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Interest Rates Are Low, but Banks Balk at Refinancing

By [DAVID STREITFELD](#)

Mortgage rates in the United States have dropped to their lowest levels since the 1940s, thanks to a trillion-dollar intervention by the federal government. Yet the banks that once handed out home loans freely are imposing such stringent requirements that many homeowners who might want to refinance are effectively locked out.

The scarcity of credit not only hurts homeowners but also has broad economic repercussions at a time when consumer spending and employment are showing modest signs of improvement, hinting at a recovery after two years of [recession](#).

Refinancing could save owners hundreds of dollars a month, which could be spent, saved or used to pay down debts. Extra spending would help lift the economy, and lower payments might spare some people from losing their homes to foreclosure.

The plight of homeowners has become a volatile political issue. On Friday, as the House passed a series of new [financial regulations](#), it narrowly defeated a provision that would have allowed bankruptcy judges to modify the terms of mortgages. The measure was strongly opposed by the banking industry.

[President Obama](#), in his weekly address on Saturday, placed much of the blame for the recession on “the irresponsibility of large financial institutions on Wall Street that gambled on risky loans and complex financial products, seeking short-term profits and big bonuses with little regard for long-term consequences.”

The president is scheduled to meet with banking executives at the White House on Monday in another administration effort to increase the flow of loans to consumers and small businesses. Among those expected to attend are representatives from [Citigroup](#), [JPMorgan Chase](#), [Bank of America](#), [Wells Fargo](#) and [Goldman Sachs](#).

An estimated six of 10 homeowners with mortgages have rates that exceed the 4.8 percent rate currently available on 30-year fixed mortgages, the least risky form of home loans.

Nevertheless, only half as many refinancing applications were reported last week than were reported at the beginning of January, the peak level for the year. The total dollar volume of refinancing activity in 2009 will be about \$1 trillion. In 2003, another year when rates fell, it was \$2.8 trillion.

(Mortgage applications to purchase houses showed modest improvement for much of the year, but recently fell sharply to their lowest level in 12 years.)

“The government has succeeded in driving mortgage rates down to their lowest level in our lifetime,” said Guy Cecala, the publisher of Inside Mortgage Finance magazine. “That hasn’t been a big home run, because a lot of people can’t take advantage of it.”

It is highly unusual for mortgage money to be available below 5 percent. Average rates fell as low as 4.7 percent in the 1940s, as the government held down interest rates to finance World War II, and stayed just below 5 percent until the early 1950s. Rates went above 5 percent in 1952 and stayed there — until this year.

The super-low rates are not likely to last much longer. The Federal Reserve program that has driven rates to such lows, which involves buying \$1.25 trillion in mortgage-backed securities, is scheduled to expire in March, and Fed leaders have said that it would not be renewed.

Some analysts believe rates could jump as high as 6 percent in the spring. On a \$300,000 mortgage, such a jump would cost an extra \$225 a month.

Andrew Knapp, a sales executive in Bartlett, Ill., has tried twice to refinance, which would save his family several hundred sorely needed dollars every month. Lenders said the house had lost value and the Knapps had too much debt. “There was no urgency for them to do anything,” Mr. Knapp said.

The most recent Federal Reserve survey of lenders found that they were continuing to tighten terms for business and household loans. Banks say they are under pressure from regulators to raise their cash reserves, which means fewer loans. They also argue that a troubled economy breeds extreme caution.

“More than ever before, lenders are very conscious of making good quality loans,” said Michael Fratantoni, the vice president for research at the Mortgage Bankers Association. “They are looking at the value of the collateral and the credit quality of the borrower.”

But some borrowers argue that more refinancings now might well forestall losses for the banks later.

Mark Belvedere bought a condominium in a San Francisco suburb in early 2004 and refinanced it in 2005. He now owes \$235,000 on a property that would sell for barely half that today.

Mr. Belvedere said he would be willing to live with all that lost equity if he could refinance his loan from a variable rate, which could eventually go as high as 12 percent, into a 30-year fixed term.

His lender said no, citing the diminished value of the property. “It makes no sense and is so frustrating,” Mr. Belvedere said. “I’m ready and willing to pay the mortgage for the next 30 years, but they act like they’d rather have me walk away.”

When Mr. Belvedere refinanced four years ago, the process was so easy he hardly remembers it.

“In those days, a refinance was like a free weekend in Vegas,” said Mr. Cecala of Inside Mortgage Finance. “Now it’s between an Army physical and a root canal — and that’s if you’re successful.”

The current lending freeze owes much to the excesses of the boom. Mr. Belvedere’s lender, [IndyMac](#), failed in 2008 from too many bad loans.

“The system was abused, so they threw it out the window,” Mr. Cecala said. “Now lenders are paranoid about every loan unless it is guaranteed to be the safest deal on earth.”

An Obama administration program to encourage the refinancing of loans owned or guaranteed by [Fannie Mae](#) and [Freddie Mac](#), the government-controlled mortgage giants, is off to a slow start.

The Home Affordable Refinance Program, known as HARP, was designed to benefit between four and five million homeowners whose loans exceeded the value of their property by as much as 5 percent. But as of Sept.

30, only 116,677 loans had been refinanced.

“We’re refining our understanding of borrower behavior,” said a [Treasury Department](#) spokeswoman, Meg Reilly.

The program was modified during the summer to refinance homes where the loan exceeded the value of the property by as much as 25 percent. But since lender participation is voluntary, they have the option of rejecting these loans — and they often do, mortgage brokers say.

Jeff Jaye, a mortgage broker in Danville, Calif., said only three of the refinances he submitted to the program were successful. More than a dozen were rejected for various reasons, including the existence of second loans or the borrower’s lack of equity.

“It seems that the lenders are choosing which components of the HARP program to offer to consumers, which is unfortunate,” the broker said.

When it comes to refinancing loans that are too big to be in the government system, Mr. Jaye knows the difficulty first-hand.

“I have a perfect credit score, I make a good living and I’ve never been late with my mortgage in my life,” he said. “But as a self-employed businessman, there is no loan for me.” He plans to dispose of his house in what is known as a short sale, where the lender agrees to accept less than it is owed.

At an industry conference last week, the Illinois Association of Mortgage Professionals, a brokers’ group, proposed a federal program that would allow streamlined refinancings up to 175 percent of the median price in a local market. A quarter of the savings from the lowered payments would go into an escrow account to reduce the principal balance.

“The theory is simple,” said Jeri Lynn Fox, the association president. “If people have jobs and are making their payments at 7.25 percent, they will make their payments at 5 percent.”

For Mr. Knapp, the sales executive, any such program would be too late. He has given up on the possibility of

refinancing and is trying for a [loan modification](#). If that does not work, there is one more solution: walking away from his home.

“We’re a flight risk,” he said.

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