

the Mortgage Commentary

November 2005

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Deficits Matter

The Federal Reserve raised short term rates by another .250% on the first of November to the surprise of no one. Banks immediately followed suit by increasing their prime rates by an equal amount — to 7.000%.

Thus, monthly payments on home equity lines will increase by \$2.08 per \$10,000 balance. To the mathematically challenged, that's \$20.83 per \$100,000.

The policy statement released by the FOMC after its meeting is a near clone of previous statements.

"Upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal. Accommodation can be removed at a pace that is likely to be measured."

This virtually confirms that the final policy steps of Greenspan's term will be gradual, but persistent, hikes -- certainly through 2005.

It is important to note that only Greenspan will be leaving the Federal Reserve at the end of January. The rest of the crew will remain intact. And since the vote for a rate hike was unanimous, the expectation is that Ben Bernanke, Greenspan's probable replacement, will continue his hawkish stance on inflation.

Which brings up the burning question — what about inflation? Can continuing measured hikes in short term rates effectively keep inflation under control? Or are there other factors that could trump Fed actions?

Certainly a continuation of rising energy prices cannot be controlled or influenced by Fed policies. And as the increased energy prices ripple throughout the economy, everything we buy will cost more. To some, that

sounds like inflation.

It is true that the "core" inflation rate remains flat at a benign 2%. But would some true economist please explain to the rest of us normal people why the core inflation rate excludes food and energy? Included in the category of us normal people are those who buy food to eat, gasoline to power our cars, and gas to heat our homes.

And there is yet another inflationary factor which seems beyond the ability of the Federal Reserve to control or even influence. And that is the federal deficit.

It is not as though Greenspan is unaware of the dangers posed by continuing deficits. He has repeatedly warned congress, most recently on November 3rd, that the country could face "serious economic disruptions" if big budget deficits are not reined in.

To date his warnings have fallen on ears deafened by political considerations. Translation: congress lacks the political courage to take appropriate actions to reduce the deficits.

"I find it inconceivable, frankly, that persistent budget deficits over the long run will not have a significant impact on long-term interest rates," Greenspan said.

Greenspan observers have, for years commented on his elliptical speech and obscure language. But how could he more clearly set forth the case against deficits than he does in the above statement?

Ben Bernanke, his successor, is noted for clear speech. It is hoped that he will be as clear, and even more forceful in condemning deficits.

Long term rates depend on it.

Conforming Loans to \$359,650

| Type | Rate | APR | Trend |
|-----------------------------------|--------|--------|-------|
| 30 Yr FIX | 6.125% | 6.215% | → |
| 5/1 | 5.750% | 6.707% | → |
| Jumbo Loans over \$359,650 | | | |
| 30 Yr FIX | 6.500% | 6.563% | ↑ |
| 10/1 | 6.250% | 6.799% | ↑ |
| 5/1 | 5.875% | 6.773% | → |
| 10 Yr Bond | | 4.559% | ↑ |
| Prime | | 7.000% | ↑ |

But if H.R. 1461 becomes law, the conforming limit would increase to 150% of that amount, or \$577,500.

HELOC, just in case

A home equity line of credit can be a very handy thing to have, just in case.

Nobody likes to think about emergencies occurring in their lives. But as bumper stickers proclaim “Bad Things Happen.” Or words to that effect.

And if you can take action which costs little or nothing and that will help in case of certain emergencies, why not do so?

Those who have been mortgage loan agents for any length of time at all have received at least one call that starts something like this: “I’m looking to pull some cash out of the equity in my house.” This opener is followed by a variety of reasons for needing some instant cash.

It could be a medical emergency resulting in temporary loss of income from one of the income earners. It could be a loss of job, and the client needs a bit of cash to reduce financial pressure until a new job is found.

Or it could be an emergency of a different kind. Could be that the family car is suddenly due for replacement. Translate: it broke down and repairs are too expensive to justify.

Some emergencies are good ones. Suppose your son or daughter gets accepted into an institution of higher learning whose tuition costs will be about the same as your home cost when you bought it fifteen years ago. A HELOC can help.

And maybe it isn’t an emergency at all. Maybe you just want a new car and the interest on an equity line is lower than on auto loans. Or maybe there’s a cruise you always wanted to take. Or maybe — (you fill in the rest).

New conforming loan limits

On October 26th, the House approved H.R. 1461. If this bill is passed by the Senate and signed into law, it will benefit homeowners in more “High Cost Areas,” including the Bay Area. Here’s the deal.

Conforming size loans carry lower interest rates than jumbo loans by roughly .375%. Conforming loan limits are established each year based on the national median price of homes.

The present limit for single family conforming loans everywhere except Alaska, Hawaii, Guam and the Virgin Islands is \$359,650. These areas are allowed to exceed the limit by 50%, thus their conforming limit is \$539,475.

Under H.R. 1461, conforming limits for high cost areas will increase to the maximum of the area’s median purchase price, capped at 150% of the national limit. Anaheim/Santa Anna, Boston, Los Angeles, New York/New Jersey, San Diego, San Francisco Bay Area, Washington, DC, West Palm Beach/Boca Raton/Delray Beach would be added to the high cost areas under the bill.

Sometime around Thanksgiving Day, the new conforming loan limits will be announced. Assume the new national conforming limit for a single family will be \$385,000.

\$385,000 would be the conforming loan limit in the Bay Area UNLESS THE NEW LAW IS PASSED. But if H.R.1461 becomes law, the conforming limit would increase to 150% of that amount, or \$577,500.

The next Mortgage Commentary will contain an update on this legislation. Meantime, write your Senator expressing support.

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