BANKERS PACIFIC MORTGAGE, INC.
25 YEARS EXPERIENCE & INTEGRITY

2007 SANTA BARBARA REALTORS STATISTICAL UPDATE—2/22/07

CASH IS NO LONGER KING

Fixed mortgage interest rates ended 2006 exactly as they were in 2005—5.75 percent for conforming and 6.0 percent for jumbo 30-year fixed rates with a 1 point origination fee. This is contrary to the conventional wisdom that 30-year fixed mortgage rates would reach 6.7 percent by year-end.

We predict an actual rate decline during 2007 of one-quarter to one-half percent, as both real estate and the economy attempt soft landings. This still does not take us back to 2003-04 fixed rate levels. This is in part because inflation will continue to decline, and hints of deflation may even surface should any improvement in the Middle East conflicts—and therefore oil prices—happen this fall. Furthermore, several economists predict further declines in housing sales of 7-8 percent in 2007, which will put additional pressure on mortgage rates.

Pundits made the same mistake in 2005 of overestimating the rise in fixed rates. Why has the conventional wisdom been wrong for 2 consecutive years? Conventional wisdom tends to follow conventional economic models. But the U.S. economy and housing market have behaved anything but conventionally since 2000. Excessive credit easing by the Federal Reserve caused short-term interest rates to fall below the inflation rate, for instance, creating an anomaly—zero or even negative real interest rates.

The result of the Federal Reserve's prolonged credit easing begun January, 2001 has been a country (and world) awash in money--particularly dollars. Many of those dollars have been reinvested in U.S. Treasury and Mortgage-backed securities. The consequent demand for U.S. Treasury Bonds in particular has driven down long-term rates.

Another casualty of conventional wisdom has been predictions that inflation--particularly core inflation that doesn't account for volatile food and energy prices--would soar as the unemployment rate dipped below 5 percent. (Unemployment is at 4.5 percent today.) This usually signals an economy running at full capacity, which is inflationary. But just as globalization of the financial markets helped to drive down long-term rates, it also helped to move manufacturing (and some services) to cheaper foreign locations. This boosted production capacity immensely, while keeping labor costs low. The result of such an excess in capacity has been excess supply that depressed most consumer prices, rather than boosted them.

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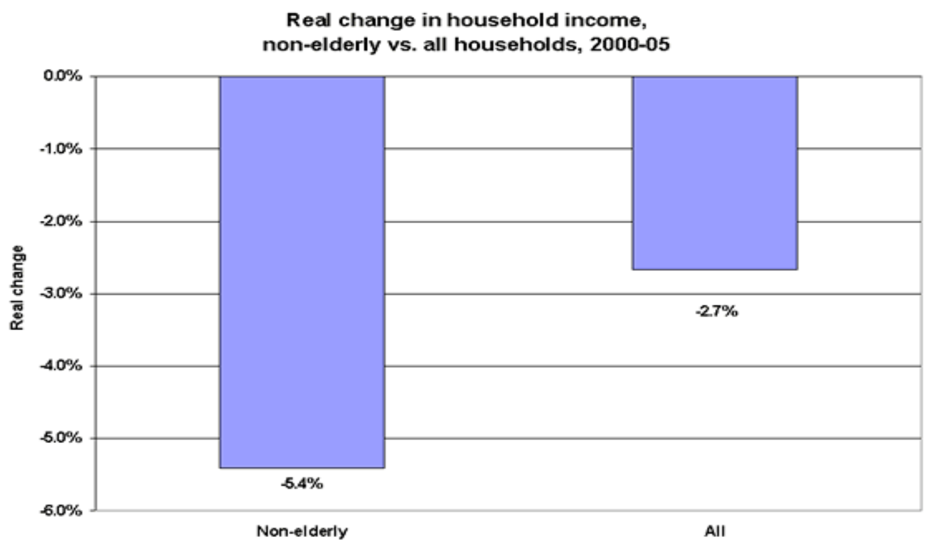

This chart (courtesy of the Economic Policy Institute) confirms the extent to which labor costs have been kept low since 2000 for non-elderly families, when accounting for inflation. Between 2000 and 2005, the real median income of households headed by someone under 65 is down 5.4%, twice that of the overall household median, which is down 2.7% over the past five years.

Lagging household incomes have been another reason so many homeowners have chosen adjustable rate mortgages (ARMs). ARMs now make up 40 percent of all mortgages by dollar volume and their underlying interest rates average 7.5 to 8.5 percent, because short-term rates have risen approximately 4.25 percent since June 2004, when the Fed began to tighten credit. Refinancing volumes have been running 10 percent higher than last year, while purchase applications are 3 percent below last year's totals.

The consensus—which includes Fannie Mae, Mortgage Bankers Association, and the National Association of Realtors—is that 2007 mortgage volumes will decline 7-10 percent over 2006 to $2.4 trillion, in line with the decline in sales' volumes. More than $2.6 trillion in mortgages was funded in 2006, the third-best year ever.