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Refinancing obstacles: Solving the refinance puzzle

The lowest mortgage rates in decades have homeowners flocking to lenders, but tough housing and credit markets provide plenty of obstacles

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The lowest mortgage interest rates in decades have sent thousands of homeowners eager to refinance their home loans scurrying into lenders' offices. Many leave empty-handed and upset.

A multipronged whammy of lower home values, new appraisal guidelines and tighter lending requirements frequently derail consumers from snaring loans at lower interest rates. Lenders say they are closing 60 percent to 70 percent of refinancings.

"It's a blow to (a borrower's) ego," said Todd Gosden, a loan originator at Avenue Mortgage in Naperville. "The guy who makes $250,000 a year, managing 150 people, who says, 'I want to take advantage of this,' and I have to say' 'You can't.' The reaction is, 'Are you kidding me?'"

A decade ago, all types of consumers were able to qualify for a particular interest rate.

In the current era of risk-based pricing, numerous variables determine the rate offered to an individual, including whether the property is a single-family home or condominium, and loan-level pricing adjustments are applied to eight different tiers of credit scores.

"There are more people that can't get a refinance today than two to three years ago," said Brad Blackwell, an executive vice president at Wells Fargo.

A case in point is a couple who six months ago easily refinanced the $365,000 interest-only loan on their $900,000 home, said David Hochberg, president of Townstone Financial Inc. in Chicago. Hochberg said the man's credit score was 790; hers was 715.

But since the last refinancing, credit guidelines have tightened, and the minimum credit score now required for a new loan at the rate they sought was 720. The only option, which the couple didn't take, would have been for the wife to remove her name, and thus her credit score, from the mortgage application.

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Self-employed borrowers face extra challenges because they have to produce two years of tax returns. If the owner of a sole proprietorship has a lot of tax write-offs that alter adjusted gross income, or the most recent year shows a substantial income decline, it can adversely affect his or her application.

"The self-employed individual — you might just as well put a skewer through their heart because they're dead," said Hochberg. "You have people that you could help and save a lot of money, and those people would put that money right back into the economy."

Appraisals are upending many refinancings. During the early part of the housing crisis, appraisers tried to separate distressed property transactions from conventional home purchases that are used as comparable sales in a neighborhood. But in some neighborhoods, distressed properties are the market and have lowered home values to a level that still surprises homeowners.

"There's definitely some people who have a realistic grasp on the market and what their home is really worth, and there's definitely a portion that don't believe it's gone down," said Chicago-area real estate appraiser Chip Wagner.

In some cases, loan officers run the numbers with potential customers before ordering the appraisals so consumers don't have to pay the costs of an appraisal and then be denied a new loan. Consumers can also check national and local real estate Web sites for the sales prices of area homes.

Current appraisal rules mean a loan officer can't directly contact an appraiser to question a report or detail the home value that's needed to qualify for a loan. However, homeowners can always walk through a home with an appraiser, pointing out upgrades and improvements made to the property since the last appraisal and volunteering what home value is needed.

If the appraisal comes up short, one increasingly popular option is for homeowners to bring money to the closing, in effect paying down the mortgage so there's the required 20 percent equity in the home. That way, the loan could be secured by Fannie Mae or Freddie Mac.

"We have a lot of clients coming in, paying the loan down $30,000, $40,000," said Ken Perlmutter, owner of Perl Mortgage Inc.

During the second quarter, 22 percent of Freddie Mac-backed customers who refinanced first mortgages did so by negotiating a "cash in" mortgage, tying the record for the third-highest share of cash-in refinancings since Freddie Mac started tracking refinancing patterns in 1985.

Before liquidating stocks or savings accounts, consumers need to figure the estimated mortgage savings versus returns on current investments. By bringing a check for $4,500 to the closing, one of Gosden's customers reduced his loan-to-value ratio to 80 percent from 81 percent and was able to trim the interest rate of a 15-year mortgage by three-quarters of a percentage point.

Consumers who are underwater, meaning they owe more on the mortgage than the home is worth and are unable to meet the 80 percent threshold, are seeking assistance from federal government programs. Some are getting help through the Home Affordable Refinance Program, a sister effort of the Obama administration's loan modification program. However, the program's success has been stymied, in part, because second lien holders have to agree to the refinancing.

Through the first five months of the year, 152,103 borrowers with loan-to-value ratios of greater than 80 percent but less than 105 percent refinanced their Fannie Mae- and Freddie Mac-backed homes through the federal program. However, borrowers seriously underwater, with loan-to-value ratios of 105 percent to 125 percent, had much less success. Only 8,420 were successful in refinancing in the January-May period, according to the Federal Housing Finance Agency.

While the program ostensibly is for loans with a loan-to-value ratio of up to 125 percent, many lenders are unwilling to take that risk, and additional overlays applied to those loans mean that while consumers may get a lower rate then their current one, it's not the lowest rate.

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Refinancing help

The Obama administration developed two programs to help consumers unable to refinance their loans through conventional channels:

•Home Affordable Refinance Program (HARP): The program administered by Fannie Mae and Freddie Mac has been extended to June 30. The program is intended for owner-occupants whose mortgages are held by Fannie or Freddie.

Borrowers must be current on their mortgages, meaning they haven't been more than 30 days late on a payment in the past 12 months, and who are unable to refinance because their loan-to-value ratio is greater than 80 percent but less than 125 percent. Borrowers paying mortgage insurance on their current loan will need to carry the same amount of insurance on a HARP loan.

It's up to loan servicers to determine whether a borrower qualifies, and some servicers have little interest in refinancing seriously underwater loans.

•FHA Short Refinance: The program, which began Sept. 7, is designed for underwater borrowers who do not have an FHA-insured loan.

One big difference from HARP: Participating lenders, and participation is voluntary, have to agree to write off at least 10 percent of the unpaid principal balance on the first mortgage, a thorny issue. The other potential hang-up is second lien holders, and the program hopes to tackle that issue by offering incentives to lien holders who at least partially extinguish those debts.

Consumers must have a credit score of at least 500, and the refinanced loan must have a loan-to-value ratio of no more than 97.5 percent. If there is a second lien on the property, the combined loan-to-value must be no greater than 115 percent. The program ends Dec. 31, 2012.