US MORTGAGE MARKET AND ITS EFFECT ON MEXICO

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The past six months have witnessed a significant shift in the U.S. mortgage market; perhaps one that will earmark our generation as the most turbulent time in mortgage history. The upheaval involving mortgages and real estate has affected more than just its own industry. The number of U.S. mortgage companies that have shut down in the last six months dwarfs any other such market turndowns. To understand the effect this may have on the Mexican mortgage market, one first needs to understand the reasons behind the current marketplace situation.

The subprime mortgage market has been blamed for much of the U.S. mortgage issues that the financing market is facing today. Several years ago, when interest rates hit an all time low, banks capitalized on this opportunity by lending money more freely in the past; to both consumers and to brokers. Because of the ease and availability of financing, the structure of the mortgage loan changed and many banks and brokers relaxed the requirements for alternative and subprime loans. Although there is no official definition of a subprime loan, it generally includes the market of those with lower-than-optimal credit scores and/or assets to secure a mortgage loan. This defined market has recently been expanded to include those that do not put down a certain percentage of money on their loans, or any other 'alternative' loan structuring that allows one to purchase a home in a price range they might not otherwise afford. This change in loan requirements and structuring opened up much opportunity, but also gave opportunity for fraud and misuse. These market trends, combined with the lack of mortgage-broker licensing requirements in many states created an enormous increase in the loan business. Not only did new brokerage firms pop up everywhere, but existing banks and brokerage firms saw a tremendous part of their business grow in the subprime sector. Marketing and advertising efforts in the lending industry over the past few years has also specifically targeted either subprime buyers or marketed alternative loans that required little or no money down, cheap monthly payments and extended mortgage timeframes.

The result? Millions of home buyers with lower credit scores and/or a history of derogatory credit who would not normally qualify for a home loan became a significant part of the lending market. The estimates, as high as 30% of the mortgage industry is considered subprime or alternately known as Alt-A in the industry.

One example of how an initially appealing lending situation can get out of hand has to do with ARM products. Adjustable Rate Mortgage, or ARM products, offer a low introductory interest rate which adjusts after a predetermined timeframe. These products are very attractive, yet widely misunderstood by buyers. The adjustment is based on prime lending rates and almost always 'adjusts' higher than the initial loan rate. In fact, these loans can often escalate as high as an additional 2% on the first adjustment. A way to remedy this situation would be to refinance at a lower rate; however, many subprime clients who bought homes at the introductory rate did not take measures to improve their credit ratings. At a time when refinancing could have saved them from higher payments, the only loan they could now qualify for had no luring introductory rate, but rather a high start rate as is typical for a borrower of this caliber. Another product that lured in home buyers is the Option ARM product, which can have catastrophic consequences if not entirely understood by the borrower, which seldom happens. With an Option ARM, a borrower is offered four options of payments. The first option is that they may have an introductory rate, which can be as low as 1% and may be fixed for the first year. Option 2 might be an "interest only" payment with an interest rate starting in the 6%'s to Libor, which adjusts with the market constantly. Options 3 and 4 are usually '15-year Principal and Interest' and '30-year Principal and Interest' payment options. The feature of this loan, which may not be immediately disclosed by the mortgage broker, is that the difference in payment between the 1% start rate and the "interest only" rate will be added to the loan balance each month. This means that the loan increases in cost every month. This is called negative amortization, and for a homeowner without extra reserves, this can quickly escalate into an unmanageable financial situation. These types of loans credited most mortgage brokers double the commission they would earn on a traditional loan; numerous unwitting buyers were lured into appalling loan situations. As was previously mentioned, many states did not require brokers to be licensed and unscrupulous lending became rampant. The Option ARM product was also heavily advertised in newspapers, magazines, and radio stations.

We can see now that these types of lending practices have left many homeowners with loan amounts that now exceed the value of the house and with mortgage payments they cannot afford. This resulted in a squeeze in the lending industry as banks were unable to get their money back and because so many loans were not backed by assets of any kind, they are unable to recoup the money. Home foreclosures are at an all-time high in the United States. Given the circumstances surrounding our current housing crisis, the

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market correction is a natural reaction. In the first six months of 2007, over 47% of all loans funded in the U.S. market went to subprime borrowers. Consequently, foreclosure is up over 40% from 2006, which saw approximately 850,000 foreclosures in the United States. The U.S. real estate market has now already surpassed that mark and we should expect to see over 1,200,000 foreclosures for 2007. These statistics demonstrate the cause-and-effect of uncontrolled lending practices to unqualified buyers.

Undoubtedly there will be effects on the real estate market in Mexico. The most noticeable effect was when power lenders such as GMAC raised rates twice in short proximity of each other and also withdrew their riskier 'Stated Income' program, before withdrawing from the Mexican market altogether. This all occurred over the course of six weeks, indicating that banks are reeling from the current damage to the lending market. GMAC was also heavily vested in the U.S. subprime market, and marks the first time a major lending source withdrew from the Mexican market since Silvergate Bank did in late 2006. Silvergate's withdrawal was primarily influenced by the outpricing of the larger banks offering cheaper money to borrowers, and not as a direct result from the any action in the U.S. market. However, GMAC's exit from the Mexican market will not leave borrowers short on options. To alleviate the troubles caused by their subprime lending practices, they were forced to raise rates and priced themselves out of the marketplace. The remaining top competitors in Mexico are not primarily invested in the U.S. market and can afford to provide borrowers stable lending options. Mexico does not have or cater to a subprime market, which is why interest rates are slightly higher than in the United States. Borrowers in Mexico are required to put 20% or more down for their home and because the market has maintained these standards, more banks are planning their move to the Mexico market. Citibank is considering a program for Mexican buyers that will offer a 30-year fixed mortgage at 7.5% with 20% down and competitive closing costs. This certainly beats the industry standard considerably on 30-year fixed products. Mexico remains a lucrative market for any financial institution as long as they are willing to go through the motions of acquainting themselves with the market and prepare for a learning curve regarding the Mexico process. The trends in financing should solidify our confidence in the Mexican real-estate and mortgage markets. Additionally, the strategies of the banks and lending institutions in Mexico serve to solidify our belief in the bright future of our real-estate market. At Baja Capital Mortgage, we anticipate continued solid growth in the Mexican market and are pleased to be an integral part of this growth.

EMERGENCY NUMBERS

Police
066

RED CROSS
065

FEDERAL ELECTRICITY COMMISSION
071

FIRE DEPARTMENT

Cabo San Lucas
143-3577

San Jose del Cabo
142-2466