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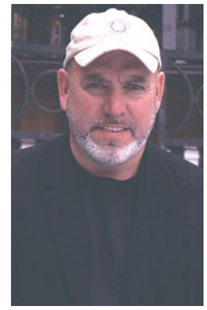

Michael A. Covino,
President

Ask MAC

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Q Are prices on multi-million dollar homes starting to soften and what concerns do you have for brokers and lenders as it pertains to transacting in this segment in a declining market should the recession continue?

This week's question submitted by:

Robert Quintero, International Mortgage Investors

A I certainly cannot predict how long the current recession will last. Some people do not think we are in a recession. For those of you that share that point of view, I ask you to ponder what a rise of 200 basis points in rates on mortgages (both ARMs and fixed) would do to property values and affordability indices. In short, the result would be devastating.

Perhaps the result would be a nationwide decline in housing prices of up to 20 percent. I think those hardest hit would be homes above $1 million. During the real estate bust in the late 1980's, million dollar homes throughout California lose 50% of their value in a 6 month period and those in other major metropolitan areas around the country lost 33% of their value. The values eventually came back over the next few years, but not before many lenders experienced huge losses and others simply bellied up. A telltale sign of a softening super jumbo market was an increase in marketing time, from 3-6 months to well over a year.

During the late 1980's, many lenders began lowering LTVs. Documentation for loans above $1 million became more cumbersome, guidelines were cut back and large money banks began eliminating multi-million dollar loan programs. Surviving loan programs experienced pricing spread increases of as much as 150-200 basis points above rates being charged for loans less than $1 million. These price increases were based solely on the perceived risk of the larger loan going bad. Does any of this sound familiar?

Most mortgage professionals believe today's low rates will not continue forever. A further rate decline is unlikely and a rate increase is probable in the near future. So my answer to your question is YES. Prices are beginning to soften and are likely to continue in the near future. Property values on high end homes have, for the most part, leveled off and they are taking longer to market. Credit guidelines are beginning to tighten and liquidity to this sector has already been affected by the recent exit of two national multi-billion dollar providers of super jumbo loans. Both lenders withdrew from offering loans above $1.5 million from their lending guidelines altogether. Unlike 13-14 years ago, when liquidity to this sector dried up overnight for as long as one year, I don't think the current retreat from this sector by lenders/investors will be as severe. For one thing, the market sector for these types of homes has increased more than five fold and, with that increase, has fostered the entrance of many more investors to this segment. I am confident that liquidity to this market will continue but that the loan documentation process will be become more traditional in nature. In this marketplace, if a borrower wants to borrow a few million dollars for a house he/she is going to have to demonstrate historical earnings to substantiate his/her ability to manage the debt. Asset profiles demonstrating diversification and savings history will become a more important basis for a lending decision than the LTV being advanced. Loan decisions will no longer be made based primarily on FICO score and LTV. We will return to the fundamentals of prudent lending. My advice to brokers looking to service this sector in the next two years is to become proficient in underwriting income documentation, such as tax returns and financial statements, as this skill will be absolutely necessary in the months ahead as the emphasis for lending to this sector swings from asset-based to borrower-based.