the very homeowners they are trying to help.

However, we are seeing solid steps toward transparency and clarity in financing, and they are likely to help generate new loan programs that more fully meet the needs of today's borrowers and of tomorrow's real estate market.

Progress Is Being Made

If we imagine, by way of comparison, that we are looking at early revisions of the airplane, we can see that progress is being made, and the market should be flying sturdily with well-designed loans relatively soon. There is not enough awareness, perhaps, that the task requires a thorough rethinking of real estate financing—developing financing whose primary purpose is to help homebuyers, not to enrich Wall Street financial corporations and their investors—then we can move toward more specifically appropriate loan instruments that work both for the bank and the borrower, and that extend homeownership more successfully to those capable borrowers with less than stellar credit records whom the subprime loans sought to assist in the first place.

It can be done. Reasonably good starts are being made.

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Dear Friends:

For exceptional service and for answers to today's real estate questions, please call today!

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A vast amount of ink is being invested in the on-going real estate story in the media, most of it finding someone or something to blame for today's market "meltdown," and almost all of it remarkably negative in tone and topic. It is the sort of "news" that our newspapers, magazines, television and radio programs seem to thrive on.

In this environment, our legislators are attempting to find ways of making certain the real estate market becomes safer for the homebuyers and homesellers it serves. Here, too, there is an inclination to assign blame where, if anything, "blame" can be spread far and wide. Most people saw opportunity in the recent boom. Some gained greatly from it. A smaller but very visible percentage also abused the opportunity, leaving us with plentiful cleaning up of ill-starred financing to do.

The news media, meantime, are missing the inevitable opportunities and revolutionary changes in real estate that a stunningly creative society such as ours is already working on. It isn't time to gaze longingly at the past. It's time to look for the innovations of the future, and to become a part of them.

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