Click here for Full Issue of EIR Volume 8, Number 19, May 12, 1981

Banking by Kathy Burdman

Volcker and variable mortgage rates

Mortgage deregulation will make homebuying unaffordable to the average family in the United States.

The landmark ruling by the Federal Home Loan Bank Board this week deregulating mortgages and eliminating all ceilings on mortgage interest rates could mean the end of the American dream of home ownership.

As of April 30, the traditional fixed-rate American mortgage is dead, according to a source at the Regan Treasury.

Increasingly, the fixed-rate mortgage, in which the home buyer gets a guaranteed fixed interest rate for the 20- to 30-year life of the loan, will be replaced by the new "alternative mortgages," which the Home Loan Bank Board's ruling now allows all federally chartered savings and loans to make.

The new regulations specifically permit savings and loans to offer an instrument called an "adjustable mortgage loan," which is a version of the variable rate mortgage (VRM). Payments rise or fall according to an index mutually chosen by borrower and lender, such as the rate for U.S. Treasury bills.

With VRMs, a rise in the index could be passed on to the borrower in one of three ways: monthly payments could rise, without limit; payments could stay the same, and the unpaid balance on the loan could be increased; or the terms of the loan could be increased, up to 40 years. The banks will be able to change the interest rate paid by the home buyer as often as every six months.

The move could be a terminal blow to whole segments of the U.S. homebuilding industry. Already, the high interest rates forced on home buyers by Federal Reserve Board Chairman Paul A. Volcker have shoved the average mortgage base rate up from 9 percent in 1976 to 14-15 percent today. That fact alone has made home buying so unaffordable that one-third of the members of the National Association of Homebuilders went bankrupt in 1980 alone.

Now, with variable rate mortgages, the home buyer won't even be certain that 15 percent is all he'll be paying over the 20-30 year life of the mortgage. If Volcker keeps pushing up rates, homeowners' payments on a mortgage taken out today could rise in a few years to 30 percent or more.

The U.S. mortgage market will thus increasingly be *indexed* to inflation and day-by-day market interest rates. This is akin to Brazilian-style indexation which understates the real rise in inflation rates.

The rise in new variable rate mortgages could be dramatic, as it was in the state of California, which deregulated mortgages for state-chartered savings and loans in 1975. From 1976 to the end of 1980, fully 32.5 percent of all new mortgages written in California were done as "California-style VRMs," authorized to be revised as often as the lender chose, with no ceilings whatever on interest rates.

VRMs, which are written only on one to four family homes, are an even higher percentage of home mortgages, since the California totals include commercial mortgages.

As of the end of 1980, most VRMs and other so-called alternative mortgages outstanding were held in California. Out of a nationwide total of $19 billion in alternative mortgages, some $17.2 billion were in California.

Under the new Home Loan Bank Board ruling, all federally chartered S&Ls, which held 55.8 percent of all mortgages outstanding for a total of $276 billion at the end of 1980, can now move to VRMs.

The Board's ruling was made to help S&Ls (who are paying an average 16 percent for deposits but only earning an average 8 percent on mortgages held,) make ends meet. But while hiking up the mortage rate may make the S&Ls' books look better in the short run, in the long run they're just destroying their own market.

Indexation "may make housing simply unaffordable," Roy Green, vice-president of the U.S. League of Savings Associations told *EIR* recently. "I'm not sure that housing will ever be competitive at 15-19 percent interest rates. I don't think the consumer can afford such rates for any length of time."

And that is the point. The answer to the severe losses of $1.5 billion and more expected by the savings and loans this year is not deregulation of the mortage-lending side of their balance sheet. This will only destroy the U.S. homebuilding industry. Rather, the S&Ls should go after Fed Chairman Volcker and his interest rate squeeze—now.

© 1981 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.