CREATIVE MORTGAGE TALK

A Periodic Newsletter on Creative Financing

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THE PURCHASE PRICE/INTEREST RATE DILEMMA

Unfortunately, at the current time the United States and virtually the entire industrialized world (*except for China*) are experiencing a significant economic recession. Although the recession began in December 2007 in the Lower 48, Alaska actually experienced economic growth during 2008. However, it now appears that Alaska will join the Lower 48 and enter into a mild recession in 2009. If the forecasts for decreases in employment, which range from -0.2% by State Department of Labor to -1.3% by Northern Economics, are correct the effect is small enough that the vast majority of Alaskans will feel little or no real impact. However, President Obama has stated that his Economic Stimulus Bill will save or create 8,000 jobs in Alaska, which means that if he is correct we could actually see job growth. But, because all our news comes from the national media, we are being bombarded with stories of doom and gloom.

WORDS OF WISDOM

"The problem with socialism is that eventually you run out of everyone else's money."

Margaret Thatcher

Fortunately the truth is not as bad as the media portrays it. According to the Case-Shiller, 20 City Housing Index, home prices have declined by 26.7% from their peak in 2006. That decline means that prices in the Lower 48 are now at the level they were in late 2003, but are still 50% higher than they were in 2000! Unfortunately, most potential home buyers are not schooled in finance and economics and are strongly influenced by the media. For this reason many persons who would like to own a home, and who can afford to purchase, are postponing their purchase decision in the belief that prices will continue to decrease.

Considering that we now enjoy record low interest rates and that we now have an $8,000 tax credit for 1st time homebuyers, I don't expect a significant decrease in median price homes in Alaska. But even if I am wrong, there is another very important element of the cost of housing that is overlooked by many potential buyers. That is the impact of the interest rate on their mortgage and its effect on their total cost of homeownership. There is little that anyone can do about the cost of utilities, taxes, insurance and repairs, that are part of the cost of homeownership, but by doing a critical analysis they do have some control of the major costs of homeownership, which is the sum of their down payment and mortgage payments made over the time they own their home. Changes in interest rates often have more impact than changes in price. If it were assumed that ownership would continue for the full amortization period of the mortgage, the impact of interest rates would be even more profound. But since surveys show that the average period of ownership is 7 years, all of the calculations and examples that I show herein are based upon a 7 year holding period.

Now let's look at an example, assuming a $300,000 priced home, with 10% down and a 30 year fixed mortgage payable at 5.25%. The monthly payments on the $270,000 mortgage would be $1,490.95. Therefore, over a period of 84 months total mortgage payments would be $125,240 and when the $30,000 down payment is added the total ownership cost over 7 years is $155,240.

Now lets look at the situation where the price decreases by 10%, but the mortgage rate increases by 1.5% to 6.75%. The monthly payment on a $243,000 mortgage at 6.75% is $1,576.09 for an 84 month total of $132,392. Adding the $27,000 down payment then indicates a total ownership cost over 7 years of $159,392. This is a cost of $4,152 more than buying at the higher price with the lower interest rate mortgage. And if interest rates increased to 9%, which is the approximate average rate since 1972, the increase in the 7 year cost of homeownership would be $36,000.

The importance of this illustration is due to the fact that we are now experiencing very favorable mortgage rates that are the low end of the range over the last forty years. Further importance of this illustration is that every economist expects that the government's massive deficit spending to stimulate the economy will cause very significant inflation and higher interest rates once the recession is over. How high will interest rates go? No one knows, but look at the following chart from the Federal Home Loan Mortgage Corporation showing the average annual interest rates since 1971 through January of this year. Notice that the average rate over that period of time was 9.06%.

HISTORICAL 30 YEAR FIXED MORTGAGE INTEREST RATES					
1972	7.38%	1985	12.43%	1998	6.94%
1973	8.40%	1986	10.19%	1999	7.44%
1974	9.19%	1987	10.21%	2000	8.50%
1975	9.05%	1988	10.34%	2001	6.97%
1976	8.87%	1989	10.32%	2002	6.54%
1977	8.85%	1990	10.13%	2003	5.83%
1978	9.64%	1991	9.25%	2004	5.84%
1979	11.20%	1992	8.39%	2005	5.87%
1980	13.74%	1993	7.31%	2006	6.41%
1981	16.63%	1994	8.38%	2007	6.34%
1982	16.04%	1995	7.93%	2008	6.03%
1983	13.24%	1996	7.81%	2009	5.05%
1984	13.88%	1997	7.60%	AVERAGE	9.06%

Since it is impossible to predict future interest rates, or future sales prices, there is considerable risk in delaying a decision to purchase a home that is currently suitable and affordable. While it is possible that purchase prices might decrease in the next year or so, it is almost certain that within two years interest rates will begin to increase. It is therefore important for the prospective purchaser to weigh the impact of postponing a purchase decision in hopes of a lower price, but then having to pay the increased cost of a mortgage with a higher interest rate.

While it is relatively easy for anyone familiar with a financial calculator to calculate the cost of ownership using several scenarios as illustrated in the examples above, it is extremely time consuming to calculate all of the possibilities of the interplay between price reduction and interest rate increase. For this reason, I have developed a Price/Interest Rate Calculator that calculates the 7 year cost of ownership based upon declining purchase price in 2% increments to a total reduction of 20% and increasing interest rates in 0.25% increments from the current interest rate to a rate 4% higher than the present rate. To instantly calculate 200 variations in the 7 year cost of ownership it is necessary to enter only the purchase price, the percent of down payment, the current mortgage interest rate, and the loan amortization period. The Calculator then makes all of the other calculations, showing the forecast 7 year cost of ownership at the current purchase price, interest rate, percent down and loan amortization period and then calculates the decrease or the increase in homeownership costs at the various price and interest rate scenarios.

You can use this calculator by going to www.cash4you.net and clicking on Price/Interest Rate Calculator.

BUT WHAT IF THE BUYER CAN'T QUALIFY FOR A LOAN?

Although as I have noted above, interest rates on conforming loans are now at a 40 year low, I recognize that now that banks have returned to more traditional underwriting where Buyers must have good credit and verifiable income, there are many potential Buyers who will not qualify for conventional financing.

For Buyers who don't qualify for conventional financing the solution is to use the forms of Creative Financing that were prevalent during much of the 1960's and 1970's. Although I have talked about these techniques in past issues and will continue to do so in future issues, these techniques include the following:

- Seller Financing if the property is owned free and clear or if the Seller has a large equity.
- Cash Out and assumption of existing mortgage if equity is small.
- Some cash and assumption of an existing loan and a Seller Financed wrap-around or second mortgage.
- Exchange of other assets necessary to balance the equity and allow an assumption.

To learn more about the subject of Creative Financing I recommend the following steps:

1. Go to our website: www.cash4you.net and click on CA$H NOW SELLER FINANCING WEBINAR. In this free 20 minute webinar you will be introduced to the techniques needed to overcome Seller reluctance to Seller Financing.
2. For a more detailed introduction to the concepts of Creative Financing go to www.Cash4You.net and click on Financing Outside the Box.
3. Read the book "***Owner Will Carry***" which can be purchased at www.arnettbroadbent.com/ownerwillcarry.html .
4. Read the book, "***How to Finance Any Real Estate, Any Place, Any Time***" which can be purchased at www.JimMisko.org/books.html .

CASH NOW SELLER FINANCING™

With today's financing, many properties and many Buyers will **not** qualify for a bank loan. The way to sell non-financeable properties is to use Seller Financing. **Buyers love it!** Unfortunately, many Sellers will not consider this effective and time proven financing option because the Buyers' down payment is not enough to meet their needs.

The answer to this dilemma is simple. We will pay **CA$H NOW** for Seller Financed Notes with a simultaneous closing so the Sellers walk away from the closing with the cash they need.

A FREE WEBINAR

To learn more about this concept, visit our website at www.Cash4You.net and take our new Webinar titled **"MORE SALES WITH CA$H NOW SELLER FINANCING™."**

THINK POSITIVE,
MAINTAIN PERSPECTIVE,
AND YOU WILL DO FINE IN 2009!