pressdemocrat.com

REAL ESTATE

Rising rates inspire lender creativity

By MICHAEL COIT
THE PRESS DEMOCRAT

Published: Sunday, March 26, 2006 at 3:00 a.m.

Rising interest rates are cooling the housing market this year, hitting hardest buyers who relied on adjustable-rate loans to stretch financially and get into ever more expensive homes.

Interest-only loans should remain popular because they reduce monthly mortgage payments. More buyers also are turning back to 30-year, fixed-rate loans because adjustable-rate loans no longer offer significant cost savings, lenders said.

Loans featuring even lower, minimum payment options have been increasingly popular. More buyers also are taking out 40-year mortgages to keep down monthly payments.

"Now it's getting harder to qualify buyers. We had to figure out a way to get them into that property," said Joan Picard, senior loan officer for Cal-Bay Mortgage in Santa Rosa and president of the Redwood Empire Mortgage Lenders Association.

The lending industry has been creative in coming up with loan programs to help buyers stay in expensive housing markets such as Sonoma County.

Adjustable-rate mortgages accounted for nearly 70 percent of all new purchase loans in the county last year, compared with 15 percent in 2001. Interest-only loans accounted for about half of all home purchase loans last year, compared with 2 percent in 2001, according to LoanPerformance, a mortgage information company.

Most popular have been interest-only loans featuring lower, adjustable rates that are fixed for an initial period, often 3 or 5 years. Buyers get lower monthly payments and count on rising home values to build equity rather than paying down mortgages.

Before the interest rates become adjustable, they plan to sell or refinance into a longer-term loan with a better, fixed rate.

But those initial rates are no longer a great deal. A year ago, such an interest-only loan would feature rates 1.5 to 2 percent under that for a 30-year, fixed-rate loan. That spread has disappeared.

Buyers could find it increasingly difficult to qualify for a loan with a rate in the low 6 percent range, compared with rates in the low 5 percent range a year ago.

Federal money managers have been raising short-term interest rates to keep inflation in check. Those hikes have pushed up adjustable-rate mortgages, but longer term, fixed-rate loans have been largely unaffected.

"We're in the process of converting a lot of people who have adjustable-rate loans. I think the 30-year, interest-only loan is probably the vehicle of choice," said Dale DeGennaro, president of the North Bay Chapter of the California Association of Mortgage Brokers.

Lenders report a resurgent refinance market as more homeowners get out of various adjustable-rate mortgages to lock in today's rates long term.

"The past three to four months have been some of the best volume in mortgages we've seen in a long time," said Brett Martinez, chief executive of Redwood Credit Union in Santa Rosa, the North Bay's largest credit union.

While there has been a slowing in purchase lending, Martinez said it's not dramatic.

To help more people get into homes, Redwood Credit Union is offering two new adjustable-rate mortgages promoted by the credit union industry.

One resets the interest rate every two years. Another is fixed for three years at 1 percent below the national rate for similar loans.

Loans offering monthly payment options have soared in popularity in the past year when buyers faced double-digit annual home price increases.

The main attraction is a minimum payment option that doesn't even cover the monthly interest due, also known as negative amortization. This loan's other options range from interest-only and 30-year principal and interest payments to a 15-year principal and interest payment.

But buyers must be comfortable with a loan, particularly if they are making minimum or interest-only payments or face sticker shock when interest rates rise, lenders said.

"Does the buyer fully understand the loan they're getting? That's my job," Picard said.

The latest addition to the menu of loan choices is the 40-year loan. It reduces monthly payments by amortizing a loan over an even longer period than the traditional 30-year loan.

"The 40-year loan reduces their short-term monthly payments. The benefit over interest-only loans is that it enables the borrower to pay down principle, avoiding deferred interest," said Scott Sheldon, a mortgage advisor with Financial Company of America.

You can reach Staff Writer Michael Coit at 521-5470 or mcoit@pressdemocrat.com.