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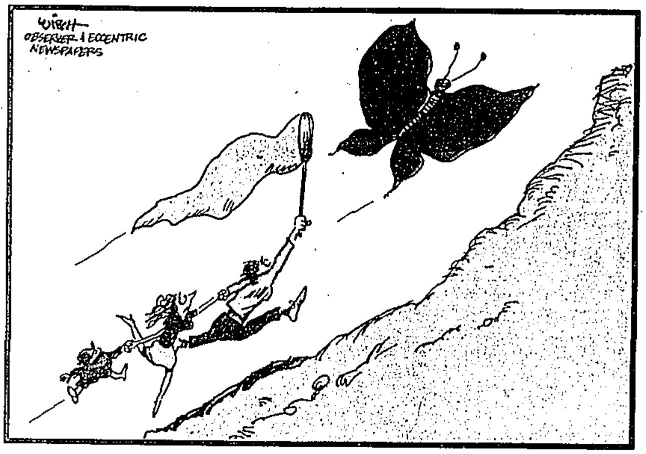

Large down payments offset mortgage rates

By Larry O'Connor
staff writer

The return of lower interest rates has brought a sense of deja vu to the home-buyer's market. But more stringent qualifying standards could be smudging an otherwise rosy picture.

Traditional methods of home financing with short-term mortgages and spending less income toward housing are back, according to study by the United States League of Savings Institutions on 1985 house-financing data.

The results could mean increases in both home equity as loans are paid off, more quickly and in personal finances because prospective buyers have to save substantially more for a down payment.

But falling mortgage rates do not necessarily mean houses are more affordable. The average conventional mortgage payment in 1985 was $865 compared to $845 in 1984, indicating buyers were opting for more expensive homes. In the Detroit area, interest rates averaged 11.37 percent for the last half of 1985. In 1984, they averaged 11.56 percent.

Area banks and mortgage companies, for the most part, back up the study. The major exception to the trends set in the past few years is the vanishing of adjusted-rate mortgages. Adjusted-rate mortgages, though initially offering a lower rate (8½ percent at one bank compared to about 10 percent for fixed-rate mortgages), can fluctuate upward with inflation. A fixed-rate mortgage remains the same throughout the loan period. ARMs captured two-thirds of the conventional home mortgage market in 1985, more than twice the 31.9 percent in 1983.

BUT THIS YEAR fixed-rate mortgages are what's in demand at area lending institutions.

"There's no risk involved like there is with the ARMs," said Tom Fitzsimmons, mortgage representative for the National Bank of Detroit office in Farmington. "Now it's more popular because the fixed rate has come down."

> *'New standards for qualifying for a mortgage are now in place — and are the equivalent, in terms of income needed to qualify, of a 1½ percent increase in interest.'*
> — U.S. Housing Markets

The 15-year mortgage appears to be supplanting the popularity of ARMs.

"Since the first of the year, I'd say 99 percent of our business has been with the 15-year fixed rate," said Ken Nelson, branch manager of First Federal Savings of Michigan in Westland. "There's very few adjusted-rate mortgages around."

But 30-year fixed-rate mortgages have one major advantage — lower monthly payments. The monthly payment on a $96,000 mortgage with a 15-year mortgage at 10¼ percent is $1,046.37. The 30-year monthly payment at 10¾ percent is $895.72, a $150 difference. Lending institutions generally offer lower rates for 15-year mortgages than for 30-year loans.

"The difference in the monthly payment isn't dramatic," said William Yaw, director of marketing for First Standard Federal in Troy, "but the interest paid is significant." (See accompanying story.)

ALTHOUGH LOWER interest rates would seemingly mean more buyers could qualify for loans, a new development has canceled out for many purchasers the effect of the interest rates. According to the publication, U.S. Housing Markets, "new standards for qualifying for a mortgage are now in place — and are the equivalent, in terms of income needed to qualify, of a 1½ percent increase in interest."

In 1985, lenders reverted to the 28-percent-of-income limit that had been followed in the 1970s. Translated into income dollars, the publication reports that the borrower now needs 3.57 times his annual payment instead of the former three times to be considered for a mortgage. From late 1980 to early 1985, a borrower without heavy debt obligations could qualify for a conventional mortgage if first-year payments were as high as 33⅓ percent of gross income.

Even Federal Housing Administration and Veteran's Administration loans, which always were more lenient in income standards, have tightened their guidelines. Previously a borrower could qualify with payments 40 percent of their income and sometimes higher. Since last year, there has been a firm 38 percent ceiling with some exceptions, according to the publication.

"These new limits were not arbitrarily imposed. They are a reaction to the high rate of delinquencies and foreclosures of the last few years. There is no longer enough appreciation in home prices to bail out overextended buyers."

Area lenders agreed.

"It's getting hard to approve a loan with a 5 percent downpayment these days," said Nelson.

Another aspect of home buying — age of the buyers — seems to be changing. Contrary to the League of Savings report, which said the median age for a person purchasing was 36 in 1985, many home buyers appear to be younger, according to those selling area real estate.

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Switch is on to 15-year mortgages

In 1983, only 6.2 percent of all conventional mortgages matured in 15 years. In 1985, that percentage more than doubled to 13.8 percent. Fifteen-year mortgages proved more popular among repurchasers than among first-time buyers, but first-time buyers were still responsible for 34 percent of the 15-year mortgages written in 1985.

The principal advantage of the 15-year mortgage is its rapid equity build-up from loan payments. With interest rates at 10 percent, the borrower amortizing a loan over 15 years will have accumulated 5½ times more equity in five years just by loan repayment than if the borrower had taken out a 30-year loan.

Lenders typically offer slightly lower interest rates on 15-year mortgages. But this small break on the interest rate is not enough to offset the higher monthly payment per thousand dollars of loan amount. For example, a 30-year mortgage at 12 percent carries a monthly payment of $10.29 per thousand dollars of loan amount, while a 15-year mortgage at 11½ carries a monthly payment of $11.68 per thousand dollars.

SO TO MAKE monthly payments comparable between 15- and 30-year mortgages, borrowers using the shorter-term loan must buy less expensive housing or make larger downpayments. Otherwise the larger monthly payment would oblige them to spend a larger percentage of their income on the mortgage payment.

In 1985, home buyers with 15-year mortgages tended to be slightly older than those being financed for 30 years. But in most cases, the 15-year mortgagors had lower incomes. Although it might be expected that lower incomes would be associated with lower purchase prices, borrowers choosing 15-year mortgages bought even less expensive homes relative to their incomes than their counterparts with 30-year mortgages.

Fifteen-year mortgagors made relatively higher down payments than 30-year mortgagors did. The combination of lower interest rates, lower home prices, higher down payments and lower rates typically produced lower monthly payments with 15-year loans than for those with 30-year loans.

And home buyers with 15-year mortgages tended to find less expensive homes among existing housing stock, particularly in that part of the housing stock built 25 or more years ago. Relatively few first-time buyers bought new homes or condominiums with 15-year mortgages.

— *United States League of Savings Institutions*

Financing menu serves up change

With the strong likelihood that inflation will remain in remission, many of the trends in home ownership that have emerged in the mid-1980s will continue, according to the U.S. League of Savings Institutions. Here is what the league sees in its crystal ball.

- Never again is a single type of mortgage instrument likely to dominate the market as the long-term, fixed-rate mortgage did for so long. Adjustable-rate mortgages have established their place on the mortgage menu, and short-term mortgages, such as the 15-year mortgage, are doing so today.
- Disinflation has begun to impose more stringent loan underwriting standards on mortgage borrowers — higher down payments and lower ratios of housing expense-to-income. Disinflation is the reduction of the general level of prices, planned to increase purchasing power while controling deflation. The data presented in the 1985 Home Buyer Survey revealed the decline in the percent of income devoted to housing expense; higher down payments will be evident long before the next survey is taken.
- The need of many prospective home buyers to save substantially more than in the past to meet those down payment requirements should contribute to — although not by itself a cause — a reversal of the long decline in personal saving rates. Higher downpayments will almost certainly mean that young households will achieve home ownership a bit later in life than those who preceded them in the 1970s and early 1980s.

Inflation's effect on home buying

	1957	1977	1979	1981	1983	1985
Median age	37	32.4	32.8	33.6	34.4	35.8
Median income	$7,300	22,700	26,110	39,196	35,987	42,396
Median home price	$17,100	44,000	58,000	72,000	65,000	75,000
Median downpayment (% of home price)	32.7	20.4	21.2	22.4	18.5	18.8
Median percent of income spent on mortgage payment	15	14.4	17.1	19.1	17.5	18.2
Average term to maturity of loan in years	19	26.2	27.4	26.4	26	26
Annual average rate of home price inflation during preceding 7 years	8.1	10.1	11.6	10.4	8.5	6.2

Sources: United States League of Savings Institutions, Federal Home Loan Bank Board, U.S. Department of Commerce, National Association of Realtors

Consumers sees area stake in Midland plant

By Tim Richard
staff writer

Even southeastern Michigan residents who buy electricty from Detroit Edison have a stake in Consumers Power Co.'s plan to convert its idle Midland nuclear plant to a gas-fired generator, said CP Chairman William T. McCormick Jr.

The new chief of the state's largest utility called a news conference in Detroit Monday to announce a request for a 25-percent electric rate increase over five years for outstate customers. CP's natural gas customers in the metro Detroit suburbs, however, would face no rate increase.

The rate increase, if granted by the state Public Service Commission, would generate more than $500 million in revenue. The revenue would be invested in converting the $4 billion, unfinished, nuclear plant at Midland to a natural gas combined-cycle facility by 1990.

The PSC said it has no authority over new power plant construction, other than to set electric rates to be paid by customers.

The board of directors of Consumers Power, meeting in Jackson Tuesday, approved the plan.

"Michigan's future power requirements should be met by facilities in the state for reasons of economy, reliability and security of supply," McCormick said.

BUT WHEN nearly all of the tri-county area gets electricity from Edison, why did McCormick make his announcement in the heart of Edison's territory? He gave four reasons:

- The Midland plant, abandoned two years ago, would be converted to gas. Existing gas facilities would be better utilized, and distribution costs would be reduced at least $15 million a year, McCormick said. (CP's 1985 gas revenues totaled $1.5 billion. The savings would be 1 percent.)
- The utility can't go into the capital market for conversion funds. Selling stock is impossible because common stockholders suffered a 1985 loss of $4.42 a share. "We can't borrow — our bonds are below investment grade," McCormick said.

But by using electricity revenues to make the 4½-year conversion, he said, CP could restore itself to fiscal health and find acceptance in the capital market in a future year.

- CP and Edison are part of a seven-state grid — the Michigan Electric Power Coordination Center located in Ann Arbor — that distributes electricity where it's needed during peak demands, McCormick said. If CP has adequate capacity, then so does Edison, he reasoned. He predicted supply would outpace demand in a decade, even with Edison's Fermi II plant coming on-stream.
- Many companies which do business statewide are headquartered in metro Detroit. CP's electricity sales rose 12 percent in four years, pacing the state's general recovery, he said.

McCORMICK, 42, was an executive of the parent company of Michigan Consolidated Gas Co. until a year ago.

He succeeds John D. Selby as chairman of CP. Selby was forced out in the political-financial flap over the cost overruns of the Midland nuclear plant.

McCormick said CP engineers and outside experts analyzed many options before deciding the cheapest — to ratepayers and in terms of construction time — was to convert the Midland plant to natural gas in two stages.

Cost to electric customers would be a 5 percent increase a year for five years, or 25 percent.

Current average bill is $36.30 a month. After five years, the CP electric customer would see the household cost rise by $9.08 to $45.35.

REJECTED OPTIONS were:

- Abandoning the nuclear plant entirely. Despite counter statements from the attorney general's office, McCormick insisted CP would be entitled to a 19 percent rate increase to recover the cost from customers. "Anyone who thinks we will get nothing for abandoning Midland is kidding himself," he said.
- Buying power from other sources — a 33-percent rate increase. This breaks down to a 19-percent increase for abandoning the nuclear plant and a 14-percent increase for buying electricity elsewhere.
- Converting to coal — a 25 percent rate increase, plus longer conversion time and a dirtier plant when completed.
- Completing the nuclear plant — 41 percent more from customers.