Finding a Mortgage in Tougher Times

Turmoil in Subprime Market Hits Home as Terms Tighten
For Some Borrowers; Better Deals for the Prime Segment

By JANE J. KIM
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Just two days before Shari Scott and her family were supposed to move into their new home, her loan officer at New Century Financial Corp. called her with some bad news: The company wasn't going to be able to lend her the money for her mortgage after all.

"I literally stopped the car and threw up," says the 30-year-old accountant from Burleson, Texas, who got the news on her cell phone while driving home from work this month. By that point, she already had the mortgage title papers in hand and was supposed to close on the loan the next day. "Homeless was the first thing that went through my mind," she says.

Ms. Scott's plight shows how the turmoil on Wall Street is hitting Main Street. Fears about defaults have slowed the flow of investments to riskier segments of the mortgage market, which has dried up the amount of money available for loans to riskier borrowers. As a result, some mortgage companies such as New Century Financial are halting new loans to borrowers with blemished credit histories, while others are tightening lending standards. Some lenders are backing out of loan agreements, leaving borrowers scrambling for more expensive financing. Ms. Scott was able to arrange a new subprime mortgage, but the monthly payment was several hundred dollars more than the New Century loan. A New Century spokeswoman declined to comment.

For prime borrowers, or those with the best credit, finding a mortgage may actually have gotten easier, and the loans more affordable. Declining yields on Treasury bonds have pushed down rates on 30-year fixed-rate mortgages to about 6.3% currently from about 6.5% early last month, according to HSH Associates. Lenders may be willing to negotiate an even better deal for the best borrowers.

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Meanwhile, borrowers in the gray area between prime and subprime, a category known as Alt-A, are encountering tighter lending standards, as are buyers of investment properties. "Four or five months ago, I could get a loan for zero down," says Howard Shatsky of Los Angeles, who has been trying to secure financing for a real-estate investment. "It makes it hard for somebody without a very high credit score to get a loan," he says. "Right now, I'm a little nervous."

The turmoil that began in the subprime sector has changed the dynamics of getting a mortgage and, coupled with flattening home prices, is squeezing many consumers' finances. Here's what the shakeout means for borrowers across the credit spectrum.

Subprime Borrowers with weak credit are having the greatest difficulty finding loans. Many cash-strapped borrowers are getting shut out of the market as lenders drop products, such as no-down-

payment loans that carry little, if any, documentation of income, assets or employment. Other borrowers are now being required to pony up money for a down payment or to boost their credit scores.

Patrick McCarroll, a mortgage banker in Fort Worth, Texas, says he has been inundated with notices from subprime lenders in recent weeks that are suddenly dropping loans and changing terms. Many are now requiring a 5% to 10% down payment on loans that previously required none and a higher credit score in order to qualify, he says.

"If borrowers can't afford to put any money down, they should stay out of the market," says Mitch Ohlbaum, a mortgage broker in Los Angeles. "You're going to get so badly beat up on the rates and terms."

Borrowers who can find a loan are likely to pay interest rates that are several percentage points higher than they were a few weeks ago, brokers say. Adam Stein, a mortgage broker in Auburn, Wash., says that while he was able to find new financing for two clients after their loan agreements collapsed, the terms on the new loans are less favorable. "While I might have had at least five lenders competing for their business before, now I'm lucky if I can find one," he says.

There are a number of ways to gauge a borrower's credit scores, but the most widely used is the FICO score developed by Fair Isaac Corp. (Visit myfico.com for more details.) The best mortgage rates are offered to prime borrowers with scores typically of 720 or more. Subprime borrowers often have scores below 620, while many of the newer nontraditional loans are aimed at those Alt-A borrowers with credit scores between 620 and 700.

It's not just low-income borrowers who are getting caught by problems in the subprime market. Borrowers with higher incomes can also have scuffed credit. In recent years, many Americans took out adjustable-rate mortgages that often carry a low teaser rate that rises sharply after two or three years, to buy properties they expected would rise in value, allowing them to sell before the rate adjusted. Many of these loans came with inducements -- such as little or no down-payment requirement -- to make a mortgage more attractive.

Vicky Pierce of Plano, Texas, took out an ARM in 2003 with a fixed rate of 6.5% for three years on a rental property. "I really didn't expect that we would have that property very long," she says. "Our hope was that the market would appreciate and we'd sell it within three years." But an expensive divorce that dinged her credit score derailed her plans. Because she had pulled cash out of the loan, she had very little equity in the property, making it hard to sell the property without losing money.

Now, after the rate on her loan reset last fall to 8.5%, her monthly payments are $400 higher and she expects the payments will jump by another $400 in May. Ms. Pierce is trying, so far unsuccessfully, to sell the rental property. Her backup plan: Sell her main residence and move to a smaller home.

Shifting Strategies for Home Buyers

The problems roiling the subprime mortgage market have changed the dynamics of getting a home loan for risky borrowers, customers with stellar credit, and those in between. Here's what to expect if you are shopping around for a loan:

Type of Loan	What's Changed	What You Can Do
Subprime loans	Lenders are dropping many of their no-money-down loans that carry little, if any, documentation of income or assets.	■ Consider mortgages backed by the Federal Housing Administration. Rates on FHA-insured loans are generally lower than average subprime rates, although consumers will have to document their income, make a 3% down payment and pay mortgage-insurance premiums. Find an FHA-approved lender by calling 1-800-Call-FHA. ■ Since many lenders are tightening their standards, improving your credit score is crucial.
Prime	Mortgage rates for prime borrowers have dipped in recent weeks as Treasury bond yields have declined.	■ Borrowers with adjustable-rate mortgages that are about to reset should consider refinancing into a standard fixed-rate loan. ■ Compare terms among multiple banks and brokers. Since more lenders are competing for borrowers with strong credit, you may be able to negotiate a better deal.
Alt-A*	Lenders are tightening their standards for these mid-tier borrowers. They are looking for customers with higher credit scores who can afford bigger down payments.	■ As lenders tighten their standards on many nontraditional loans, improving your credit score is crucial. Try to boost your credit grade at least six months before applying for a mortgage. ■ Be prepared to make at least a 5% to 10% down payment and document your income and assets.

*A catch-all category that includes many nontraditional loans

Source: WSJ research

One alternative for some subprime borrowers is to consider a loan insured by the Federal Housing Administration, a government agency that helps low- and middle-income home buyers qualify for low-interest mortgages. The FHA, which offers lenders a guarantee that a loan will be repaid, requires borrowers to make a minimum down payment of at least 3% and pay mortgage-insurance premiums that could amount to as much as 2% of the loan.

Prime Borrowers with good credit looking for conventional loans, able to make a down payment and willing to document their income are being rewarded with lower rates. Big banks, such as *Bank of America* Corp. and *J.P. Morgan Chase* & Co.'s Chase Home Lending, say they are seeing substantial gains in new loan applications and refinancings amid the drop in mortgage rates in recent weeks and as buyers gear up for the spring selling season. "We think we may have gained some market share," says Bob Caruso, Bank of America's national servicing executive.

"If you have a credit score of at least 720, the lending pool increases dramatically," says Philip Tirone, a mortgage broker in Los Angeles, who is advising clients with the best credit and who have adjustable-rate mortgages to think about refinancing into a longer-term fixed-rate loan. "Since there are more lenders competing for your business, you'll be able to negotiate a better rate."

Alt-A

Some of the concerns hitting the subprime market are spreading upward to borrowers with mid-tier credit scores, and those who take out Alt-A loans, a catch-all category that includes many of the nontraditional loans that helped to fuel the housing boom, such as option ARMs and mortgages that carry little, if any, documentation of income or assets.

Now, lenders are dropping loans that provide 100% financing for borrowers in this category who aren't willing or able to document their income or assets. In notices sent to brokers this week, Capital One Financial Corp.'s Greenpoint Mortgage raised the minimum credit score and cut the maximum amount homeowners could borrow without documenting their income and assets on certain mortgages. Earlier this month, Countrywide Financial Corp. stopped offering borrowers the option of no-money-down home loans. Chase Home Lending reduced the maximum amount homeowners could borrow to 95% from 100% without documenting their income and assets last month.

Borrowers can boost their chances of getting a loan and a better rate by taking steps now to raise their credit scores. Consumers in the middle of closing either a subprime or Alt-A mortgage should also ask their agent to extend any contingencies -- a standard clause that allows them to back out of a deal if they cannot sell their current home or obtain financing -- until the loan is closed, brokers say. Otherwise, borrowers could be at risk of losing their deposits.