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Change in Mortgage Standards Puts Columnist in Financial Crisis

By NANCY KEATES

This is the latest installment of Teardown Diary, columnist Nancy Keates's account of building a new home in Portland, Ore.

When my husband and I signed on to build a new house last March we anticipated we would run into problems with construction. Everyone does. But since we both had jobs, solid credit ratings and healthy savings, we didn't expect financing would be an issue.

In the current housing crisis, we find, it doesn't matter whether you made prudent financial decisions in the past: when the market changes, you are out of luck.

Since last year, while the price of building our home hasn't changed, interest rates on jumbo mortgages have gone up and the amount banks are willing to lend has shrunk. We may wind up getting less money at a higher rate and have to scramble for more cash. I'm having trouble sleeping at night, thinking about the shortfall. In the worst case scenario, even foreclosure isn't impossible – something I never would have imagined.

Before we tore down our house and started building a new one we signed an agreement with Wells Fargo called a Construction Perm Advantage loan: It is a loan that carries individual home builders from construction through the permanent financing, or home mortgage. The bank agreed to lend us the money we needed (I am not going to name the amount for privacy's sake) in two phases: A construction loan and a home mortgage that would also cover what we have left on our old mortgage.

Wells Fargo did a rigorous review of our finances, our contractor and our house plans – and then ordered an appraisal of the value of the house we planned to build. The bank even went as far as restricting the amount we could pay monthly for our rental house. The subsequent approval included enough money to make the project feasible for us. We came up with the remaining cash and closed with a title company.

It was tight, but, given interest rates at the time and our salaries, plus what we'd saved for ten years for a new house, we had enough in our accounts to handle what we calculated would be the monthly payments.

The construction portion of the loan was at a rate of prime plus one: 1% above the prime rate, as reported by The Wall Street Journal and based on the fed funds rate, which is set by the Federal Reserve. That's been a good thing for us, as the current prime rate is 3.25%, down from around 7.25% a year ago.

Three months before our construction is complete -- probably in March -- we are to notify Wells Fargo. At that point the bank commissions another appraisal of our newly built home and they can determine the rate for our permanent financing. In this case we haven't been so lucky.

Since last March interest rates for most home mortgages have come down. But the market for jumbo loans -- mortgages that exceed \$625,000 in Portland -- has not gone along for the ride. The secondary market for these kinds of loans is minimal since they don't qualify for purchase by Fannie Mae and Freddie Mac. That means banks that offer the larger loans are stuck with them in their portfolio -- they can't resell them.

The result: The average jumbo rate is 6.8%, according to Bankrate.com. That's almost two percentage points higher than so-called conforming loans, which qualify for purchase by Fannie and Freddie. Through most of this decade the spread was only about one-third of a percentage point.

The rules about credit scores when it comes to jumbo loans have also changed. Most banks have raised the credit score requirements for certain rates; some no longer even giving a jumbo loan to anyone with a credit score lower than 700. Our credit scores -- though above 700 -- will play a role in the loan rate we get.

We also won't be able to get as much money as Wells Fargo initially told us we would. The reason: the bank has raised its loan-to-value ratio requirements. The loan-to-value ratio or LTV is calculated by dividing the loan balance of a property by the market value and is expressed as a percentage. For example, a property with a loan balance of \$400,000 and a market value of \$500,000 has a Loan-to-Value Ratio of 80%.

We were approved for our two mortgages (the bank split it up into two pieces because it was so large) at a ratio of 70% for the first mortgage and 80% for the second mortgage. Now, Wells Fargo has tightened its requirements on second mortgages and we will only get a 75% LTV ratio, lowering the loan amount. We would need to come up with the extra cash -- probably more than \$100,000.

Worse, the amount Wells Fargo will lend us for our first mortgage could decline if they determine that the county we live in is in a certain level of distress or if the appraisal shows an actual decline in the value of our home. Housing prices in our neighborhood have been relatively stable throughout the downturn, although just recently they did decline a bit.

For advice, I called Daniel Shlufman, President of FCMC Mortgage Corp., which originates loans in New York, New Jersey, Florida and Pennsylvania. He said one way to reduce the impact of higher jumbo loan rates is to opt for an adjustable rate mortgage rather than a 30-year fixed mortgage. A five-year jumbo ARM is about 5% right now, a whole percentage point lower than a fixed jumbo, he says. (ARMs tend to have lower rates because they transfer some of the risk from the lender to the borrower.)

Mr. Shlufman also suggested looking outside the big, national banks like Wells Fargo to see what rates regional savings banks are offering. He says those smaller banks didn't traditionally resell their jumbo loans; they tend to be more willing to offer them and hold them in their portfolio. "You'll find a savings bank that's willing to do some loans. It might take some work but you'll find one," he says.

To find out about the lower housing values and changing lending guidelines I called Stuart Tyrie, of Wells Fargo Home Mortgage. He couldn't comment on my loan in particular, but he said the last thing anyone at Wells Fargo wants to see is another foreclosure. "The last thing we want is to foreclosure because no one wins in that situation. We work diligently with each customer to find solutions to their particular situation," he says.

My husband and I have some more savings we can use. And we are looking into getting a line of credit to help us out just in case Wells Fargo does sharply reduce the amount of the loan. But foreclosure is a possibility in our case.

Write to Nancy Keates at nancy.keates@wsj.com