

The Mortgage Crunch: Lessons to Help Get Back on Track

Mary Rowland Personal Finance Column – November 2007

What will happen to homeowners, homebuyers, and those who have lost their homes as a result of the mortgage crunch of 2007? If we believe the hysteria coming out of the media, Americans may never be able to sell or buy another home—perhaps never be able to get out of debt. Beyond that, our country will soon be mired in a debilitating recession. If you're not suffering right this minute, don't get too comfortable. You soon will be.

But let's take this with a grain of salt. In *The New York Times* of Sunday, September 30, 2007, Alan S. Blinder, an economics professor at Princeton, wrote that we must figure out whose fault this problem is and then attempt to correct it and prevent it from happening again. He points to "Six Fingers of Blame in the Mortgage Mess."

I think this is baloney. Most financial disasters stem from two things: fear and greed. We cannot do much to prevent mortgage lenders or mortgage investors from becoming greedy when homebuyers seem ready to do whatever it takes to get money for a home. But now that we're in the midst of the storm, we can do our best to pull some lessons from it rather than become Chicken Little.

For Younger Members Starting Out

If you're thinking about the possibility of buying a home, get ready now. Time was when the first-time homebuyer was seen as a supplicant, someone begging for loan approval, ready to offer anything to get it. It's still important to clean up your debt, polish your credit rating and put some money aside for a down payment.

But what happened in the recent mortgage debacle was that mortgages were too easy to get. Mortgages were given to borrowers without proof of their income (called no-doc loans because they required no documentation.) You can't assume, going forward, that if a lender offers you a mortgage loan, you can afford to repay it. You must do your own homework. Keep track of spending. Monitor yourself. Pay your rent on time. Get out of debt. Begin to accumulate an emergency fund. Buying a house will be no fun if you must struggle to make the monthly payments and worry about losing your home.

For Mid-Career Members

You may be buying your first house—or even a "trade-up" model. You will want to educate yourself about the mortgage market to find the pitfalls and danger zones.

Over the past several years, lenders offered introductory mortgage rates that were extremely low, thanks to the easy money available from the federal government and the demand from investors for "mortgage-backed securities" or MBSs.

What this means is that mortgages, yours and many others, are packaged into large pools and then cut into sections, or *tranches*. This process is called "securitization" because individual mortgages are turned into securities that can be sold to numerous investors, spreading the risk. And because returns were so low on other fixed income products, many investors turned to the mortgage market to buy these newer securities, bringing so much demand for mortgage-backed securities that lenders pushed homebuyers to buy a house even if they couldn't afford it by offering incredibly attractive terms. For homebuyers whose credit history made them high risk, lenders offered "subprime mortgages," which means that the buyers pay much higher interest. When the Federal Reserve Bank began to tighten the money supply by raising interest rates, many new homeowners could no longer pay the escalating monthly payments.

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A lender will never ask you if you want a “subprime loan,” which costs more and often carries a “prepayment penalty,” which means you are not allowed to pay off the loan in advance of its term if, for example, you sell the home, unless you pay the penalty. You must find out for yourself if you are in one of these categories.

For Pre-Retired Members

You have probably been around and around in the housing market over your career, yet there’s always something new. Whatever new regulations are put in place now, they’ll likely apply to everyone without taking into consideration the fact that while some homebuyers may have used credit irresponsibly, others have used it wisely over several decades as homeowners.

Your home may have lost value when the housing bubble popped. You may have trouble getting a home equity loan because your mortgage lender has tightened up on the requirements or on the loan amount. If you were planning to make a move this year or next, you may need to postpone it until home prices stabilize and the market begins to function smoothly again.

For Retired Members

Look at this housing bust as an opportunity to make firm plans for your future. You have time to decide whether you want to sell your house when the market returns to the upswing again. Do you want to move to a smaller house or a condo? To a different part of the country? Or do you just want to stay put and pay off your mortgage?

Financial advisors often argue about whether investing in stocks gets a better return than paying off the mortgage. It may, depending on the market environment, but paying off your mortgage is more psychologically satisfying. One planner told me, “no client has ever been sorry for using their money to pay off the mortgage.”

Conclusion

The mortgage crunch is not over. We have not even addressed the problems of those who fear they cannot hold on to their homes. Yet few developments are irretrievably bad. We must look for the silver lining in the form of lessons to be learned that will guide us in the future.

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NEA Member Benefits has formed a partnership with the National Foundation for Credit Counseling (NFCC) to provide debt management and mortgage crisis counseling to NEA Members and their families either free or at very affordable rates. Visit www.neamb.com/debtadvice to locate a certified credit counselor in your area. For assistance and resources specific to the current mortgage crisis, go to www.housinghelpnow.org.

Mary Rowland is a nationally known business and finance writer. The former personal finance columnist for The New York Times and former co-host of a nationally syndicated radio show, Ms. Rowland is the author of several investment books and speaks regularly to consumers and financial planners about investing and personal finance.