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## Four-step solution to housing crisis

East Bay Business Times - by [Bill Aboumrad](#)

The housing crisis has reached dire proportions with seemingly no end in sight. There is a four-step solution to the mortgage problems caused by poor lending practices.

From December 2007 through the end of May this year, 7,087 Alameda County residents and 9,387 Contra Costa County residents received notices of default from their lenders, according to [ForeclosureRadar.com](#), in Discovery Bay. Put in perspective from a year ago (May to May), that's a 259 percent increase of default notices in Alameda County and a 310 percent increase in Contra Costa County.

These defaults can be avoided if the banks holding and servicing the loans are willing to change the way they do business and begin working with their customers. The problem with the vast majority of loans going into default is that consumers cannot afford the new monthly rates that are re-setting at current, higher rates. For example, a borrower emerging from a period of fixed and very low "teaser" rates is likely to experience a sudden 2.5 percent to 3 percent increase in the borrowing rate. Take a "current" \$500,000, 30-year loan at 5 percent interest and the monthly payment would be \$2,685. At the reset and new rates of approximately 8 percent interest, that same 30-year note would cost consumers \$3,670 a month. Who can afford a \$1,000 increase in one month?

1. Banks should consolidate the separate functions of loan modifications, short sales and foreclosures. By establishing a "Loss Mitigation Department," the hard-nosed "short sale" managers could be more accommodating on the front end of a workout and reduce the number of foreclosures that the real estate-owned (REO) department later inherits. And by the time a home is foreclosed on, its value is greatly reduced from its status as a short sale.
2. Allow borrowers to keep original "teaser" rates a little longer, and then gradually and incrementally raise rates (perhaps 1 percent a year). Due to financial market conditions, borrowers that took out loans from 2003-2005 have experienced first-year increases of 2.5 percent or more after the teaser rate period expired. Banks should view the lower, 1 percent increase as a preservation mechanism to lock in the original "asset" they acquired, namely, a performing loan vs. a non-performing loan.
3. Banks should adjust the amortization schedule of 30-year notes to 40-year notes. Take the earlier example of the \$500,000 mortgage with an original 5 percent interest rate (\$2,685 a month),

increase the rate one point to 6 percent and modify the amortization schedule to 40 years, and that same home owner would pay \$2,750 a month, or only a \$65 monthly increase from the original loan. Homeowners that remain employed and want to stay in their homes can afford modest increases.

4. Tie the modified loans to 10-year balloon payments, with loans to be paid in full or restructured by the end of the term. Popular in the 1980s when interest rates reached 18 percent, balloon payments give consumers an extended period in which homes can appreciate in value, while at the same time provide banks with assets that are more valuable than the adjustable rate loans they have funded in recent years.

Restructured or modified loans are not new loans requiring loads of documentation and new fees. A workout is simply an addendum to an original mortgage and coordinated with the bank that is servicing the loan. Property titles don't have to be changed. Lenders just have to verify borrower information (like employment, income) and restructure loans to reflect new interest rates, a revised amortization schedule and payout period.

Homeowners that want to stay in their homes and are at risk of mortgage default should call their lenders and ask for loan modifications. Banks should change the way they manage their loan portfolios. We can stop the hemorrhaging in the housing and financial markets if we take these steps to solve existing problems.

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