Public Interest Institute

IOWA ECONOMIC SCORECARD

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Buying a house is not the same as buying beef for dinner tonight

by Deborah D. Thornton

When buying beef at their local grocery store, a task done every week or so, most Iowans instinctively know the differences between "Prime," "Choice," and "Select." Many don't realize there are additional categories such as Utility, Cutter, and Canner grades. This meat is generally used to make processed products. Even without this knowledge, consumers are comfortable making a buying decision and generally satisfied with the result.

However, start talking about "Prime" and "Sub-prime" mortgages and it is an entirely different story, not only for Iowans, but for most Americans. Most people only buy a house a few times in their life, compared to weekly beef purchases, and the process is generally long, tedious, and confusing. A myriad of rules and regulations have been established to protect buyers and sellers of real estate, yet are we really sure what we just signed? These rules and regulations were established by a wide variety of federal and state agencies and consumer protection organizations, and are well documented, yet today we find ourselves in the midst of the "Sub-prime" mortgage "crisis" and everyone is nervous about what happens next.

Just what is a sub-prime mortgage? According to the Iowa Division of Banking, sub-prime mortgage loans were originally established as a "Temporary credit accommodation in anticipation of early sales of the property or in expectation of future earnings growth."[1] However today they have morphed into "credit repair" or affordability" products. One key feature of a sub-prime mortgage is that the interest rate is generally three percentage points above the rate that the most credit-worthy customers pay.[2]

Much of the current problem is specifically with adjustable-rate mortgages (ARMs). Sub-prime borrowers who were qualified with ARMs at low initial interest rates lasting one, two, or three years are now dealing with increases in the rates and the resulting increases in their payments. The ARM products that are problems may have the following characteristics: a fixed introductory rate that expires after a short time, then adjusts to a variable index rate plus a margin; very high or no limits on how much the payment amount or rate may increase at the reset; limited or no documentation of the borrower's income; frequent refinancing options which continually extend the final term of the mortgage in order to maintain affordable payments; or substantial repayment penalties.[3] Often the mortgage may have allowed for no down payment or be an "interest-only" loan. Additionally, the payment of the property taxes and homeowners' insurance may be separated from the monthly mortgage payment instead of being paid at the same time and being escrowed. If the homeowner is not disciplined and does not plan ahead, this can result in large bills being due, called "payment shock," which the homeowner is then unable to pay.[4]

According to the *Chicago Fed Letter* of August 2007, the sub-prime ARM market is less than 7.5 percent of the total U.S. mortgages, and of those 7.5 percent, only 14 percent were delinquent, or slightly over 1 percent of the total mortgages held by consumers. Delinquency is defined as being at least 30 days past due.[5] In contrast, fixed-rate mortgages in both the prime and sub-prime mar-

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Dr. Don Racheter

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kets have not seen an increase in delinquency rates. Current delinquency rates in both areas are below their historical highs of 2.5 percent and 16.6 percent and are staying relatively flat.[6] Further, RealtyTrac, an online marketer of foreclosed properties, recently reported that November 2007 filings fell 10 percent compared to October.[7] So an initial analysis would show that contrary to the hysterical headlines in the newspapers, the sky is not falling.

Though the percentages are small, the true numbers are large since the total U.S. residential mortgage market in 2006 was $10 trillion, with the sub-prime portion being $1.5 trillion. In real numbers, about $100 billion of sub-prime ARMs are delinquent nationwide.[8] Though the November drop reported by RealtyTrac was good news, it was still higher than November 2006. James Saccacio, chief executive for RealtyTrac, recommended we all keep an eye on the "trend of flat or decreasing foreclosure activity," adding that if it continues through the first few months of 2008, it would "certainly bode well."[10]

Unfortunately, once a mortgage becomes delinquent, it is often difficult to bring it current because of penalties and fees, and some homeowners fall into a foreclosure situation. Herein is the current problem. As of September 2007, the Mortgage Bankers Association reported that 8.63 percent of sub-prime mortgages in Iowa were in foreclosure. This places the state fourth in the nation. The total foreclosure rate was 1.65%, or ninth in the nation.[11]

For some in Iowa, the current mortgage situation reminds them of the 1980s farm crisis. During that time quickly rising real estate prices and high borrowing were followed by an economic downturn in which both demand and prices for agricultural products fell. During that time the Iowa Mediation Service (IMS) worked to assist land owners and their creditors in resolving delinquencies. Over two-thirds of the 33,000 cases handled were resolved satisfactorily, generally with farmers paying something, but banks settling for less than the full amount owed.[12]

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The mediation service has been asked by state Attorney General Tom Miller to assist with the current situation. The IMS is working informally to facilitate settlements of delinquent mortgages, primarily by promoting loan modifications. They have set up a Foreclosure Hotline, 877-622-4866.[13] The IMS is free to homeowners and being paid by state government from the Civil Reparations Fund. The current budget for Fiscal Year 2008 is $100,000.[14]

Though called a "Foreclosure" Hotline, the service is available to any homeowner who is concerned about their situation. They do not have to be delinquent. At this time IMS staff have spoken with 4,000 homeowners and are handling 600 official cases. Of these cases about 200 are "seriously delinquent," either 90 days or more past due or officially facing foreclosure. According to Cynthia Martin, the Mortgage Response Coordinator, IMS has resolved 60 cases, helping the homeowner to get mortgage modifications such as refinancing or lower interest rates. Many of the problems are the result of a job loss or serious family illness. An example Ms. Martin gave was of a couple where the husband had a heart attack and couldn't work, the wife's job was low paying, and the medical bills were large, resulting in many stressors and a long-term difficult financial situation.[15]

Neighborhood Finance Corporation, a lending and buyer education organization based in Des Moines, tries to teach people how to buy a house before they begin the process.[16] They try to teach consumers how to tell the "Prime" from the "Canner" loan deal. Holly Olson, Executive Director, said that "homebuyers often don't adequately analyze the situation they're going into" and this creates the longer term problem.[17]

Key to this analysis is the use of standard "affordable" home pricing when buying a house and getting a loan. *Money* magazine outlines guidelines followed by most lenders. First is a total debt-to-income ratio of no more than 36 percent. The housing payment-to-income ratio should be between 28 and 33 percent. They recommend you also consider other savings needs, such as retirement and college costs. Further, property taxes (nationwide average $3,500) and homeowners insurance (nationwide average $481) should be considered as part of the total monthly payment. If the down payment is less than 20 percent of the purchase price, Private Mortgage Insurance must be included. This often ranges from $50 to $80 additional per month.[18] Only when all of these factors and many more are considered can a potential homeowner make an informed decision about a house purchase. After all, we're not buying beef.

(Endnotes)

1 Statement on Sub prime Mortgage Lending, Iowa Division of Banking, September 20, 2007, p. 1.

2 S.P. Dinnen, "Sub prime mortgage woes bad news for marginal homebuyers," *The Des Moines Register*, March 24, 2007.

3 Statement, p. 5.

4 Ibid.

5 "Comparing the prime and sub prime mortgage markets," Chicago Fed Letter, August 2007, No. 241, p. 2.

6 "Comparing," p. 3.

7 Les Christie, "November foreclosures take a dip," CNNMoney.com, December 19, 2007, <http://money.cnn.com/2007/12/19/real_estate/foreclosures_take_dip/index.htm?postversion=2007121906> (December 20, 2007).

8 "Comparing," p. 2.

9 Les Christie.

10 Les Christie.

11 Iowa Ranks 4th in Nation in Subprime Forclosures, 9th in Overall Foreclosures, Iowa Banking Law Blog, September 12, 2007, <http://www.iowabankinglawblog.com/subprime/index.html> (December 20, 2007).

12 Vikas Bajaj, "How to Solve a Sub prime Mess? An Iowan Says, Let's Caucus," *The New York Times*, December 9, 2007. 13 Pat Curtis, "New hotline may help Iowans facing foreclosure," Radio Iowa, September 11, 2007.

14 Conversation with Cynthia Martin, Mortgage Response Coordinator, Iowa Mediation Service, December 20, 2007.

15 Ibid.

16 S.P. Dinnen, "Sub prime mortgage woes bad news for marginal homebuyers," *The Des Moines Register*, March 24, 2007.

17 Ibid.

18 "How much house can you afford?" CNNMoney.com, <http://cgi.money.cnn.com/tools/houseafford/houseafford.html> (December 20, 2007).

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Iowa's Monthly State Revenue:

Iowa's monthly state revenue for Fiscal Year 2008 tands at $3,091.9 million in December 2007. For the fiscal year to date total gross cash receipts increased $287.9 million (10.3 percent) compared to Fiscal Year 2007. Personal income tax, sales and use tax, and corporate income tax receipts all increased.

Iowa's Estimated Net Yearly Revenue:

The Revenue Estimating Conference met in December and the "estimate for FY2008 net General Fund receipts is now $5.983 billion, an increase of $337.1 million compared to actual 2007."

Source: Legislative Fiscal Bureau, "Monthly Revenue Memo," Revenue Estimating Conference Report

Iowa's Unemployment:

Iowa employers added 3,200 jobs in November, and the unemployment rate remained stable at 3.9 percent. Iowa's Workforce Development reported that total employment in November increased to 1.6 million, representing the "highest level of employment" so far this year. The largest increases were in the trade and transportation sectors, with 1,100 jobs added. Nationally the December 2007 unemployment rate was 5.0 percent. In addition payroll jobs were up 18,000 and productivity during the 3rd quarter 2007 was up 6.3 percent.

Source: Iowa Workforce Development, Labor Market Information Bureau, "Monthly Unemployment Rate" News."

Consumer Confidence Index:

In the late Fall/early Christmas season the Consumer Confidence Index posed a slight increase, to 88.6, up from 87.8 in November. The Conference Board reported that consumers' "short-term outlook regarding business conditions, employment, inflation and stock prices improved marginally." This reverses a four month slide in the CCI. Regionally the Index rose even more to 108.3.

Source: Conference Board, "Consumer Confidence Survey."

Consumer Price Index, Monthly Change:

The seasonally adjusted Consumer Price Index for urban consumers increased 0.8 percent in November 2007, driven mostly by the energy index, which increased by 5.7 percent. Next highest was Transportation at 2.9 percent. The Indexes generally increased across the board, with Recreation and Education increasing the least at only plus 0.1 percent. In the Midwest the CPI only increased by 0.7 percent, also led by higher fuel prices. Excluding the volatile energy sector, the Midwest CPI was only up 0.1 percent over all categories from October 2007.

Source: U.S. Department of Labor, Bureau of Labor Statistics

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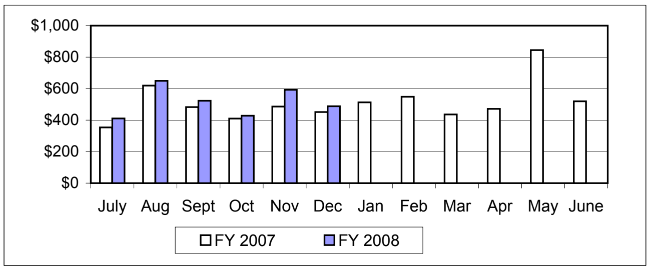
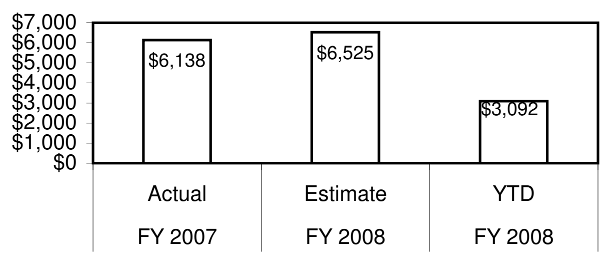
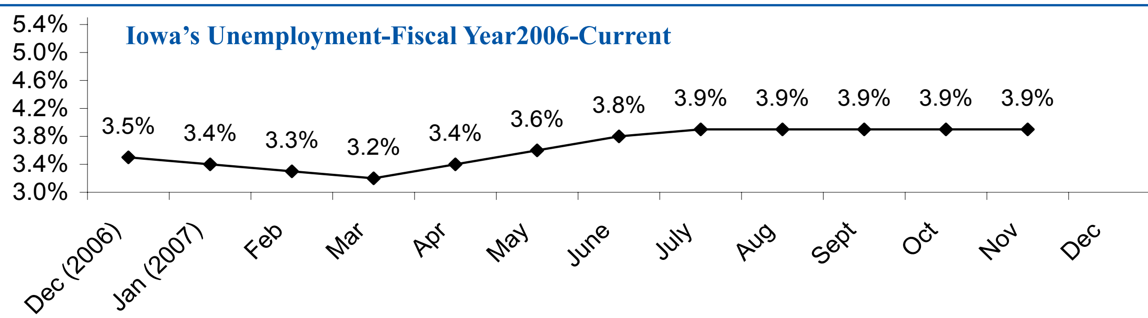
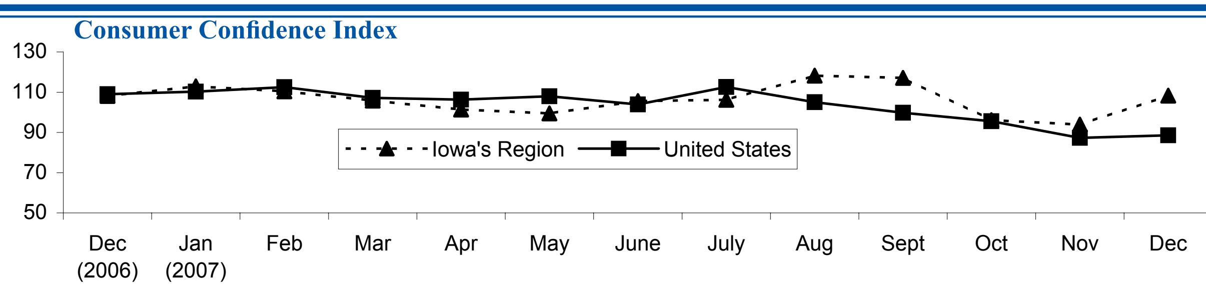
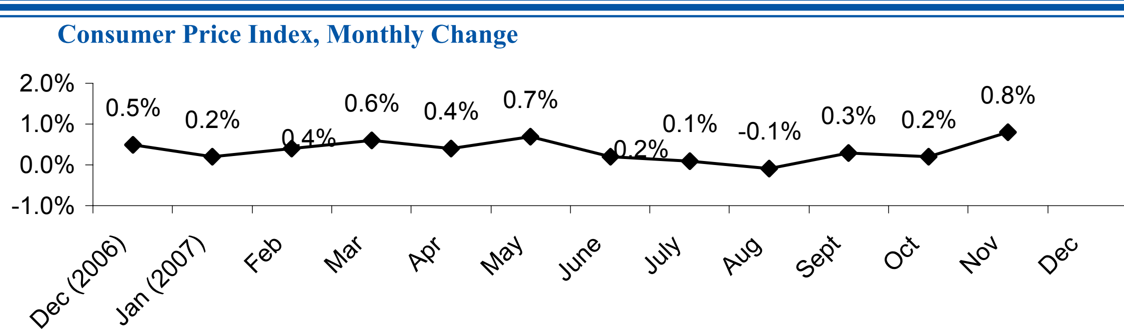
Iowa's Monthly State Revenue and Estimated Net Yearly Revenue (in millions)











REVENUE ESTIMATING CONFERENCE
ESTIMATE OF GENERAL FUND RECEIPTS

Historical Figures

TAX RECEIPTS	FY 06 ACTUAL	FY 07 ACTUAL	% Change FY 07 Act. Vs FY 06Act.
Personal Inc. Tax	2,854.2	3,085.9	8.1%
Sales and Use Tax	1,881.1	1,910.1	1.5%
Corporate Income Tax	348.6	424.6	21.8%
Inheritance Tax	73.1	76.0	4.0%
Insurance Premium Tax	121.4	105.2	-13.3%
Cigarette Tax	89.5	122.0	36.3%
Tobacco Tax	9.2	12.1	31.5%
Beer Tax	14.2	14.3	0.7%
Franchise Tax	35.5	33.3	-6.2%
Miscellaneous Tax	0.6	1.0	66.7%
Total Tax Receipts	5,427.4	5,784.5	6.6%
Other Tax Receipts			
Institutional Payments	13.0	12.9	-0.8%
Liquor Profits	63.8	64.8	1.6%
Interest	17.5	28.7	64.0%
Fees	76.2	84.7	11.2%
Judicial Revenue	63.1	66.9	6.0%
Miscellaneous Receipts	49.7	35.7	-28.2%
Racing & Gaming	60.0	60.0	0.0%
Total Other Receipts	343.3	353.7	3.0%
Total Tax & Other Receipts	**5,770.7**	**6,138.2**	6.4%
Transfers			
Lottery	79.6	59.3	-25.5%
Lottery-Touchplay			
DHS Intergovernmental Tansfers			
Other Transfers*	64.4	9.3	-85.6%
Total Transfers	144.0	68.6	-52.4%
Total Receipts & Transfers	5,914.7	6,206.8	4.9%
Accruals (net)	54.0	37.4	-30.7%
Refunds	(586.0)	(597.9)	2.0%
Net Receipts	5,382.7	5,646.3	4.9%

Source: Iowa Department of Management, Revenue Estimating Conference

REVENUE ESTIMATING CONFERENCE
ESTIMATE OF GENERAL FUND RECEIPTS

Estimates of October 9, 2007

10/07 FY 08 ESTIMATE	% Change FY 08 Est. vs. FY 07Est.
3,262.2	5.7%
1,966.7	3.0%
436.0	2.7%
83.6	10.0%
125.6	19.4%
223.1	82.9%
18.6	53.7%
14.6	2.1%
30.2	-9.3%
1.0	0.0%
6,161.6	6.5%
12.6	-2.3%
67.8	4.6%
20.0	-30.3%
73.7	-13.0%
89.6	33.9%
40.0	12.0%
60.0	0.0%
363.7	2.8%
6,525.3	**6.3%**
56.3	-5.1%
13.9	49.5%
70.2	2.3%
6,595.5	6.3%
(18.9)	0.0%
(641.8)	7.3%
5,934.8	**5.1%**

Estimates of December 11, 2007

12-Dec FY 08 ESTIMATE	% Change FY 08 Est. vs. FY 07 Actual	12-Dec FY 09 ESTIMATE	% Change FY 09 Est. vs. FY 08 Est.
3,293.0	6.7%	3,450.5	4.8%
1,963.4	2.8%	2,001.4	1.9%
447.0	5.3%	416.5	-6.8%
83.6	10.0%	90.3	8.0%
118.1	12.3%	121.8	3.1%
233.2	91.1%	233.9	0.3%
19.1	57.9%	19.1	0.0%
14.6	2.1%	14.7	0.7%
30.2	-9.3%	31.2	3.3%
1.0	0.0%	1.0	0.0%
6,203.2	7.2%	6,380.4	2.9%
12.9	0.0%	12.9	0.0%
67.8	4.6%	69.8	2.9%
20.0	-30.3%	20.0	0.0%
73.2	-13.6%	72.0	-1.6%
89.5	33.8%	90.8	1.5%
36.2	1.4%	36.2	0.0%
60.0	0.0%	60.0	0.0%
359.6	1.7%	361.7	0.6%
6,562.8	**6.9%**	**6,742.1**	**2.7%**
56.3	-5.1%	58.6	4.1%
13.9	49.5%	1.9	-86.3%
70.2	2.3%	60.5	-13.8%
6,633.0	6.9%	6,802.6	2.6%
(16.8)	0.0%	10.8	N/A
(632.8)	5.8%	(673.4)	6.4%
5,983.4	**6.0%**	**6,140.0**	**2.6%**

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Question of the Quarter:

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