

## The New Mortgage Rate Calculus

It's entirely possible that in the future buying a house that is shocking pink, ultramodern or in a neighborhood that's up and coming (no Starbucks yet) could add an extra fee to your mortgage for what banks perceive as added risk. With foreclosures projected to reach 2 million nationwide by the end of next year, bankers are rethinking how they set mortgage rates.

"The industry would love to be able to do a retinal scan before they give you a mortgage," says Keith Gumbinger, vice president of HSH Associates, which tracks the home-lending market. "They want to be able to assess the risk - practically down to the biological level - that you won't pay your mortgage."

Up until now: There have always been differences in rates. But historically they were based on the type of mortgage you chose and the amount of money you borrowed. A 30-year fixed-rate mortgage, for example, would come with a higher rate than a 15-year fixed-rate loan because over 30 years there was a greater risk that interest rates would rise.

What's more, mortgages for less than a specified amount (previously \$417,000 and now as much as \$750,000, depending on where you live) could be off-loaded to Fannie Mae (FNM, Fortune 500) or Freddie Mac (FRE, Fortune 500). Because banks didn't have to bear the risk of default on mortgages sold to those government-backed insurers, they came with lower rates. But as long as your credit score was 580 or higher (on a scale of 350 to 850), the rate was the rate.

"Everyone who was prime had the same rate," says Scott Happ, CEO of Mortgagebot, a lending technology company. Now that is changing.

The next evolution: Lenders have already begun to assess up-front fees that vary with credit scores. Instead of a great divide between the "have a 600 credit score or better" elite and the unlucky have-nots, there will be graduated levels of risk.

Gumbinger says, for example, that borrowers with credit scores of 700 to 719 making 20% down payments can expect to pay an additional fee of as much as 0.5% of their total mortgage at closing beyond what is paid by those with a higher credit score. And if the credit score drops to between 660 and 679, the fee can more than double to 1.25%. Some lenders assess the fee by boosting their interest rates.

"Credit scores matter more than they used to," says Jack Guttentag, founder of the Mortgage Professor website and professor of finance emeritus at the Wharton School. "Everything matters more than it used to."

That's just the start, however. Eventually, mortgage pricing may come to resemble pricing for, say, homeowners insurance, which takes into account dozens of factors, including your neighborhood, whether your house is brick or wood, its replacement cost, its proximity to a fire hydrant, your credit score and past insurance claims for the house before you bought it. The good news is that this new wrinkle could help borrowers with pristine credit records and conventional tastes get lower than average interest rates and better terms on a mortgage than they did previously. For now, credit scores matter the most, and the higher your score is, the lower your rate and fees will be.

But larger than normal down payments - 25% to 30% of the value of the property, for example - can also lower your interest rate by convincing the bank that you won't walk away at the first sign of an economic chill. (Money Magazine)

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Regards,

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