Soft Market + Motivated Seller + 6% Seller Contribution = 5.50% Fixed Rate 30 Ye...

An anomaly is defined as a deviation from the normal order. At this very moment in many real estate markets in many parts of the country a soft market can lead to opportunities for many buyers.

With many 30 year fixed rate loans with an 80% Loan To Value (LTV) the mortgage program guidelines will allow a seller to pay up to 6% of the buyer?s closing cost. For example if there is a negotiated sales price of $500,000 with an 80% LTV of $400,000. A seller contribution would be allowed up to 6% on $400,000 mounts up to $24,000. This would need to be a very motivated seller who needs to sell now. Unless a borrower tolerates total gouging on closing costs, this would be a heavy amount. However, a sum of $8,000 to $10,000 or less would handle the closing costs for this property, not including prepaids such as insurance and tax escrows. On the surface, it would seem the difference between $24,000 less say $10,000 would allow $14,000 in additional costs. With today?s rates, a one percent (1%) lender discount could buy the rate down from say 6.25% to a rate of 5.5%. Thus, $400,000 x 1% = $4,000.00. A buyer borrower would need to be armed with the facts prior to negotiating a real estate contract so that the seller can determine their bottom line at closing.

For the benefit of the buyer, if they are going to stay in the home for a long-term period then there will be great benefits for the buyer to get a lower rate. Looking at the principal and interest payment for $400,000 at 6.25%, 30-year term the payments then is $2,462.87/month for principal and interest. With the same terms with a rate of 5.5% the payment is $2,271.16/month for principal and interest. That would result in a monthly savings of ($2,462.87- $2,271.16) is $191.71/month in savings versus a 6.25% interest rate.
Example of payment at 6.25% shows $2,462.87/month x 360 months = $886,633.20
Example of payment at 5.50% shows $2,271.16/month x 360 months = $817,617.60
Life Time Mortgage Savings------------- $ 69,015.60

A borrower simply being armed with the information on a rate buy down can enter negotiations that may lend some long term benefits. Six months ago, seller help was just a dream. Today, it?s a real consideration of any purchase. Will it last forever? No, it?s an anomaly. Temporary and fleeting. So?buyers need to get it while they can.

Where are these opportunities to be found? In any area look for vacant homes, on a lock box with some sort of sales pressure. If the lender allows for a 6% seller contribution of the contract price on say an 80% Loan To Value loan then why not go for it. Many of these potential properties can be searched and identified using a Realtor and the local MLS system. Builders who are setting on a huge inventory of homes may be willing to grant major concessions in order to keep the price levels consistent until the home prices firm up. This would be a situation where a borrower would need to determine that the market in that particular subdivision is at a ?temporary? lull and not a trend. Otherwise it would be a case of throwing good money after bad. Working with a Realtor who knows the market will go a long way in avoiding those kinds of pitfalls in builder subdivisions where resale homes are less than the new homes on the market. In that case, the builder is upside down on pricing. This will need to be avoided. What we are talking about here is temporary anomalies that a buyer will want to exploit, like now in the current market. The best evidence of a buyer?s market is where there are more homes for sale than ready buyers and there is a glut of homes on the market just sitting. A forest of for sale signs.

With lower priced homes with say FHA and VA loans there be an opportunity where the seller in addition to paying all the closing cost and prepaids could pay say 2 points to buy the rate down on a ?2-1 Buydown? Program. The beauty of this program allows a buyer to buy using a FHA mortgage with as little as a 3% investment and a VA mortgage with zero down. This is a great program of for Debt To Income challenged borrowers who are just squeaking into the property.

If the rate were 6.75% on a mortgage of $205,000 on a thirty-year basis the payment would normally be $1,329.63/month for principal and interest. If the taxes are $300/month, the hazard insurance is $220/month and Mortgage Insurance Premium (MIP) of $85.42/month then the total payment is $1,935.05 per month with $1,050 in installment and credit card debt for a total monthly debt load of $2,985.05 including the new housing expense. If the income were $6,395/month the Debt To Income (DTI) ratio would be around 47%. Let?s assume, due to credit history and other factors, the underwriter is not willing to accept this level of DTI nor will any Automatic Underwriting system accept it. An alternative would be to consider the 2-1 Buydown Program with the first year interest rate of 6.75% - 2% = 4.75%, the second year would be 6.75%-1%= 5.75% with the third year and beyond 6.75%. With this program the borrower can qualify at the start rate of 4.75%. The principal and interest payment with this start rate is $1,069.38/month or $260.25/month less at the fully loaded rate of 6.75%. The DTI than is 42.60% and the underwriter will sign off on that. The theory is that the borrowers will have two years to cut debts and increase their income and get their ratios in a more satisfactory position.

What?s the point of all this. If the home is selling for $208,200 and the seller is willing to pay up to closing costs and prepaids which would be $208,200 x 6% = $12,492 and the costs add up to say $9,500, why not use the allowable seller contribution to buy down the loan rate. The main benefit is to get the borrower?s DTI in line and lower the payment in the early years all funded with the seller contribution. VA loans can go much higher and in certain areas, FHA loans can go a lot higher as well.

This anomaly will not last. It is a buyer?s market so why not maximize the buyer?s benefits by applying part of the 6% seller?s contribution to buy the loan down and not leave any money at the closing table which can be utilized for the buyer?s benefit. Negotiation is king.

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Short note about the author

Dale Rogers is a thirty-year mortgage veteran and frequent contributor to the Broken Credit Blog. The BCB is a free website created to assist the general public with information about credit repair and responsible mortgage lending.

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