

Getting a Mortgage in 2010

More than three years into a painful housing crash, the real estate market has sent recent—albeit tentative—signs of stabilization. Home sales have increased, inventory levels are down, and price declines have become less precipitous. Along with more affordable home prices and attractive mortgage rates—which remained below 5 percent as of late June—have been a driving force behind this development. The availability of low mortgage rates will play a decisive role in the performance of the 2010 housing market as well. To help consumers better understand the requirements and costs they will face as they shop for a home loan next year, *U.S. News* spoke with a handful of housing market experts and compiled a list of 10 things to know about getting a mortgage in 2010.

1. Still tight: The steep run-up in home prices during the first half of the decade was fueled in large part by breezy lending standards. Some bankers handed out loans without down payments or documentation requirements. But when the housing bubble popped and those loans became massive losses, banks began raising lending standards for borrowers of all stripes. And with the labor market continuing to erode—the unemployment rate hit 10.2 percent in October—and mortgage delinquency rates setting new records, there is no reason to expect credit requirements to loosen in 2010. “Lending standards have tightened dramatically between 2007 and 2009,” says Scott Stern, CEO of Lenders One, a cooperative of independent mortgage bankers. “I think there will be a little more belt-tightening in 2010.”

2. Down payments: This tight credit environment affects consumers in several ways. First, down payment requirements will be higher than they were just a few years ago. Loans backed by the Federal Housing Administration are at the low end of the spectrum and come with minimum down payments of 3.5 percent. (More on FHA loans below.) Down payments on loans outside of the FHA will vary depending on the market, the borrower, and the property type. “Generally, to get the best rate around, you need at least 20 percent for a down payment,” says Guy Cecala, publisher of *Inside Mortgage Finance*. “That doesn’t mean you can’t get a mortgage if you have less of a down payment . . . it just means that you are not going to get the best interest rates.” Could lenders ease up on down payment requirements in 2010? Possibly. If lenders become convinced that home prices are improving, they may allow borrowers to put slightly less down. But don’t expect that to occur until the end of the year—if at all.

3. Credit scores: Cecala says that borrowers will need a FICO score of at least 730 to get the best mortgage rates. They also will need to fully document their income and assets. To ensure that your credit score is as strong as possible, borrowers should access their credit reports. The Fair and Accurate Credit Transactions Act entitles consumers to one free credit report from all three major credit reporting bureaus—TransUnion, Equifax, and Experian—each year. (The free reports can be obtained at annualcreditreport.com.) Consumers should examine each report to make sure it doesn’t include any errors. “[Consumers] ought to know what their credit score is; they ought to know what’s on their credit report; they ought to make sure that what’s on their credit report is in fact theirs,” says Rick Allen, director of strategic initiatives for Mortgage Marvel, an online mortgage shopping website. “That’s a must do for everybody.”

4. FHA: Borrowers who can't meet these tighter lending requirements can turn to the FHA, a federal agency that insures mortgage loans against default. Standards for FHA loans are typically less onerous than those for private lenders. The average credit score for FHA borrowers is about 690, and the minimum down payment is 3.5 percent, Cecala says. "If you can't make the 730 [credit score] or you can't make the 20 percent down [payment], the next best thing is FHA," Cecala says. The downside is that FHA loans come with additional costs. Borrowers must pay an insurance premium as well as a slightly higher interest rate, Cecala says.

5. FHA increase? With so many borrowers unable to meet today's stricter lending requirements, FHA-backed loans have become increasingly popular. Today, the FHA guarantees nearly 3 of every 10 new home mortgages. That's a stunning increase from 2006, when the agency backed roughly 3 percent of new home loans. Meanwhile, the agency's finances have deteriorated considerably. The seasonally adjusted delinquency rate for FHA loans increased from about 13 percent in the third quarter of last year to 14.36 percent in this year's third quarter. At the same time, the agency's capital reserve ratio dipped below the level that Congress mandates. In the face of mounting political pressure, the Obama administration has announced new steps that may make it more difficult for some borrowers to obtain mortgages backed by the agency. The steps include raising the minimum FICO score, increasing up-front cash requirements, and possibly charging higher insurance premiums. "We want to ensure that we are able to continue to support the housing market in the short term and provide access to homeownership over the long-term, while minimizing the risk to the American taxpayer," Housing and Urban Development Secretary Shaun Donovan told a congressional committee in written testimony.

6. Asset purchase program: Mortgage rates in 2010 are expected to climb from 2009's extremely low levels. After the Federal Reserve announced plans to purchase debt and mortgage-backed securities from Fannie Mae and Freddie Mac last year, rates on 30-year fixed conforming mortgages fell to historic lows, plunging to 4.97 percent in late November from 6.19 a year earlier. But the Fed's asset purchase program is scheduled to expire at the end of the first quarter of 2010, and a lack of private demand for mortgage-backed securities could lead to higher rates. Keep in mind that the Fed has already extended this program once. And if it appears that the market needs additional government support to keep rates low, the Fed could always decide to remain in the market. Keith Gumbinger of HSH.com expects rates to increase from current levels to between 5 and 5.25 percent by the end of March 2010.

7. Jumbo mortgages: Rates on more expensive home loans—or jumbo mortgages—have dropped to extremely attractive levels, hitting 5.88 percent in the week that ended November 27. "That ranks with all-time bests," Gumbinger says. But while he expects rates on jumbo mortgages to remain historically attractive throughout 2010, many borrowers won't be able to obtain them. That's because most banks have to keep jumbo mortgages on their books and therefore apply much stricter lending standards to them. (Smaller conforming loans can be sold off to Fannie and Freddie.) "Your down payment requirements [for jumbo mortgages] are anywhere between 40 percent down to 20 percent down, depending upon what is happening in your marketplace," Gumbinger says. "You may have to show superhuman strength in terms of credit, [and] you may have to show extraordinary income size."

8. Fed rate hike: In attempting to jump-start the economy, the Fed has slashed its benchmark federal funds rate to as low as zero percent. And even as some express concerns about future inflation, the central bank in early November said that economic conditions were “likely to warrant exceptionally low levels of the federal funds rate for an extended period.” As such, economists don’t expect the Fed to raise rates anytime soon. “The statement does not lead us to change our view that the Fed will keep rates unchanged until the September 2010 meeting, when we expect the first rate hike,” Dean Maki of Barclays Capital Research said in a report. But while an increased federal funds rate could push rates on certain products—such as adjustable rate mortgages or home equity lines of credit—higher, it has little direct influence on fixed mortgage rates.

9. Recovery: A recovery in the U.S. economy may also lead to increased mortgage costs. That’s because economic improvement could create more demand for credit, which pushes rates higher. At the same time, a recovery could embolden investors to move money out of ultra safe assets like 10-year treasuries and into more risky investments. And since 30-year fixed mortgage rates tend to track the yield on the 10-year treasury note, such a development would put upward pressure on mortgage rates. Gumbinger says that economic improvement and other factors could push rates on 30-year fixed mortgages as high as 5.75 percent by midsummer. “After that, you are going to be at the whims of the economy,” he says.

10. Fannie and Freddie’s future: A wild card in the outlook for mortgage rates is the administration’s plans for Fannie and Freddie. The two mortgage finance giants—which buy home loans from banks—are a key source of liquidity for the market. The government-chartered companies have long been controversial, and speculation about their future has been mounting since their shaky finances forced Uncle Sam to take over last year. The administration’s plans for their future—which could include liquidation or converting them to public utilities—could become clearer in early 2010. This decision could have profound implications for mortgage rates, Gumbinger says. “We could have some dislocations in the supply chains with mortgages depending upon how immediate or how gradual the changes to the structures of those companies are,” he says.

Note: Please be aware that the above information is believed to be accurate as of this writing, July 12, 2010, but mortgage guidelines are consistently changing and a mortgage professional should be consulted for accuracy.