



MY FATHER SAID HE NEVER HAD TO GO THROUGH THIS!

My father said . . . ; my neighbor said . . . ; my Realtor said . . . ; my attorney said. . . . Most people think they know something about real estate financing and where to get the best rates. They are not shy about telling you their experiences, every one of which will probably be different. And all of their stories may be true. Each person's slightly different situation can alter the type of loan the lender recommends and how it is processed. Most loans, however, are approved or denied, based on some very fundamental rules. Over the years, these rules have become the standards by which the industry functions, but they have not always been in effect. Today, most of the accumulated industry guidelines have been squeezed, mashed, stretched, added to, chopped apart, and put back together inside a computer program. Many loans can go from application to approval within an hour. That is why your father, and anyone else who hasn't received a loan since the late 1970s, can't tell you what it's like today.

A good example is my first loan, which I got in the early 1970s. There were basically two lenders in town: a mortgage subsidiary of a bank and a savings and loan (S&L). The S&L was run by an old man who knew just about everyone. I walked into his office one day and said, "I'm buying a house, and I need a loan." He said, "Just let me know about two weeks before you need to close. Who is going to be your attorney?" He wouldn't give you the loan if he didn't like your attorney. That was the entire application and approval. He did not even ask me how much I needed to buy the house. That may be a little easier than even what your father had to do for his loan, but it illustrates the fact that lenders

of that time really did make loans the old-fashioned way: They used their own money, or **portfolioed** the loan. Remember the term *portfolioed*; we will talk about it later.

Several years after I bought that house, I did what every normal American does: I bought a larger house and went deeper into debt. This time I went to the mortgage banker, the one that was a subsidiary of a bank that made mortgage loans. He also knew me. Unfortunately, he felt it was necessary to get a little information and keep me waiting for several weeks before I got loan approval. He made references to “verifying” my application. Didn’t he trust me? No, he thought that I was just fine. It was **Fannie Mae** who didn’t know me from Adam. This made it sound as if we were dealing with someone from James Dickey’s *Deliverance*. Fannie Mae might be fat, ugly, mean. Wore one of those sack dresses with small flower prints all over it. Looked at you with a kind of sour squint. Now, why would someone like that be looking at my loan?

As most people today are painfully aware, Fannie is not some mountain blossom, but an acronym for the **Federal National Mortgage Association**, or **FNMA**. Being a child of the federal government, Fannie Mae herself gave birth to some more mountain folk, **Freddie Mac** and **Ginnie Mae**, known to the more refined as the **Federal Home Loan Mortgage Corp. (FHLMC)** and the **Government National Mortgage Association (GNMA)**. Fannie and kin are the ultimate authorities of mortgage lending. In most instances, you do what they say.

If you give these stories a little thought, it may seem logical to go to the S&L. For a long time, most people did exactly that. Actually, to an extent, the same is true today. But things have changed drastically since the late 1970s. How did things change so much? Let’s take a look.

WHY DO THEY DO THE THINGS THEY DO?

Once upon a time in the old days (until the late 1970s), savings and loans, or thrifts, were the predominant lenders of mortgage loans. Their charters actually require that the majority of their loans be home mortgages. That is why S&Ls came into existence. The most important thing to know about thrifts is the source of their money. They got it from savers. At some time or another you may have had a passbook savings account, one in which you put \$10 or \$20 a month at 5% interest. That was, of course, back when

inflation was 2% to 3% a year. The thrifts would lend that money out at 7% or 8%, thus making a profit. Obviously, people were constantly putting in and taking out their money, which you might think would wreak havoc when that money was supposed to be tied up in a 30-year fixed rate loan. We know that this didn't happen, so how exactly did they make those loans when the money was coming and going? They borrowed it from the government. Actually, they would normally have sufficient assets on a day-to-day basis to cover most of their loans, but when they were a little shy of cash, they would go to the Federal Home Loan Bank and borrow short-term. The rates would be low enough that those 7% and 8% loans were still moneymakers. The more deposits they took in, and the more income they earned, the more loans they could make. It was a very neat arrangement that provided money for homes and a profit for the thrift.

Are you ready for a quick lesson in math? If Johnny borrows money and pays 12%, and then lends that money out at 8%, how much money will Johnny make on the deal? (Anyone who doesn't think that Johnny is coming out on the short end, please give me a call. I would like to ask you for a loan.) In the mid-1970s what happened to Johnny is exactly what happened to the thrifts.

Inflation and interest rates went into double digits, which meant that the cost of money for everyone, from lenders to homebuyers to the federal government, became very high. The big problem for the thrifts was that they had already lent money out at low long-term rates on the assumption that they would always be able to obtain money cheaply enough to cover those loans, plus overhead and profit. But when you have to pay 12% to cover loans that are already on your books at 8%, you have a substantial deficit on millions of dollars of loans, which is not healthy for the bottom line. To add to the thrifts' problems, people were taking their money out of their savings accounts at the thrifts and putting it into high-yield investments. This phenomenon is called *disintermediation* the movement of funds from one place to another that is caused by a wide disparity in interest rates.

All of a sudden, those friendly folks down at the local savings and loan were not only losing money, but also rapidly running out of money to lend. During this period, when I was a Realtor, I sold some houses and took my clients to the S&L to make their loan applications. To our surprise, it was not making loans. It was taking deposits, but no loan applications. This was the

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same thrift where I had received my one minute loan application years before. We went to a local bank and got a short-term note that would be paid in full when the purchase could be refinanced, that is, when the thrift again had money to lend.

Where did that situation leave us? It left us with houses to sell, people who wanted to buy them, high interest rates, and, most importantly, very little money available to make the loans on those houses. How did we fix this mess? By using Fannie Mae, Freddie Mac, and all the other investors in the secondary market.