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THE WALL STREET JOURNAL.

WSJ.com

WEALTH MANAGER | JANUARY 22, 2009, 12:01 P.M. ET

Demand For Reverse Mortgages Climbs

By JILIAN MINCER

As the credit crisis has worsened, more seniors have turned to federally insured reverse mortgages to tap home equity and, in some cases, to prevent foreclosure.

While still a very small share of the borrowing market, demand for these mortgages climbed in 2008 as credit tightened and retirement savings plunged. The market is expected to grow significantly as loan amounts increase and baby boomers with inadequate savings tap their home equity to fund retirement. Consumer groups, however, warn that fees are high and the cash sometimes is misused.

"Americans have the bulk of their assets tied up in their homes, even now," says Greg McBride, senior financial analyst at Bankrate.com. "The demand for reverse mortgages is increasing by the day."

The Federal Housing Administration approved 115,176 loans in 2008, up 6.4% on a calendar-year basis.

Loan providers expect a jump in closings this year because a bill passed in July by Congress created a nationwide \$417,000 equity limit for FHA reverse mortgages, also known as Home Equity Conversion Mortgages (HECMs).

Consulting firm Reverse Market Insight reported that Miami is the No. 1 market for reverse mortgages, followed by Los Angeles, Tampa, Fla., Santa Ana, Calif., and Baltimore.

As the name implies, reverse mortgages enable a person 62 or older to convert home equity into cash without selling a house. The older the person, and the more valuable the home, the more money they could borrow.

"It gives people another lever to pull," says McBride. "Reverse mortgages let you tap into the value of your home."

Peter Bell, president of the National Reverse Mortgage Lenders Association, says, "If the goal is to stay in the home, this is an excellent tool."

Unlike a home-equity line of credit, consumers don't need to have income or high credit score to apply for a reverse mortgage. They must own all or almost all of their home. The amount of money from the reverse mortgage depends on the person's age, appraised value of the home and current interest rates. A person must receive mandatory counseling before applying for the loan to ensure that they consider other options such as selling their home.

Payments can be set up as an annuity or a line of credit. The fees are high, with limits of \$6,000 plus closing costs. The FHA guarantees the loans and ensures the homeowner that payments will be made as long as the borrower remains in

the home. The FHA also guarantees the lender that it will receive its full payment.

"People who thought their retirements were set are finding out they don't have the resource they thought they would," says Bronwyn Belling, reverse mortgage specialist at the AARP Foundation, an affiliated entity of AARP. "It's a really valuable way to help make ends meet and to stay in their own homes."

But she warns that the decision should be delayed as long as possible and should not be made lightly because the fees are high.

Bell says the current economy has contributed to the demand. There are more cases of people who can't or don't want to sell their homes in the current market.

Today, a growing number of the borrowers are using the federally insured loans to free up monthly cash and to avoid foreclosure. McBride says consumers also use the extra cash for a repair or to pay taxes if they convert a traditional IRA into a Roth IRA.

The credit crisis has dried up the availability of private reverse mortgages with much higher limits, says Bell.

In some places home values have fallen so much that many seniors do not qualify for the loans.

Wealthy homeowners had been using the cash for a variety of reasons including to purchase second homes, distribute assets and purchase insurance policies.

Consumers shouldn't use the loans if they're not going to be in the homes for at least a couple of years because the upfront costs are high. Someone could expect to pay \$15,000 or more in upfront fees and then additional monthly costs as well as the interest.

One of the biggest mistakes is using the money too early. The average rate of the borrower has declined to 73.1 years from 76 years in 2000.

"We're also starting to hear more reports that people are being encouraged to use the loan proceeds to invest unnecessarily in long term care insurance, shoddy home repairs or annuities that didn't pay until someone is over age 100," says Belling of AARP.

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THE WALL STREET JOURNAL.

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JANUARY 29, 2009, 12:11 A.M. ET

New FICO Credit Score Debuts

By JANE J. KIM

Fair Isaac Corp. is rolling out its new-and-improved FICO score, but it's likely to take a while before consumers see how they stack up under the new system.

On Thursday, Fair Isaac and one of the three major credit bureaus, TransUnion LLC, will start offering the revamped score, dubbed "FICO o8," to lenders. [Equifax Inc.](#) is expected to follow in the second quarter, while [Experian Group Ltd.](#) declined to comment due to pending litigation with Fair Isaac.

The new score is supposed to do a better job of predicting borrower defaults, be more forgiving of one-time slipups and take a harder line on repeat offenders. The score, which will still range from 300 to 850 -- the higher, the better -- is fine-tuned to do a deeper analysis of subprime borrowers or those with "thin" or young credit histories, according to Fair Isaac. More consumers with accounts in good standing should also see their scores increase slightly, says Tom Quinn, vice president of global scoring solutions at Fair Isaac. Overall, Fair Isaac predicts FICO o8 will improve the accuracy of lending decisions by as much as 15%.

FICO o8 will still factor in credit-card accounts for authorized users, such as children or spouses. Fair Isaac had originally planned to exclude authorized users in order to curtail abuse by "credit repair" Web sites. Such sites arrange for people with poor credit to boost their scores by becoming authorized users on accounts held by strangers with better credit. But Fair Isaac tweaked its model in a way that will still help legitimate authorized users improve their credit scores -- although perhaps to a lesser extent than prior FICO versions would -- but would also protect lenders from people who were trying to game the scoring mechanism.

It could be months or even years before the score is widely available to consumers. Lenders typically do their own analysis on the score to see how it works with their business and loan portfolios before they start using it. Some mortgage lenders might not adopt the new score if it's not available through all three credit bureaus, says John Ulzheimer, president of consumer education at Credit.com.

The rollout comes at a time when more lenders have criticized FICO's ability to predict defaults. Fair Isaac says its score does what it's supposed to do. "What we're seeing in all of our analysis is that the model is doing what it's supposed to do, which is to rank-order risk," says Mr. Quinn.

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REAL ESTATE | JANUARY 28, 2009, 12:17 P.M. ET

Builders Offer Delayed Payments, Low Rates, Layoff Insurance

By DAWN WOTAPKA

Forget free kitchen upgrades, tropical vacations or complimentary closing costs. The latest marketing efforts from home builders center around financing, with rock-bottom mortgage rates, delayed payments and mortgage insurance for job losses.

It's the newest batch of offers from an industry limping through the worst downturn in decades and gearing up for what's set to be an abysmal spring selling season. Builders know cash is essential to pay the bills and survive, so they're trying anything to make a sale, even if it further stresses margins as cash flow concerns mount.

Lennar Corp., Toll Brothers and Hovnanian Enterprises are offering interest rates well below a national average hovering above 5%, with industry giant Lennar lowering the bar to 3.875%. As soon as this weekend, Hovnanian expects to offer insurance that covers payments for some laid-off homeowners, while Pulte Homes will foot the bill until 2010 in several markets.

"I give them credit; they're not just rolling over and playing dead," Robert Curran, Fitch Ratings' lead home-building analyst. "They're looking to distinguish themselves among their peers in a very, very tough market. It probably pulls [in] some incremental sales, but I think in the environment we're in right now, it's probably not going to make a big difference."

Most of the nation's largest builders stuck in a string of quarterly losses realize that. As shares have plummeted by nearly half in the last year, the sector's confidence has hit record lows, dragged down by job losses -- tens of thousands on Monday alone -- and plummeting prices. Eleven of 20 metro areas showed record rates of annual decline, according the S&P/Case-Shiller home price data through November.

That's in addition to increased competition from foreclosures. The National Association of Realtors reported this week that December's existing sales showed a surprisingly strong gain, aided by banks dumping foreclosures for bargain prices and "short selling" by troubled sellers getting less than they owe.

While the trade group's chief economist noted that the market remains "far from normal balanced conditions," the fact that sales happened as the financial meltdown continued gives builders hope. Industry watchers constantly mention pent-up demand from buyers awaiting pricing stability or lower mortgage rates. Builders are increasingly impatient: Since the housing bubble popped, the sector has tried everything to move inventory.

As the market began to sour, companies resisted price cuts, instead offering gourmet kitchens, landscaping and

getaways. Price wars followed, with a circus atmosphere and discounts hitting six figures.

Builders also employ "buydowns," which make an upfront cash payment to an investor purchasing the mortgage. Since November, [Centex Corp.](#), the nation's third-largest builder, has offered a 3.25% mortgage rate that rises to 4.5% after two years. It reports Feb. 3, but executives recently said fiscal third-quarter orders crumbled 80% from a year earlier.

Toll Brothers recently shocked the industry by extending the financing for the loan's life. The Pennsylvania-based luxury builder offered a 3.99% fixed interest rate for 30 years on loans of \$417,000 or below for buyers with at least a 720 credit score and a 20% downpayment. For qualified buyers, Pulte also offers a conventional fixed 3.99% for three decades in six markets including Denver, Chicago and Cleveland.

Not to be outdone, Lennar recently rolled out its 3.875% fixed rate in a number of its 40-plus markets. No further information was available.

K. Hovnanian American Mortgage, which has offered a 4.5% rate for several weeks, will likely match Toll's number in some markets by this weekend. It could require as little as 5% down for strong credit scores. [M.D.C. Holdings Inc.](#)'s HomeAmerican Mortgage Corp., meanwhile, has a 30-year fixed rate at 4%.

But even the lowest rates seen in years aren't enough to overcome unemployment, which increased nationwide last month and has spared few sectors. Those without jobs or afraid of losing them are unlikely to buy.

That's why No. 6 builder Hovnanian is putting the finishing touches on a policy for "involuntary unemployment" that would pay the monthly mortgage for up to six months. The plan includes a 60-day vesting period and a 30-day wait from the date of losing a job where the borrower worked for 30 hours or more per week for at least 12 consecutive weeks.

"We hope this will give a little peace of mind" to jittery buyers, said Dan Klinger, Hovnanian's mortgage arm's president. "The investors that buy these loans after closing should also like the idea ... The mortgage payment is still made."

It doesn't apply to the self-employed, independent contractors or seasonal workers. Firings and voluntary resignations don't count. New Jersey-based Hovnanian's builders fund the policies, which cost just a few hundred dollars per year per qualified loan, Klinger said.

Another strategy involves giving even those who remain employed a temporary break. For strong buyers closing on or after May 1, Pulte, the nation's fourth-largest builder, will cover 2009's payments, up to six months. The deal, which can't be combined with the 3.99% offer, is available in Minnesota, Denver, Chicago, Indianapolis, Michigan and Cleveland, according to a spokesman. Michigan and Minnesota buyers must put down 10%, with 20% for others.

Such programs come with a cost that has eroded once-healthy margins. Last year's estimated average gross margin was 12.8%, compared with 26.2% in 2005 -- the highest in recent years, according to [JPMorgan](#). Toll leads the list at 24.3% in 2008, down from 32.2% in 2005. Hovnanian's 6.67% is 2008's lowest, a plunge from 25.3% in 2005. Lennar slipped to 17%, from 26.3%, while Pulte hit 11.9%, from 23.3%, JPMorgan noted.

But for most builders, margins aren't the most relevant metric. "The goal is to generate enough cash, stay liquid, survive and play another day," said David Goldberg, UBS' building analyst.

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REAL ESTATE | JANUARY 9, 2009

Fannie Mae Tests 'Short Sales' as Alternative to Foreclosures

By NICK TIMIRAOS

Fannie Mae is testing a new program to stave off foreclosures by preapproving "short sales" of homes, in which mortgage companies allow homeowners to sell houses for less than the value of existing loans, forgiving the difference.

As the number of homeowners in default on their mortgages began to rise several years ago, real-estate agents started touting short sales as a way for troubled borrowers to sell their homes quickly to potential buyers looking for bargains. Real-estate agents reasoned that banks and mortgage companies would go along with short sales, because they tended to lose less money in the transactions than if a home fell into foreclosure.

In reality, most short sales unraveled, because lenders, servicing firms and mortgage guarantors rejected the sales price agreed upon by the buyer and seller, or because it took the mortgage companies too long to approve the transactions and the deals fell through.

"Short sales have received such a bad reputation among real-estate agents that, as a portion of the overall mortgage market, they have gone down," said Tom Popik, a survey director for research firm Campbell Communications. "We hear a lot of people say, 'I'm tired of doing them. They've been a nightmare.'" A survey Campbell conducted in November of real-estate agents found that the average wait time to get an answer from a lender on a short sale stretched to 8.1 weeks, up from 4.5 weeks in a survey conducted earlier in 2008.

Fannie Mae wants to reduce that delay and spur sales by agreeing on a price for a home -- and the loss Fannie is willing to take on the sale -- even before a buyer has been found.

Two pilot projects, in Phoenix and Orlando, Fla., began at the end of December and will last for three months. The test run is limited to properties secured by a Fannie Mae mortgage and serviced by Countrywide Financial Corp., a subsidiary of Bank of America Corp. Only homes already listed at less than the unpaid balance on the mortgage are eligible for the pilot. So far, about 400 homes have qualified for preapproval between the two markets.

While mortgage holders still take a loss with a short sale, they don't have to take possession of the home and find a new buyer. An analysis by Clayton Holdings Inc., which tracks mortgage loans for investors, found that short sales result in average loan losses of about 19%, compared with an average loss of 40% for homes sold after foreclosure.

Fannie Mae officials say that if the pilot program is successful, it may be expanded to other lenders and regions.

"Fannie Mae's goal is to make the short-sale process as fast as possible for homeowners in financial distress," in order to ensure a "graceful exit strategy for homeowners," said Kevin Brungardt, Fannie Mae's vice president for servicing

management.

Both Phoenix and Orlando have been particularly hard hit by foreclosures. Home prices fell in the Phoenix region 33% last year through October, according to Standard & Poor's/Case-Shiller home-price index, the worst decline in the country. Some 29% of the state's borrowers had negative equity in August, and an additional 6% of borrowers were approaching negative equity, according to a report by First American CoreLogic, a data provider.

In the nation's hardest-hit housing markets, where many borrowers owe more than their homes are worth, short sales are often the only alternative to sales of foreclosed homes. "Values have come down so far that everybody here's upside-down," said Ron Leis, a Sacramento, Calif., real-estate broker who says about 80% of the properties he sells are bank-owned. "Until we can come up with approved sales, we're stuck selling foreclosures," he said.

But some real-estate agents say that Fannie's effort may be too little, too late, because prices are declining so quickly -- at a rate of almost 3% each month in Phoenix -- that prices may have fallen by the time a home is preapproved for a short sale.

"I don't know how you can determine a price today unless you also have a buyer," said Kevin Kauffman, a Phoenix real-estate agent who specializes in short sales and completed 65 such sales last year. He says a preapproval won't go far "in a market like this, where waiting one month costs you a couple percentage points."

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Follow the leaders

Top bond-fund managers buying corporate, mortgage debt; selling Treasurys

By [Deborah Levine](#), MarketWatch

Last update: 1:41 p.m. EST Jan. 29, 2009

NEW YORK (MarketWatch) -- The handful of U.S. bond-fund managers who avoided last year's market bloodbath by hiding out in Treasurys now say they favor owning corporate and mortgage bonds and selling U.S. government debt.

PIMCO, Vanguard, Morgan Stanley and First Pacific Advisors funds that gained from about 5% to a stunning 49% while the Standard & Poor's 500 stock-index plunged 37% last year are inclined to take a bit more risk.

They're sticking to mortgage-related debt and other bonds supported by the Treasury or Federal Reserve. And they are cautiously buying corporate bonds.

"Investment-grade credit is very attractive," said Gregory Davis, head of bond indexing at Vanguard and portfolio manager for its Long-Term Bond Index Fund. It gained 8.6% in 2008, making it one of the top-performing U.S. bond funds last year, according to investment researcher Morningstar Inc.

For corporate bonds, "a lot of bad news is priced in, including defaults and downgrades," Davis said.

Top-performing fund managers are selling or paring their holdings of U.S. Treasurys, one of last year's best-performing assets. The \$2 trillion in new bonds the Treasury is expected to issue this year will likely weigh on prices.

Meanwhile, other government programs to bail out the credit markets, say by guaranteeing bank debt, will make Treasurys less attractive, managers say.

"As policy maneuvers are implemented and make the way through the system, prudent investment managers are going to be reducing their risk-free exposure and going more towards risk products," meaning anything besides Treasurys, said Steve Rodosky, manager of PIMCO Long Duration Total Return Fund, which gained 12.4% last year.

By comparison, the Barclays Capital U.S. Aggregate Bond Index rose 5.24% in 2008. A wide range of bond funds took huge losses as volatility and illiquidity in credit markets made trading dicey, and investors fled most assets in favor of the safety of Treasurys -- slamming holdings in corporate debt, mortgages, and even municipal bonds.

If more investors follow these managers' strategy into corporate debt and mortgages and out of Treasurys, the government will end up paying more to finance its growing deficits. And investors who have hung onto Treasurys bought in the current rally could see their portfolios take a nosedive.

Copying the Fed

One strategy that successful managers say has some legs is to buy debt that the government is also buying.

That strategy lends itself to holding mortgage-backed securities and debt sold by the big housing finance agencies including Fannie Mae, Ginnie Mae and the Federal Home Loan Banks.

The Fed has purchased \$24.6 billion in agency debt since December, and aims to buy up to \$100 billion worth, in the hopes of lowering mortgage rates and reviving the housing market.

First Pacific Advisors' New Income Fund, which rose 4.8% last year, is keeping the biggest chunk of its cash in mortgage-backed securities.

Thomas Atteberry, who helps run the fund and was named Morningstar's fixed-income manager of the year for 2008, plans to keep that segment around 42% of the fund. He also has about 20% of the fund in agency debt. Both benefit from having the Fed as a major buyer, in addition to the government taking over Fannie and Freddie last year, effectively guaranteeing those entities.

"The Fed will keep those capitalized because it needs the institutions to implement policies in the mortgage space," Atteberry said.

Companies that are explicitly benefiting from policy actions are likely to have the best opportunities, said Rodosky, who also manages the PIMCO Extended Duration Fund. That fund gained 49% last year, predominantly by holding Treasury and agency zero-coupon bonds that perform well in a declining rate environment, he said.

Debt sold by banks that is guaranteed by the Federal Deposit Insurance Corp. should do well, he said.

Also, debt sold by firms that have issued FDIC-backed notes but that trade on their own rating have good potential relative to the risk involved, he said.

Goldman Sachs and Morgan Stanley have issued FDIC-backed bonds. [See previous story on FDIC extending program.](#)

Still, "there are going to be some losers in this process, despite the government guarantees," he said. Several institutions are likely to be consolidated.

"Not every bond out there is money good," he said.

Company debt looking better

Several managers recommended investment-grade debt, rated at least Baa by Moody's Investors Service or BBB by Standard & Poor's, saying its yields compared to benchmark Treasuries is advantageous.

Corporate bonds rated A or higher carry yields 4.66 percentage points over Treasuries, according to an index compiled by Merrill Lynch. That spread skyrocketed to as much as 5.90 points in early December, after generally being below 1.5 points until late 2007.

Wide spreads mean there's a good opportunity for those bonds to improve as the gap narrows, Vanguard's Davis said.

"If we see even a stabilizing economy, we can see outperformance in this sector," he said.

Part of Vanguard's gains can be attributed to engaging in less trading than more actively-managed funds, because it's designed to match the characteristics of the Barclays Capital U.S. Government/Credit Bond Index, Davis said.

That Barclays index rose 5.7% in 2008.

In matching the index, the fund's biggest holdings include General Electric Co. and AT&T Inc.

GE's bonds, rated AAA, sold off sharply last year as a broader crisis of confidence led investors to demand higher yields on all company debt, but ended 2008 much closer to where it started it.

David Armstrong, who helps oversee the Morgan Stanley Long Duration Fixed Income Fund, also has focused on companies that have conservative operating and financial leverage and are able to withstand a severe recession.

"It is hard to judge the depth and duration of the economic contraction so we are concentrating on credit quality," Armstrong said.

The fund returned 10.9% in 2008. It started last year with about 30% in corporate bonds, less than its benchmark, anticipating more weakness in the economy than many others were positioned for. The fund is now up to 45% in company debt, largely through the addition of high quality industrial names, he said.

He noted a number of high-quality issuers have issued debt recently, including Wal-Mart Stores Inc., McDonald's Corp. and Emerson.

Treasury rally over

Bond managers expressed the most distaste for Treasuries, which helped several avoid the market's pitfalls last year. They expect Treasury bond prices to fall, pushing yields up, by the same policies that help other assets. The government is incurring a lot of debt buying other securities and propping up financial markets, let alone the massive economic stimulus package expected to be approved in the next month or so.

"We're going to see rates back up on the longer-dated paper," Davis said. "There is a lot of supply to be digested."

Ten-year notes yield 2.73%, up from a record low of 2.04% on Dec. 18.

Still, uncertainty about the economic outlook for 2009 has First Pacific Advisors' Atteberry cautious.

Enough policy questions remain to keep him from aggressively adding to holdings he already had.

For example, legislation to change bankruptcy laws to allow judges to change mortgage terms could wreak havoc for the mortgage market, where investors focus intently on how long a given mortgage will be outstanding or be refunded. [See story on legislation.](#)

Also, the speculation that the government wants to help a lot of home purchasers lock in mortgage rates close to 4.50% for 30 years means those owners will have little incentive to move, also affecting how long a mortgage will actually be outstanding, Atteberry said.

"These are fundamental changes to the rules of the mortgage space, so prudence tells you to back away," he said.

A reflection of that view, the fund has about 31% in cash or cash equivalents, he said.

"There are a lot of policy moves and I think people should wait and see what the rule changes look like," Atteberry said. □

Deborah Levine is a MarketWatch reporter, based in New York.