Housing 'Points' Causing Confusion

WASHINGTON -- For the last three years, home buyers of moderate means and sellers of moderately priced homes have had to surmount a formidable barrier to make a deal.

The barrier -- called "points" -- is easily defined but difficult to understand.

Everyone in the government concerned with housing knows what points are, but they are so puzzled by them that Congress recently passed a law authorizing a special commission to study them.

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FOR THE RECORD, a "point" is 1 per cent of the face value of a home mortgage. This is how they cause trouble:

Imagine a couple, John and Mary Smith, who are looking for a house. John Smith earns $11,000 a year and has saved $3,000.

The Smiths find a 20-year-old brick rambler for sale for $25,000. They learn that about $1,000 dollars will be required to cover moving expenses, taxes, fees, and deposits connected with the transaction. This leaves $2,000 for a down payment.

A mortgage banker tells the Smiths that he can get them a $23,000 home loan insured by the Federal Housing Administration. They will have to pay the newly authorized maximum FHA interest of 6 3/4 per cent on the loan, which will run 25 years, and another 1/2 per cent into the FHA insurance fund that guarantees repayment of mortgages.

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THEN COMES the bad news. The mortgage banker explains that the insurance company which will actually provide the loan can easily earn 7 1/4 or 7 1/2 per cent with its money by making other investments. Therefore, it will only buy a home mortgage with a 6 3/4 per cent interest rate if the home seller will pay 5 points - 5 per cent of the $23,000 dollars mortgage.

This means the sellers must pay $1,150 just to help the Smiths get a loan. They think the Smiths ought to do the paying, but the FHA forbids buyers to pay more than one point, or $230 in the case of a $23,000 mortgage.

The sellers add the $1,150 in points to the $1,500 commission they will have to pay the real estate broker selling their house and decide that $2,650 is too much.

They paid $22,000 for the house five years ago and are shocked at the idea of making only $350 on the resale. After all, prices have soared in the past five years and they hoped to get at least a $1,000 profit out of the house to help them relocate in another city.

So they tell the Smiths "No deal."

COUPLES LIKE the Smiths run into the same problem throughout the country. Consequently, only about 20 per cent of single-family homes sold today are financed by FHA-guaranteed mortgages.

The problem arises from the fact the deficit-plagued federal treasury and booming private business have been heavy borrowers for the past three years. Their demand for credit has enabled big investors to earn interest of 6 and 7 per cent or more on loans and bonds considered more secure than home mortgages.

Even individuals of modest means have been buying government and corporate bonds directly, instead of depositing money in savings and loan association and mutual savings banks which normally supply the bulk of home loans.

For the first two years of the "credit crunch" that began in 1966, eased somewhat last year, and threatens to intensify again this year, the maximum rate on FHA loans, and loans insured by the Veterans Administration, was 6 per cent. On May 7, it was raised to 6 3/4, still below the earning potential of many sound investments.

Home buyers who want to avoid the point barrier can get "conventional" loans that are not insured by the Government and carry interest rates limited only by state usury laws. But conventional loans in some areas require a 25 per cent down payment. That would be $6,250 on a $25,000 house, too much for the Smiths and thousands of other families.

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THE OWNERS of the home might have evaded the point problem by adding $1,000 to the price of the house. But if the FHA appraiser set a value of only $25,000 for the home, the maximum loan would still be $23,000. The Smiths, if they were willing to pay $26,000, would have to come up with another $1,000 for down payment.

Government-insured loans require lower down payments because they can be more easily sold to out-of-state investors who are familiar with FHA appraisal standards and know, in any event, that the Government guarantees repayment.

When these big investors – insurance companies, savings banks, or other institutional lenders – buy mortgages, they pay a price stated as a percentage of the face value.

Thus, a package of $1 million of 6 3/4 per cent mortgages may be sold by a large mortgage banker to an insurance company at a price of 495. This should provide the insurance company with a gross return of 7 3/8 per cent. The company will be earning 6 per cent of $1 million, although it only paid $950,000 for the investment.

If the insurance company pays the mortgage banker 3/8 per cent to "service" the mortgages – collect payments – then the company's net earning is 7 per cent.

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THE 1 POINT that the home buyer using FHA financing is permitted by law to pay has come to be regarded as "automatic" during the protracted tight money market and is usually referred to as a "originator's fee" that goes to the mortgage banker.

Institutional investors also derive certain tax and accounting advantages from the system. They have the option of amortizing the discounts over the life of the mortgage, even though it may be paid off early or amortizing it over an accepted average period, even though it is held to full maturity.

While most lenders and builders are willing to see charges of 2 or 3 points continue, charges of 5 or more are considered a troublesome barrier to home sales.

The same act of Congress which authorized an increase in the FHA ceiling from 6 to 6 3/4, set up a commission composed of members of Congress and the Administration to study the mortgage problem.

Burroughs Picks New Director

Formation of a Department of Urban Affairs at Burroughs Corporation has been announced by Ray W. Macdonald, president.

Robert W. Anderson, who served for two years as director of the Burroughs-operated Job Corps Center for Women at Omaha, Neb., has been named director.

The new department, a part of the Corporate Communications Division, will be responsible for the company's involvement in educational and employment programs in the major urban areas in which the Corporation is a significant employer. These include Los Angeles, Philadelphia and Rochester, as well as Detroit.

Anderson has been with Burroughs since 1960 when he joined the defense contracts staff in Paoli, Pa. where he was manager of contracts for the company's ALRI and BUIC air defense systems programs. He was director of the Omaha Center for two years prior to November 1967 when he was named manager of education systems in the company's Defense, Space and Special Systems Group in Paoli.