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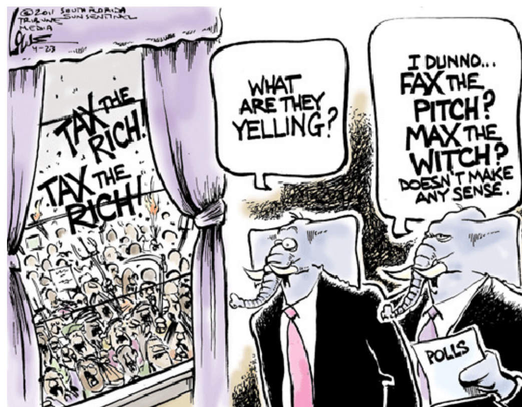
IN THIS MONTH'S ISSUE:

* TERMS—15-yr. vs. 20-yr. vs. 30-yr. vs. 40-yr.
* TAX HIKE ON THE RICH WOULD IMPACT JUST 3% OF TAXPAYERS
* EXPIRATION OF TEMPORARY HIGH BALANCE LOAN LIMITS
* THE MONTH IN REVIEW
* RATE SUMMARY
* SPECIAL(S) OF THE MONTH
* MORTY'S MAILBAG
* MORTGAGE MIRTH



THE MONTH IN REVIEW

8/1-8/5 Last week's **Gross Domestic Product** report showed the U.S. economy **grew at a sluggish annualized pace of just 1.3% in the second quarter.** More disturbingly, **the first-quarter reading was revised down to 0.4%.** Monday's dour **MANUFACTURING** report from the Institute for Supply Management revealed a slowdown in the nation's factories as the **ISM index fell from 55.31 percent in June to 50.9 percent in July**. Relief over the signing of the Budget Control Act of 2011 which raised the debt ceiling and averted a U.S. default was short-lived because the data underscored just how weak the economy is. The stock market reacted and pushed the Dow down for an 8th straight day as **the Dow dived below the 12,000 level for a 265-point loss.** The Institute for Supply Management's **SERVICE sector index fell to a reading of 52.7—worse than the 53.7** reading that economists had hoped for, but still indicating expansion in the sector. **The yield on the 10-year note dipped to 2.45%,** after trading at over 3% less than two weeks ago. Thursday**, the stock market plummeted 512-point**s amid fears about a global slowdown and recent weak domestic economic data.

The latest reading on **jobless claims** showed the number of first-time filers for unemployment benefits **fell last week,** but remained at a key level signaling that the job market remains sluggish. Standard & Poor's downgraded U.S. government credit worthiness from AAA to AA+.

8/8-8/12 Wall Street dominated the news this week. **The Dow plunged 635-points, Monday, after the S & P downgrade of the U.S.'s credit rating, late Friday.** It was Wall St.'s worst day since 2008. **The following day the market rebounded with a 430-point gain. The Fed said it would keep its key interest rates low until sometime in 2013** because of the slower than expected economic growth. **After a one-day respite, U.S. stocks plunged yet again, Wednesday,** as investors were confronted with mounting fears about Europe's ongoing debt crisis, this time in France. **This time it was a 520-point drop. U.S. equity markets rose again some 423-points, Thursday, on positive news about corporate earnings and jobless claims hitting 4 month lows.** The University of Michigan's **consumer sentiment** reading for August fell sharply, to the lowest level since 1980. **The index fell to 54.9, from 63.7 the prior month**. **Stocks climbed 126 points, Friday,** to post their second day in a row of gains.

8/15-8/19 **The stock market posted another 214 point gain, Monday,** based on a merger mania among several Fortune 500 companies. **Housing starts fell 1.5% in July to an annual rate of 604,000, while permits to build new homes slumped 3.2%.** Both reports came in worse than expected. **The Labor Department's Producer Price Index, which measures wholesale inflation, rose 0.2% in July.** The National Association of Realtors **said EXISTING home sales dropped by 3.5% in July, far worse than the 2% rise that the market was looking for. Thursday, renewed concerns about the U.S. and global economies sent markets plunging anew and pushed gold to a new record high. The Dow closed down 419 points. Once again, the market retreated. This time it fell 173-points, Friday.**

8/22-8/26 **NEW home sales fell 0.7% in July** to 298,000 units, according to the Commerce Dept. It was the third straight month of declining sales for hard-pressed home builders. **Stocks staged a broad rally, Tuesday, with the market posting gains of 322-points**. **The Commerce Department reported a 4% jump in orders for durable goods in July**, compared to a 1.3% decline in June. **U.S. stocks tumbled 171-points, Thursday, over European debt worries. Buoyed by comments from Fed Chairman Bernanke that the Fed would do all it could to support the recovery, stocks gained 135 points.**

8/29-8/31 **Stocks rallied 254 points**, following a trifecta of positive news: A Greek bank deal, a solid U.S. consumer spending report and relief that Hurricane Irene caused less damage than expected.

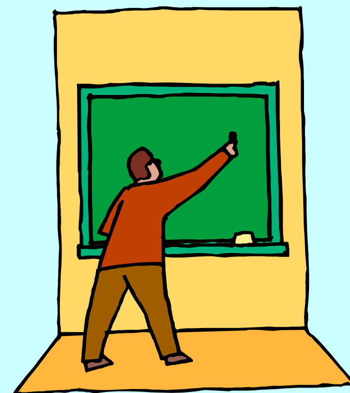
Personal income rose 0.3% in July while spending climbed 0.8% during the month, the Commerce Department reported. Economists were expecting income to tick up 0.4%, spending to edge up 0.5%. **Pending home sales fell 1.3% in June,** according to the National Association of Realtors. **Home prices rose 3.6% during the second quarter, according to the Case-Shiller 20-city home price index.** That was the first quarterly increase in prices in a year.

THIS ISSUE'S TOPIC: TERMS—15 vs. 20 vs. 30 vs. 40

Most borrowers focus on interest rate to save money on their mortgage, this is overly simplistic and not very cost effective. Allow me to illustrate my point with some real world numbers. Even at today's historically low rates the numbers are a real eye-opener. Below are three different mortgage scenarios for an amortized fixed-rate loan (repayment of principal and interest) for **$400,000 at 4.375%.**

Scenario 1

- Total Payments: $718,971
- Total Interest: $318,971



Scenario 2

- Total Payments: $600,884
- Total Interest: $200,884

Scenario 3

- Total Payments: $546,206
- Total Interest: $146,206

Remember, the **interest rates** and **loan amounts** for all three are the **same**. Which one would you rather pay? Even among No-brainer's, the obvious choice is scenario 3.

What's the difference? **THE TERM**: Scenario 1 is a 30 year, scenario 2 is a 20 year and scenario 3 is a 15 year. In short, the savings between a 15 year mortgage and a 30 year for a $400,000 loan is $172,765.

But wait (as they say on TV infomercials), there's more. It gets even better because the rates for shorter term loans are even cheaper.

You can get a 20 yr. fixed rate today at 4.25%, thus the total payments would be...

Scenario 2

- Total Payments: $594,464
- Total Interest: $194,464

And you can get a 15-yr. fixed rate for 3.5%, so the payments would be...

Scenario 3

- Total Payments: $514,715
- Total Interest: $114,715

Thus, the actual savings between a 15 yr. term and a 30 yr. term would be $204,256 ($318,971-$114,715).

DID YOU KNOW THAT ON A STANDARD **30-YEAR FIXED RATE MORTGAGE**...

- **Not until year five does 30% of your payment goes toward principal.**
- **Not until year fifteen does 50% of your mortgage payment goes toward principal.**

AS CONTRASTED WITH A STANDARD **15-YEAR FIXED RATE MORTGAGE.**..

- **During the first year, 60% of your payment is going toward principal reduction.**
- **By Year seven, 75% of your mortgage payment is going toward principal reduction.**

THEREFORE, IF YOU CAN AFFORD A 15-YEAR PAYMENT, THIS IS THE WAY TO GO!

Even so this is only half the story because of the opportunity cost. What could you do with those potential mortgage payments if you retired your mortgage debt 15 years earlier?

Borrowers can realize considerable savings by restructuring their loan term. If a person doesn't have the cash flow to handle the payments on a 15 year loan, I advocate **20-year loans**, which offer **two thirds the benefit** term-wise, with **only one third the payment increase**.

30-yr. Term Monthly Payment: $ 1997

20-yr. Term Monthly Payment: $ 2477

15-yr. Term Monthly Payment: $ 2859

On the other hand, even with the relatively low payments that a 30 year terms affords borrowers, there are still folks that need something with even lower payments and a longer term—like **40-years.** Based on what we have covered you pretty much know the pros and cons of these loans.

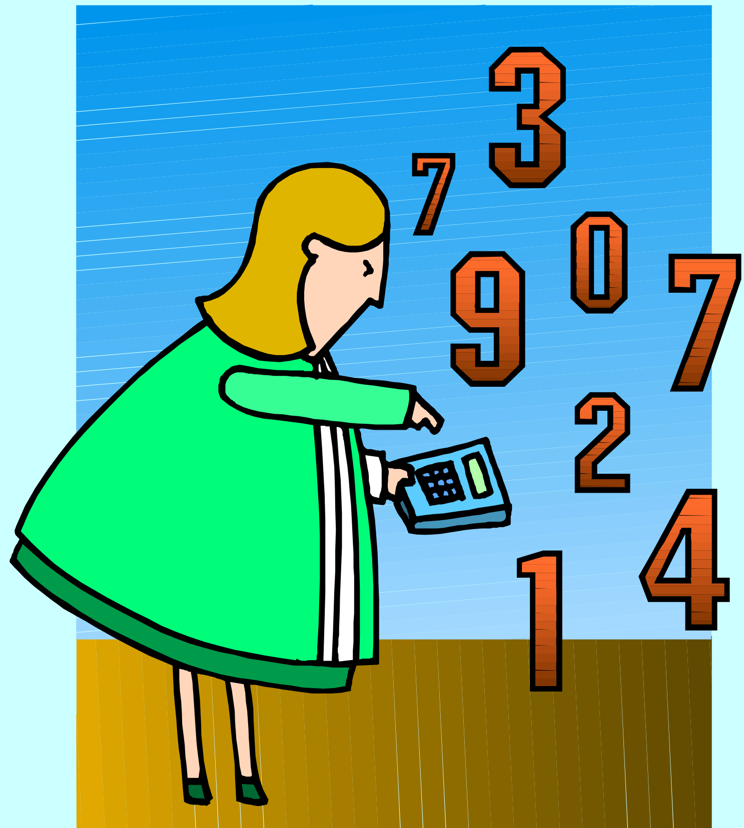
The Pros: Where affordability is an issue because of income (or in more costly markets) they offer lower monthly payments.

The Cons: They build equity at a snail's pace and consumers who keep these loans end up paying far more in interest than they would with a traditional 30-year fixed-rate mortgage.

To keep our comparison of apples to apples the same, I'll use the same $400,000 loan amount for an amortized fixed-rate loan with a 40 yr. term.

- Total Payments: $909,978
- Total Interest: $509,978
- Monthly Payment: $1895

Today's prevailing rate on a 40 yr. term would be at 4.875%. As you can see when compared to a 30 yr. term your payments would drop about $100 per month, but the Total Interest paid over 40 years nearly total $190,000 more. Thus, term is far more impactful than rate when it comes to financing one's home.



EXPIRATION OF TEMPORARY HIGH BALANCE LOAN LIMITS

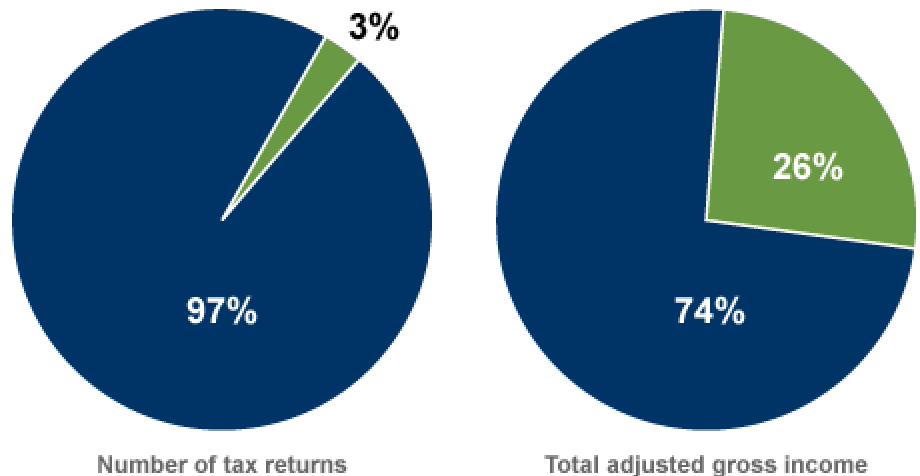
The previous maximum of $697,500 for Fannie Mae and Freddie Mac loan limits in San Diego County will be reduced to $625,500 as of September 30th. Loans will need to be submitted prior to September 9th at the latest to qualify under the old limits. Docs must be out by September 30th and these loans must fund by October 10th to still be eligible for the higher loan amounts.

(AT THE RISK OF ALIENATING THOSE AMONG US THAT EARN MORE THAN $200,000 PER YEAR, I AM PRESENTING THE FOLLOWING ARTICLE FROM CNN MONEY.COM.)

TAX HIKE ON THE RICH WOULD IMPACT JUST 3% OF TAXPAYERS

As the government looks for ways to climb out of its massive hole of debt, all eyes are on the rich. President Obama and many of his fellow Democrats continue to call for higher taxes on the wealthy. And, according to results of a CNN/ORC International Poll, many Americans agree that it's the only way the country can dig itself out of its current economic mess. In the survey, 63% of the 1,008 people interviewed over the phone said they think the new bipartisan committee in charge of deficit reduction (required under the recent debt ceiling agreement) should raise taxes on higher-income Americans and businesses.

But just how many rich people are there? And are there enough of them for a tax increase to really make a dent in the United States' trillions of dollars in debt? President Obama has defined the nation's wealthy as those who make $200,000 or more a year. According to a recent report from the Internal Revenue Service, that leaves out about 97% of the tax-paying population.



The report, which provides a complete breakdown and analysis of returns for the 2009 tax year, found that only a mere 3% of tax returns were filed by people earning a gross adjusted income of $200,000 or more. Americans earning $1 million or more were even more rare, comprising just 0.2% of total tax filers and accounting for a mere 236,883 of the 140 million tax returns received in 2009. The wealthiest taxpayers -- those earning $10 million or more in adjusted gross income—are even less prevalent. There were only 8,274 people belonging to that elite club, according the IRS. Out of the nearly 4 million "rich" people making more than $200,000 a year, 1,470 didn't pay any income tax whatsoever in 2009. But the people who did pay taxes earned a total of nearly $2 trillion in income—about 26% of total taxpayer income in 2009.

President Obama's tax proposals—which many Republican's call "job-killing" tax hikes—include getting rid of some corporate tax breaks enjoyed by oil and gas companies and corporate jet buyers, and restoring some Bush-era tax rates for high-income households. If the Bush tax cuts expire as planned in 2012, the top two income tax rates will revert to 39.6% and 36% from 35% and 33%, respectively. Yet, even though these high-income earners are a minority, Obama says the proposed tax increases would boost revenue by $750 billion over a decade. It's not quite the multi-trillion figure the U.S. needs to pay off the deficit, but for many of those who responded to the CNN/ORC International poll it's evidently a good enough start.

RATE SUMMARY:

Rates improved significantly, this month.

*** Conventional conformings—down by an 1/8TH – 3/8ths.**

*** Jumbos—UNCHANGED**

*** Governments (FHA/VA)—BETTER by ¼ to ½ point.**

FOR CURRENT INTEREST RATES FOR THE 16 MOST POPULAR PROGRAMS GO TO: www.mortgagestraighttalk.com Then, click on the menu tab labeled "RATES". The rate sheets are updated every Friday.

SPECIAL(S) OF THE MONTH:

Conf. 5/1 ARM @ 2.75% (lowest rate)

*

Conf. 5/1 Interest Only ARM @ 2.875% (lowest payment)

*

High Balance Conf. 30 yr. fixed @ 4.00%

*

FHA/VA Conf. 15 yr. fixed @ 3.25%

*

Home Ownership Accelerator @ 3.288%

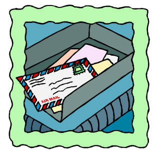
*

Jumbo 30-yr. fixed @ 4.75%

*

Jumbo 5/1 ARM @ 3.375%

MORTY'S MAILBAG



Q. I don't get it: The nation averted disaster by passing the debt-ceiling bill and the very day the House passed it, the market fell 10-points. The next day, after the Senate passed the same bill, the market dropped 265-points. Can you explain why the markets would react this way? I thought raising the debt-ceiling would remove the uncertainty that the market supposedly hates and it would cause stocks to rise.

A. It's really rather simple— the nation's finances are unsustainable in the long term without some tax increases. The stock and bond markets refused to buy into the idea that many in Congress seem incapable of understanding, namely that tax revenues must increase to offset the deficits. MORE SPENDING CUTS WON'T SOLVE THE PROBLEM OF PAYING FOR DEBTS THAT HAVE ALREADY BEEN INCURRED: it only exacerbates the problem because it shrinks the economy. With spending cuts more people are laid off and forced on to unemployment which adds to the government's costs even more. With more people out of work, the tax revenues are reduced further and the debt problem worsens. Given the scale of the debt problem, a credible plan requires both revenue enhancement measures and entitlement reform. The Budget Control Act of 2011 (the debt deal) did not include either. It relied heavily on cuts to discretionary spending, which was not the major driver of the country's long-term deficits, (more about that later) while ignoring the need to reform entitlements and raise more revenue—both of which are key ingredients to improving the country's long-term solvency. This is why the stock and bond markets reacted negatively to the news.

That's the short answer to your question. Here's the detailed version. While it's true that we're awash in debt, it wasn't always like this. The nonpartisan Congressional Budget Office reported that when George Bush took office, our national debt was $5.7 trillion. During his presidency, the federal government racked up another $5.3 trillion. Congress and the recession share the blame—but mostly the former president and the Congress. The recession and other economic changes account for the remaining $3.3 trillion. Since 2001, lawmakers have time and again cut taxes or increased spending without finding ways to pay for their decisions.

Even President Obama has adopted the position of his opponents in connecting the economy to the debt by saying the nation's budget is like a family's income, claiming that both must live within their means. This is a spurious argument because unlike the U.S. government, a family can neither levy taxes nor print its own money. Regardless, the focus on the deficit at the expense of everything else was wrong-headed and a self-inflicted wound. The debt-ceiling debate was breath-taking in its hypocrisy since conservatives' anti-tax absolutism was responsible for creating so much of the debt from 2001 to 2008.

Be that as it may, the debt limit does not limit the debt. It's an illusion of a law, instituted in World War I to persuade gullible taxpayers that Congress is exercising responsible oversight over borrowing. Congress already controls spending and taxation. If it wants a smaller debt, it can cut spending or raise taxes at will. But, to allow the deficit to rise, and then refuse to pay for it months later, is the epitome of financial irresponsibility. America's real crisis is not a debt crisis. It's an unemployment crisis. Yet this agreement not only fails to address unemployment, it's guaranteed to make it worse.

As many economists have been saying for at least two years the Stimulus Package in 2009 was far too small. The effects of it carried the economy through 2009 and 2010, but it had wound down by 2011. Evidence of this was painfully clear by August 1st when the government reported that the economy (GDP) had grown by less than 1% (0.4% in the first quarter and 1.3% in Q2) during the first six months of the year, in part because of earlier spending cuts by state and local governments. Now, the problem is exacerbated by the federal government cutting spending, too. Further proof that the economy was winding down came in the form of two reports from the Institute for Supply Management. The first confirmed that the MANUFACTURING sector was losing steam as the ISM index fell from 55.31 % in June to 50.9% in July. A week later, another ISM report on the SERVICE sector showed the index posting full point lower than what was expected. The worst thing you can do in these circumstances is slash government spending, since that will depress the economy even further. So those demanding spending cuts now are like medieval doctors who treated the sick by bleeding them, and thereby made them even sicker.

The solution to our current fiasco is to grow our economy. The United States did this in the past. After World War II gross federal debt reached 122 percent of GDP, the highest ratio on record. (It's currently about 95 percent). But over the next 40 years it fell to about 33 percent. (Incidentally, the top tax tier in the 40' & 50's was 91%; today it is 35%). Back then, our revenues (taxes) were more than adequate to cover our expenditures (debts). Since consumer spending is responsible for roughly two-thirds of our GDP. When consumer spending wanes and the private sector (business) isn't spending, it is incumbent that government steps in and supplements the shortfall as it did in the 1930's. Spending by the federal government could create jobs to rebuild our infrastructure, retrain unemployed workers, invest in energy technologies, etc. In times of economic hardship it is critical that government intervenes because it is the only entity with sufficient resources to get the economy back on its feet. This is the principal tenet of Keynesian economics.

What follows are compendium of Congressional programs that got us where to we are:

BUSH TAX CUTS: 2001, 2003 and 2006

After a few years of budget surpluses at the end of the Clinton administration, lawmakers began the new century by reversing course with major tax cuts. According to the Congressional Budget Office, the Bush tax cuts alone added nearly $2 trillion to the deficit. Beginning in 2001, they were reauthorized and expanded in 2003, and then again in 2006. In 2010, in exchange for extending unemployment benefits, President Obama agreed to another two-year extension of the Bush tax cuts at a cost of $544.3 billion. Proponents argued that the tax cuts would spur economic growth. Since they didn't do it between 2001- 2010 why did anyone believe it would be different in 2011?

MEDICARE DRUG BENEFIT: 2003

Without finding a way to pay for it, Congress passed a law in 2003 that expanded prescription drug benefits for seniors on Medicare. Originally estimated to cost $395 billion over 10 years, costs are now expected to be much higher—and there is no expiration date. Bush characterized the measure as "the greatest advance in health care coverage for America's seniors since the founding of Medicare." But there was no corresponding tax increase or spending cuts to pay for it. Now, it's estimated that Medicare Part D will cost about $1 trillion dollars over the next 10 years.

WAR FUNDING: 2001 TO PRESENT

In order to fund wars in Iraq and Afghanistan, Presidents Bush and Obama have spent more than $1 trillion on direct costs alone. On top of that, annual defense spending has just about doubled since 2001, rising to almost $700 billion in 2010. Military spending now accounts for more than 20% of the entire federal budget. Obama ordered more troops to Afghanistan in 2009, while he has simultaneously drawn down forces in Iraq.

Costs are still sky-high. In February, Obama requested $118 billion to fund the wars just for fiscal year 2012.

BUSH STIMULUS: 2008

With economic indicators signaling a slowdown, lawmakers mounted a bipartisan effort to move a $168 billion stimulus package through Congress in hopes of stopping the recession in its tracks. The tax cuts and other incentives—totaling around 1% of GDP—weren't paid for. Bush praised the quick work of Congress and urged Americans not to "overreact" to the economic troubles. But, it was vastly insufficient for what was needed.

TARP BAILOUTS: 2008

In October 2008, Congress authorized the Treasury Department to spend up to $700 billion to help stabilize financial markets. The money was used to bail out banks and Wall Street firms, finance General Motors and Chrysler's trips through bankruptcy and help homeowners modify mortgages they could no longer afford. When lawmakers authorized Treasury Secretary Henry Paulson to tap the aid, it was unknown how much would ever be returned to the Treasury. Turns out, the bank bailouts have turned a small profit, while taxpayers are still holding the bag for bailouts for the auto industry and AIG. According to the latest CBO estimate, TARP—the whole program—will ultimately cost taxpayers $19 billion.

AMERICAN RECOVERY ACT: 2009

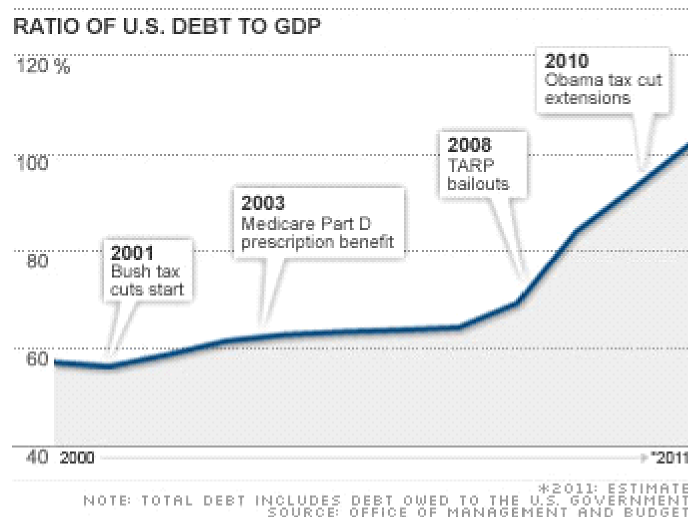
In the face of a deepening recession, Congress put together a massive stimulus package. It was a combination of government spending and tax cuts, the bill included money for infrastructure, energy-related projects and unemployment benefits, among other items. It was originally estimated to cost $787 billion but later revised to $862 billion. Not a single Republican in the House voted for the bill. It actually worked better than people gave it credit for. Roughly $260 billion of this was offset by cutbacks at the state and local level.

OBAMA TAX PACKAGE: 2010

Sold as a form of stimulus, this legislation included a reduction in the estate tax threshold, a patch for the alternative minimum tax, a partial one-year payroll tax holiday and some additional tax breaks for businesses that invest in plants and equipment. It also included an extension of the Bush tax cuts through the end of 2012, and is projected to cost $858 billion over ten years. The spending and tax cuts in the bill were, once again, not offset by any increase in federal revenue. With both the annual budget deficit and public debt hitting record levels, and the House now controlled by cut-happy Republicans, the debate has shifted to reducing the size and scope of government.

CURRENT SITUATION

Democrats and Republicans alike pushed major legislation that increased government spending, without corresponding increases in revenue. The recession which began in 2007 caused tax revenue to plummet even further. As a result of a decade of fiscal mismanagement, diminishing revenues and political brinksmanship, Standard & Poor's downgraded U. S. Treasury debt from AAA to AA+. S & P based its downgrade and its negative outlook for America's credit rating partly on the assumption that Bush-era tax cuts for high incomes would be extended past their 2012 expiration, "because the majority of Republicans in Congress continue to resist any measure that would raise revenues." S & P said it could change its outlook to stable if the tax cuts ended.



Both liberal and conservative economists suggest that emphasizing spending cuts is better for long-term growth. But there are few, if any precedents, for paying down such a large debt solely through spending cuts. Washington should be focusing on stimulating the economy in the near term to induce people to spend money and create jobs, while settling on a long-term plan for spending cuts and tax increases to take effect only after the economy recovers.

In the mean time, the worst thing policy makers can do in these circumstances is to slash government spending; it will only make matters worse. As interest rates on federal borrowing are still very low, spending cuts now will do little to reduce future interest costs. On the other hand, weakening

the economy now will also hurt its long-run prospects, which will in turn reduce future revenue. Government has to spur demand and create jobs in a deep downturn, even though doing so worsens the deficit in the short run. Spending cuts alone will not close the gap; the chronic revenue shortfalls from serial tax cuts are simply too deep to fill with spending cuts alone. Revenues must rise.

Recipients of the newsletter are invited to Ask Morty any real estate or financing questions. The answer to the question will be answered either by phone or email and posted in the next issue for the benefit of all. Questions may be forwarded via mail phone or fax. Due to the high incidence of spam, if you email me a question it needs to identified as “real estate question” on the subject line of the email. (See front of issue for phone and fax numbers). Morty’s email address is.... **morty@mortgagestraightTalk.com**

MORTGAGE MIRTH

A pessimist's blood type is always b-negative.

If you’d care to share one that you’ve heard, please email it to me at.... **rod@mortgagestraightTalk.com**

NEXT ISSUE’S TOPIC:
INDEXES REVISITED