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Are No Cost Mortgages Going Extinct?

Ann Arbor, MI January 8, 2009 – Throughout the mortgage refinance booms of the last 10 years, many homeowners benefited from “no closing cost” mortgages. “This was due to the fact that mortgage brokers and bankers had sufficient flexibility when pricing mortgages to charge a slightly higher interest rate, make a bigger commission from their lenders, and use the bigger commission to pay the borrower’s closing costs,” said Gibran Nicholas, Chairman of the CMPS Institute, an organization that certifies mortgage bankers and brokers. The process worked something like this:

Offer #1:

- 7% = Your current interest rate on a \$200,000 mortgage
- 6.25% = The interest rate you would pay if your broker or banker made a 1% commission (\$2,000) and you paid \$2,000 in closing costs (appraisal, title insurance, etc.)
- You experience a savings of \$99 per month (\$1,231 new monthly payment at 6.25% vs. \$1330 old monthly payment at 7%)

Offer #2:

- 7% = Your current interest rate on a \$200,000 mortgage
- 6.5% = The interest rate you would pay if your broker or banker made a 2% commission (\$4,000) and paid \$2,000 in closing costs on your behalf (appraisal, title insurance, etc.)
- You experience a savings of \$66 per month (\$1,264 new monthly payment at 6.5% vs. \$1330 old monthly payment at 7%)

With offer #1, you would have paid \$2,000 upfront to save \$99/month. With offer #2, you would have paid nothing to save \$66 per month. Offer #2 would have clearly been the better deal in most cases, because you could refinance as often as rates dropped without it costing you a single penny. A lot of homeowners saved a lot of money using this strategy. For example, if interest rates were 7% at the time you bought your home, you could easily refinance to 6% or 6.5% when rates dropped and it wouldn’t cost you anything to do so. If you refinanced at 6% or 6.5%, you could refinance yet again when rates dropped to 5.5% and still it didn’t cost you anything.

“This was effectively a risk-free strategy for homeowners, because you could enjoy the benefits of a fixed interest rate AND save money whenever rates dropped without it costing you any money,” Nicholas said. “However, lenders today are severely limiting the commissions they give to mortgage brokers and bankers. This means the mortgage professional you are working with has much less flexibility than they enjoyed in the past when pricing loans and negotiating with funding sources.”

A big part of this has to do with the malfunctioning market for mortgage backed securities (bonds that are issued on the bond market by Fannie Mae, Freddie Mac and other financial institutions that buy loans from banks and mortgage companies). “In the past, demand for mortgage-related bonds issued by Fannie, Freddie and other institutions was so strong, that these institutions were willing to pay higher premiums when buying mortgages from banks and mortgage companies,” Nicholas explained. “The banks and mortgage companies were then able to use these higher premiums to pay bigger commissions to their bankers and brokers. These higher prices and commissions could then be used by the broker or banker to pay your closing costs.”

Now that Fannie, Freddie and other financial institutions are unable to sell bonds as easily on the bond market, they are paying banks and mortgage companies a much lower price for the mortgages they do buy from them, and severely limiting the tiered premium structures of the past. This, in turn, is causing banks and mortgage companies to limit the commissions they pay to their brokers and bankers, which means brokers and bankers no longer have the flexibility to price loans in ways that allow them to pay your closing costs.

Of course, this situation could change if the Fed’s program to purchase \$600 billion of mortgage-related bonds is enough of a catalyst to jumpstart demand for mortgage bonds in the marketplace. “Although there are some signs of premium pricing improving slightly compared to the last several weeks, it is still unclear at this point what effect the Fed’s interventions will have on the way mortgage loans are priced,” Nicholas said. “It’s becoming rather comical to watch the rate sheets every day and witness the bizarre pricing movements.” With these things in mind, it is more important than ever before for you to work with a Certified Mortgage Planning Specialist who is tuned into rapidly changing market conditions and can help you understand and evaluate your options in this turbulent environment.

About CMPS Institute: CMPS is a training, examination, certification and ongoing membership program for financial professionals who provide mortgage and real estate equity advice. Recognized for its preeminence within the industry, the CMPS curriculum represents the core knowledge expected of residential mortgage advisors regardless of the diversity of specializations within the industry. Over 5,500 financial professionals have gone through the program since its launch in 2005. For more information or to find a certified professional near you, please visit www.CMPSInstitute.org or call 888.608.9800.

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