THE FIFTH BEATLE OF MORTGAGE LOANS

The mortgage term you should make a permanent member of your band

The "fifth Beatle" is an informal title applied to people who were at one point a member of the Beatles, or who had a strong association with the "Fab Four." In general terms, it is a moniker used to identify a lesser known part of a group. To me, it is a perfect way to define the 20-year mortgage.

Pull up a random internet search for mortgage rates and you most likely will see a myriad of options for a 30-year fixed, 15-year fixed, 5/1 or 1/1 ARM loans, and even FHA or VA loan rates, but no 20-year fixed rates. Why is this?

Cash-flow Conscious vs. Debt Reducers

Lenders see borrowers as either cash-flow conscious or debt reducers. If you are a cash-flow conscious borrower, you want the lowest monthly payment you can find. You want to hold onto your cash to build equity through the market not through principal reduction. You're a prime candidate for any variation of a 30-year amortized loan whether it's a straight fixed rate or an ARM product. You will push the term as far out as you can to minimize the monthly payment.

If you are a debt reducer, principal reduction is your primary objective. You have a specific payoff date in mind, such as retirement. You are willing and able to pay a larger monthly payment to reduce your balance more quickly. You're tailor-made for the shorter term of the 15-year loan. More of your monthly payment goes toward reducing principal, which reduces your debt at a much faster rate. You'll build equity more

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your
SECONDARY MARKET SPECIALIST

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Find out more about Chris and our funding specialists at **FHLBTOPEKA.COM/INTELLIGENCE.**

quickly and own your home free and clear in a shorter amount of time.

Our own Mortgage Partnership Finance® (MPF®) Program portfolio provides a perfect demonstration of this. From March to August 2015, we purchased 3,502 conventional loans totaling $589 million. Only 463 of these were 20-year fixed mortgages, totaling $74 million and 13% of the total portfolio. This was nearly half of the 15-year activity of $122 million and barely a blip in comparison to the Lennon and McCartney numbers of the 30-year fixed with over $393 million sold.

20-yr Term	MPF Traditional	Other Investor
Rate	3.5%	3.5%
Price	102.712	101.918
LLPAs	0	-.50
Total	102.712	101.418

30-yr Term	MPF Traditional	Other Investor
Rate	3.75%	3.75%
Price	101.724	102.039
LLPAs	0	-0.5
Total	101.724	101.539

Why aren't more 20-year mortgages being done?

This is a question with multiple answers. First, the market really doesn't encourage them. The loan level price adjustments (LLPAs) charged by Fannie Mae and Freddie Mac on loans they purchase impact the interest rate or the fees assessed to the borrower, and a 20-year mortgage doesn't receive any benefit relative to 30-year mortgages through lower LLPAs. Second, due to a lack of advertising of the 20-year term, borrowers aren't as familiar with that term and don't know to ask about it. Since borrowers are either cash-flow conscious or debt reducers, they tend to decide which term they want to borrow before visiting with the loan officer. Lastly, lenders don't think to suggest it to their borrowers. You might be surprised by the number of borrowers that would select a 20-year mortgage over a 30-year if they would compare the monthly payment difference to the interest that can be saved over the term of the loan.

Why would I want to suggest the 20-year loan?

In simple terms, it's about best execution. You can make more money delivering 20-year mortgage loans into the MPF Program. Look at the two examples above. Not only does the 20-year mortgage provide a better execution compared to other investors, it provides a better execution than most, if not all, 30-year mortgage loans. This means it would be the most profitable mortgage product you could deliver in the secondary market.

The base pricing associated with the 20-year mortgage product is better than other investors, and no LLPAs are associated with loans sold into the MPF Program. Other investors are charging LLPAs as if this were a 30-year mortgage, which makes the execution even stronger with the MPF Program. In addition, the risk share (Credit Enhancement (CE) Obligation) associated with a 20-year mortgage is lower than a 30-year mortgage, creating additional benefit.

On a rate/term refinance, the average decrease in risk share when moving from a 30-year to a 20-year mortgage is approximately 75 basis points. That equates to $750 less in risk for every $100,000 sold. If you sold in $30 million per year in 30-year production and converted $15 million of that to 20-year loans, you would reduce your CE Obligation by

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Example

A borrower three years into their 30-year mortgage is looking for a lower interest rate.

Loan amount: $200,000

30-year fixed @ 4%	20-year fixed @ 3.75%
Monthly mortgage payment: $954.83	Monthly mortgage payment: $1,185.78
Total interest paid: $143,738.80	**Total interest paid: $84,587.20**

approximately $112,500 per year. On a cash-out refinance, the average retained risk is reduced by over 110 basis points, saving you over $165,000 in CE Obligation. At the same time, you're getting more income for your institution and providing your borrowers a way to improve their equity position more rapidly.

So who is right for the 20-year fixed loan?

Is it for the cash-flow conscious borrower or debt reducers? The beauty of the 20-year fixed loan is that it works for both. The cash-flow conscious borrower can make some headway on his principal, and the debt reducer can pay down principal more quickly, but with a comfortable monthly payment.

As you can see in the example above, the payment is higher with the 20-year loan by $230 a month, but the borrower will save nearly $60,000 in interest over the life of the loan and reduce the term by seven years. Best of all, they will build equity more quickly and that will benefit them if they sell the home.

The 20-year loan product isn't for everyone. There are still those customers that will fall to the extremes of the two categories, and 15- or 30-year terms are probably best for them. However, the 20-year might be a good fit for more of your customers than you realize. It is good for your customer. It is good for you and your institution. Take a look at the 20-year mortgage product, and you and your customers will be singing a happy tune.

Please contact me with any MPF Program questions or to further discuss this comparison.

Contact Chris today for solutions that work for you.

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