A new era of ‘vanilla’ financing

Lending gets back to basics

by Megan Rawlins

While the housing market nationwide may be in crisis, locally things are just a tad slower than usual, with fewer houses on the market selling at a steady clip.

Local Realtors and mortgage officers see a disconnect between the flashy headlines and the reality of the Palo Alto market.

Despite the strength of the local market, there are still some trickle-down effects that buyers simply can’t escape, Eric Trailer, a partner at Absolute Mortgage Banking, Palo Alto, said.

“The biggest fallout of the credit crunch or whatever happens to be the term du jour,” he said, “is that lending standards have tightened up dramatically.”

Lending institutions are increasingly cautious about whom they lend money to, requiring more documentation, more money down and better credit scores from borrowers.

“A year ago you could buy a 1.5 mil house for no money down,” Arash Bahman, mortgage loan officer for Bank of America, Palo Alto, said. “Now you need 35 percent. You also need a better credit score. For houses in Palo Alto you need a 700 credit score.”

For people who fit that bill, they can get a loan, but if they don’t, if they’re self-employed or don’t have the cash, lenders won’t want to do business with them. Consequently, Bahman said, volume for lenders is down.

The disconnect can cut both ways. The recent government takeover of Fannie Mae and Freddie Mac has seen a subsequent drop in interest rates for conforming and jumbo-conforming loans, which top out at $729,750.

According to the Silicon Valley Association of Realtors (SILVAR), the median home in Palo Alto was selling for around $1.6 million dollars for the first half of 2008.

“At this price,” said Trailer, “for most of the buyers we see in Palo Alto and surrounding areas, even a jumbo-conforming mortgage is too small.”

Loans that are eligible for purchase by the two government-secured entities are seen by Wall Street as less-risky investments, as more attractive to investors and thus easier to sell as mortgage-backed securities. All of this, with the now explicit backing of the government thrown in, makes them much cheaper than other loans, namely jumbo loans.

“The jumbo market is not benefiting from what the government is doing,” Trailer said. Most buyers in this area simply don’t fall under the purview of Fannie Mae and Freddie Mac.

The take-home message, according to Yulin Lee, mortgage advisor for Opes Advisors, Palo Alto, is a return to “vanilla financing,” conventional and hyper-conservative.

“We’re going back to the traditional ways of doing things,” she said, “as opposed to the creative ways we’ve seen in the last few years.”

As lenders become more traditional, borrowers might have to become more creative.

Banks now require firm documentation of income, a

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Colleen Cummins

Eric Trailer

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development that seems completely logical when a multi-million dollar mortgage hangs in the balance. But stated-income loans were not only for people who wanted houses larger than they could afford; they were often the only way the self-employed could get loans.

"People who would have been eligible for stated-income loans are having a hard time getting loans," Trailer said. "Many people in this area are self-employed, and they can't accurately document their true income or wealth."

Others can afford mortgage payments, but don't have enough savings for the 20 to 25 percent down that is now required.

These potential buyers can afford a home, but can't get a traditional loan, so some turn to less-conventional forms of financing like hard money loans, seller-financed transactions, even gifts from family.

Hard money loans are high-interest-rate loans based purely on the value of the property, not the equity of the borrower. The rates are generally in the 12 to 15 percent range, but sometimes reach as high as 20 percent. They are short-term, bridge loans, bridging the gap between what a bank will lend and what a borrower needs.

"Hard money loans are easier to get," Trailer said, "and if you can stomach the terms, then you might go that way."

Lee and Trailer both said they have been seeing more hard money and bridge loans, especially in situations when a client needs to purchase a home before the sale of his or her previous home has closed.

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"A client might use the bridge loan to buy the home until they sell their home," Lee said, "and then they'll refinance and pay off the more expensive loan."

There has also been a small uptick in down-payment gifts from relatives and seller-assisted financing, both of which require careful consideration of the specific circumstances from both parties.

Mortgage officers and brokers are taking a much more individualized and holistic approach to advising home buyers, urging them towards a more traditional, pre-housing-bubble mindset.

"One of the biggest obstacles," Palo Alto Keller Williams real estate agent Chris Iverson said, "is that we have a short attention span; we have come to see houses as investments rather than homes. We have to change the mentality and mindset. Homes are not liquid, they are not like stocks; it is a roof over your head and a neighborhood and lifestyle."

"The current market has scared people, and they are very receptive to big-picture thinking," Lee said. "How does buying this property fit into the overall financial picture of where you want to be five to 10 years down the road?"

But, Iverson said, "Even if prices do fall, you are better off buying something now. The cost of getting a mortgage is going up. The Fed is getting more concerned about inflation and will probably raise interest rates. So rates will go up, and mortgage payments will go up as well. But if you pay a little more now, and get a better rate, you will be ahead financially." ■

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