THE RIGHT FIT

RESPONSIBLE BROKERS HELP THEIR CLIENTS BY EDUCATING THEM AND OFFERING COMPARATIVE TOOLS

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COMPLAINTS. FORECLOSURES. Regrets. As bad as they sound to borrowers, they're even worse for mortgage brokers in a softer housing market.

Responsible brokers realize that their continued success lies in helping their clients find the right mortgage to fit their needs. This comes from educating customers on the various mortgage products out there, as well as offering tools to help them compare their options. By helping borrowers make informed mortgage decisions, brokers can create the best kinds of mortgage customers: the ones who walk back in.

There has been increasing concern in the housing market about what the Federal Reserve may do with interest rates this year. Plus, the Mortgage Bankers Association predicts that mortgage originations will decline by 11 percent in 2007 compared to 2006's levels.

As such, many mortgage brokers and lenders are scrambling to make every loan application count. This sort of pressure has pushed many brokers and lenders into working on deals they may have ignored in previous times.

But some companies are bucking the trend and increasing loan originations in a soft housing market. They accomplish this by educating borrowers on choices available to them, focusing on high-credit-quality borrowers who appreciate being offered clear explanations on alternative product choices, partnering with an investor that applies a common-sense approach to underwriting, developing a customer-service approach that resembles private banking and of course, focusing on current customers.

With these factors in mind, continued success starts with educating your customers. We must remember that ill-informed borrowers can turn into a broker's nightmare when they later say you sold something they didn't really understand. It is therefore important to focus on building a relationship with and educating borrowers, in addition to executing the transaction.

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The benefits of education

Unlike other financial-services professionals, mortgage brokers and lenders traditionally have done a poor job in explaining how their products and services work. In short, the mortgage

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industry has yet to match its range of products with the complementary educational resources that today's homebuyers have shown an interest in obtaining.

Numerous studies show that many homeowners feel they have little knowledge about mortgage products, even when considering that their residential mortgage is likely their largest purchase.

Responsible mortgage brokers and lenders realize that it is in their best interest to make sure that homeowners understand the products that they select. This can help them stave off defaults and foreclosures and can assist in building relationships with their customers.

Explaining loan products and services on a brokerage or lender Web site might not be enough to ensure that borrowers fully understand how specific products function. Brokers and lenders must be more proactive in providing a comprehensive set of educational tools and services to their clients.

Consider how other financial-services industries handle it. For sophisticated consumers, building long-term wealth now requires a wide array of products and services — e.g., exchange-traded funds, municipal bonds and individual retirement accounts — well beyond the interest-bearing savings account of a few generations ago.

Brokers and lenders must approach their customers' needs in much the same way. Don't view a mortgage transaction as just a way to put a family in a home; it's also a financial-planning tool for that family.

For example, if borrowers are looking for a way to minimize their monthly mortgage payments, a savvy broker can suggest the appropriate product for their needs. The broker also can explain the differences between certain products. This is vital to borrowers' satisfaction in the short and long terms.

Tools for success

As educators and marketing experts have proven repeatedly, consumers learn best when they can visualize the product and make the connection between concept and reality.

Consider which learning method is more effective to you: Is it reading a few bullet points about a small, portable music player? Or holding one in your hands, listening to it and experimenting with its software?

Although mortgage products don't have the same designer appeal as MP3 players, the same philosophy of ensuring prospective customers understand them easily should be your goal.

Rather than simply providing an explanation of a mortgage product, brokers should take it to the next level by offering hypothetical situations that precisely match the homebuyer's specific scenario. They can explain how each particular product fits into the equation with positive and negative attributes alike.

As much as possible, brokers should support each comparison with graphics that provide a clear delineation between approaches to each product. Remember, the objective is to be illustrative and demonstrative, not confusing or overwhelming.

A sample case study

Let's go back to our hypothetical borrowers who want to minimize their monthly mortgage payment. Assume they are a middle-aged couple in Phoenix. They plan to retire in 10 years and move to New Mexico. Their monthly take-home pay is $2,850, and the only raises they expect to receive in the future are cost-of-living increases.

The couple want to borrow $280,000 to purchase a $350,000 home. The fully amortized monthly payment, plus tax and insurance escrows, comes to almost $2,100. This leaves them with about $750 a month to pay for utilities, food, home repairs and more. This arrangement would limit their lifestyle.

The broker knows there are different ways to reduce the borrowers' monthly outflow. In a normalized yield-curve environment, recommending an ARM over a 15- or 30-year fixed-rate product may be good advice. Other options beyond a traditional ARM include an interest-only ARM and a pay-option ARM.

For instance, with an interest-only ARM, a product that is often available for the first 10 years of an ARM's 30-year life, the borrowers can reduce their monthly mortgage payment by the amount of the principal component associated with a fully amortizing loan.

These borrowers then would start by paying $1,817 per month, leaving a bit more breathing room. Because they plan to sell the Arizona home after 10 years, an interest-only 10/1 ARM — where the interest rate is fixed for 10 years and adjusts each year thereafter — could be the ideal product.

A pay-option ARM also would let them reduce their monthly outflow by an even greater amount. Informed of this product, borrowers can select one of several alternative payment plans on a monthly basis. These alternative plans include paying interest-only, paying interest plus any amount of principal, paying interest at a rate below the note rate or paying on a fully amortizing basis.

If the borrowers pay interest-only at a rate below the note rate, however, they face a day of reckoning down the road. Despite the reduced monthly payment, the difference between what they pay and what the payment should have been according to the note rate is added onto the loan's principal balance, creating negative amortization.

Although this product can be good for some borrowers, such as self-employed individuals who can reinvest their income into their businesses or who receive irregular monthly income amounts, our sample borrowers are neither self-employed nor earning commissions nor bonuses. And what happens if housing prices decline?

Offering a pay-option ARM to our example borrowers could be a recipe for disaster — which underscores the importance of explaining how these products fit certain situations. A more conservative product, such as an interest-only 10/1 ARM, could be a better fit for them.

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Doomsday scenarios aside, some products are just not right for some borrowers. That's why it's incumbent on brokers to know their borrowers as well as their marketplace.

By helping homebuyers make informed decisions about their own mortgages, brokers and lenders have a much better chance of building a relationship-based mortgage practice that thrives on repeat business and referrals. And it's the right thing to do.