Managing GOD's Money

From my high school Latin, I know if I played a *sub-par* round of golf (oh, how I wish!) I would have shot *below* par. And if the temperature is *sub-zero* it is *below* zero. So, if I got a subprime[1] mortgage I should expect to pay *below* prime, below the best. Right?

Wrong! So, what's *sub* about a subprime mortgage? The borrower's credit: no credit history or a poor credit rating disqualifies the borrower for a conventional mortgage but "qualifies" her for a high cost subprime mortgage!

In the 1970s, the United States Congress passed the Community Reinvestment Act "... to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound banking operations." This legislation sought to end deep rooted discriminatory lending practices. But note, "depository institutions" were to provide credit "consistent with safe and sound banking operations."

When financial institutions applied predatory lending practices to folks in these low income areas, they did not fulfill their obligations under the Act, but operated like *Vultures.*

Predatory lending expanded beyond those neighborhoods as real estate markets boomed. And soaring markets provide false security to lenders and borrowers to boot! Meanwhile, home ownership went from 62% in 1970 to around 70% today.

The subprime market was hot. In August 2005, the *Boston Globe* reported subprime loans were the fastest growing segment of the mortgage market.

And then the inevitable happened! The bubble burst and like *Humpty Dumpty,* the housing market had a *big fall.* Today, the subprime market is in crisis, over twenty companies have failed, foreclosures are soaring, and many folks' dreams are nightmares!

To try to grip this problem and its likely effects in Canada, let's look briefly at the subprime market in the USA: What it is, parallels in Canada, and the way forward.

Subprime Market in the USA

In the United States, the traditional mortgage market has minimum lending standards dealing with borrowers' ability to repay–usually, lenders charge fixed rates.

Not so in the subprime market. That market accepts a high risk level and so uses risk-based pricing for individual borrowers. To hook borrowers and create an *affordability delusion,* about 80% of these loans have a "teaser," a fixed low interest rate for two years, which explodes to *adjustable* despite prevailing market rates.

Vultures loan funds, sometimes above houses' valuations, to folks with bad or no credit, accept little or no down payment, and do little or no income verification. *Mortgage Asset Research Institute's* analysis of 100 loans without income verification, found borrowers inflated incomes by more than half in almost 60% of cases.

By 2006, subprime loans were 12.75% of the $10.2 trillion mortgage market, up from 8.5% in 2001, according to *Inside Mortgage Finance*.

Who are the clients? Women, "minorities," and lower income folks. *USA Today* reported a 2005 study based on 2003 data in 331 metropolitan areas that showed women were more likely to get subprime rather than prime loans in every area; African Americans more likely in 98.5% of these areas.

VULTURE

Somebody who waits or looks eagerly for opportunities to take advantage of somebody else, especially somebody weak or helpless. (Encarta® World English Dictionary © 1999 Microsoft Corporation.)

SUBPRIME MORTGAGE LENDER

Using computer software and the Internet, they *screen credit reports* for weak-credit folks and then pursue them. According to the *New York Times,* at the height of the subprime boom, *First Franklin*, a major subprime lender processed 50, 000 applications monthly. "... Speed became something of an arms race as software makers and sub prime lenders boasted ... how fast they could process and generate a loan..."

SUBPRIME LOAN

A higher (than prime) cost loan to a borrower with bad credit or no credit history, whom a traditional lender would disqualify. About 80% of these loans have a "teaser" interest rate for two years that explodes to adjustable even if market rates don't change.

TYPICAL SUBPRIME BORROWER

"A typical subprime borrower is not someone buying a house, but someone refinancing ... someone who has a lot of credit-card debt, and is refinancing to pay some of it off." www.responsiblelending.org

Would yee both eat your cake and have your cake? John Heywood (1497-1580)

Freddie Mac, a quasi Government organization, estimates 15% of subprime borrowers could qualify for prime loans but because of pressure and, or ignorance, they accept subprime loans.

[1]Prime rate refers to the interest rate banks charge their best (prime) customers. In the mortgage industry, *prime* refers to traditional mortgage loans to borrowers who meet financial institutions' standard loan conditions.

Sub Prime Market: The Broker

Some mortgage brokers specialize in the subprime market where they get three to four percent commission compared with one percent in the prime market. Some have been ruthless:

> When the transmission repairman underwent open-heart surgery, he told his mortgage broker he didn't want a housing loan that was in the works. "I didn't know if I was going to be dead or alive," DeWitt later recounted.
>
> But the mortgage broker, Troy Musick of Wholesale Mortgage Co., was so eager to clinch the deal, he followed the couple into the hospital, said DeWitt's wife, Ruth DeWitt.
>
> As a surgeon cracked Mr. DeWitt's chest open for a quadruple heart bypass, the broker approached her in the waiting room .... "It's now or never," she remembers him saying.
>
> Afraid of losing out on the chance to buy a home, she left the hospital and signed the loan documents. ... DeWitt survived the surgery, but not the $143,400 loan... (Reuters, 8 May, 2007)

Greed & Subprime

According to the *Chicago Sun-Times*, "... 52 percent of subprime loans were originated by non-regulated mortgage brokers, who fall through the cracks between federal and state regulation.

As "originators," they presented the contracts, which were then "underwritten" by small mortgage companies. Little or no documentation was required, either to verify borrowers' incomes or to substantiate the purchase price. The individual "mortgage brokers" received a cash fee for every loan they originated.

The greed moved quickly upstream, as the mortgages were "securitized," or packaged for resale to larger institutions that would ultimately either keep or sell the "servicing" process, the collection of monthly payments on those loans, which earned significant fees.

Then the future income from payments on these loans was packaged and sold to investors, who were eager to get higher interest rates than those available on Treasury securities.

The greed spread. The investors knew that these were adjustable-rate mortgages, and would bring an ever-increasing monthly income to them. The investors never met the borrowers -- individuals from small towns and large cities, who were told they could now make affordable payments to own their home...."

Subprime Market: Today

Excerpts from *The Center For Responsible Lending's* press release of 19 December 2006 sums up the effects of predatory lending practices:

"The *research* we're releasing today shows that subprime lenders are selling the most dangerous loans to the most vulnerable borrowers, creating the largest rash of foreclosures in the modern mortgage market. This conclusion is driven by some powerful numbers:

- 2.2 million subprime home loans made in recent years have already failed or will end in foreclosure. These foreclosures could cost as much as $164 billion ... Our study shows that one in five families who get a subprime mortgage today will lose their home to foreclosure.
- For most people, owning a home is their best chance to achieve sustainable economic security. Losing that home, in many cases, means losing life savings. ... potentially devastating consequences for African-American and Latino communities, who receive the highest share of subprime loans.

Sub Prime Market: Why Lend to Folks Highly Unlikely to Repay?

First, subprime lenders had Wall Street's backing, so funding was available: these loans backed high yield securities that Wall Street firms sold.

Second, mortgage brokers, who sell most of these loans, get paid on sales with no adjustment for failed sales, so they push sales.

Third, the "teaser" (fixed two-year low rate) hooks borrowers who expect higher income in two years when the rate will spike and become adjustable.

Fourth and most significant, borrowers believe the housing market will continue to rise so they will be able to refinance at lower payments, good news for *Vultures* because these loans carry prepayment penalties.

Subprime Lending in Canada

In Canada, for three significant reasons we don't have a similar subprime mortgage issue, *yet*. First, the market is small (less than 5% according to the *Canadian Association of Accredited Mortgage Professionals*) but growing rapidly, does not use *adjustable* rates, and lending standards are more stringent.

Second, mortgages are expensive as interest payments are not tax deductible (as in the USA); in theory, we have an incentive to repay.

Third, lenders are less aggressive than in the USA. Major lenders lend less than full property value and according to the Bank of Canada, "insure significant portion of mortgages."

That said, the American subprime issue is a symptom of a deeper problem. It is not a mortgage or housing matter. But the same basic challenge we experience in Canada, *affordability!*

The Issue isn't Housing

What does *affordable* mean? The *Concise Oxford Dictionary* defines affordable: "be in a position to do something (esp. without risk of adverse consequences)."

So, rearranging payment terms to appear manageable *today* isn't *affordable.* And that's what has been happening with housing and consumer goods' pricing.

In the USA, *Vultures* use *teaser* interest rates to hook folks whose behaviour suggest some miraculous future event will cause them to change their *attitudes*, *behaviours*, and spending *choices!* *Vultures* do the same with cars and consumer goods. They create attractive financing terms that look manageable today. Folks don't budget, don't count the cost, don't read the fine print, and so plunge deep in debt.

Governments encourage irresponsible debt financing too. The Canadian Government formed *Canada Mortgage and Housing Corporation* (CMHC) in 1946 to deal with post war housing. Today, they do not lend funds but insure mortgages with less than 20% down payment. Among other things, they "... work to enhance Canada's housing finance options, assist Canadians who cannot afford housing in the private market .... " Like *Vultures,* they dub rearranged payment terms *affordable*.

Here is a CMHC's statement:

> Many low-to-moderate income households are unable to qualify for a conventional mortgage due to insufficient income or savings for down payment. One way to assist these households is to provide them with an equity loan so they can qualify for a conventional mortgage.

> The loan is repaid after an agreed-upon time, when it is expected that either the appreciation in the property value or an increase in household income will allow for refinancing. In the interim, the loan in effect lowers the qualifying income needed to obtain a mortgage.

Is this help to a low income person? It's a noose! It's delusory, risky, and increases housing cost to those who need help!

If I had $500, but *wanted* a computer costing $1,000, I would know I couldn't afford to buy a computer until I saved $1,000. If the merchant told me I could have the computer with no money down and pay $50 monthly, still, I couldn't afford to buy. Affordable does not relate to *early payments* but to *all payments!* If the price of the computer fell to $500, then I could afford it.

Affordable must include ability to pay from today's *income stream,* irrespective of how merchants distribute total prices. We shouldn't accept debt *hoping* future housing price or personal income increases will rise to bail us out! That's irresponsible! Applying attractive credit terms to *big ticket items* digs a hole that traps low and moderate income folks!

Besides, affordable must look at an individual's life stage and budget.

The subprime market in the USA, and the *no money down* or *interest only mortgages* in Canada are classic examples of affordability delusions. Sadly, these ill conceived schemes present hope to poor folks whom do not realize they might not be able to fulfill *their* dreams in *their* timetables.

The affordability delusion seem to work for a time. All seem to go well when the economy is growing, folks have jobs, and the housing market is rising. But as happened in the USA, and *will happen in Canada,* the housing bubble will burst, and *Humpty Dumpty* will fall– lower in Canada than in the USA as housing prices here have risen less.

If the *affordability delusion* is the problem, what's the solution? Back to my high school Latin. *Caveat Emptor,* buyer beware, is one major part of the solution, learning God's PhD is another.

Caveat Emptor (Buyer Beware)

So far, I looked at Governments' and lenders' roles. But borrowers have responsibilities too. Slick mortgage brokers, circumstances and other events will pressure us to decide. So, as we decide, it's important to realize where we are placing our *hope*.

> **The *Vulture's* Teaser**
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> Paul Leonard, director for the California office of the *Center for Responsible Lending* told a state banking commission earlier this year that mortgage brokers "have strong incentives to make abusive loans that harm consumers, and no one is stopping them." As well, he cited this example: A borrower with a 2-28 adjustable-rate mortgage of $300,000, with an initial teaser rate of 6.85 percent, would pay $1,966 a month. But when the two-year period ends, and the interest rate increases to 11.5 percent, the monthly payment would climb by $600 to $2,574 a month and increase again six months later to $2,921.
> Source: *North County Times*
> http://www.nctimes.com/articles/2007/05/06/news/top_stories/1_33_265_5_07.txt

As the subprime meltdown shows, putting hope in governments, lenders, brokers, doesn't help. It might appear so for awhile, but markets fall and take their supporting casts with them!

Naturally, we will find *Vultures'* baits attractive. In my book, *Managing God's Money - 7 Branches Workbook*, I mention the *Money Triangle*[2] to remind us to look away from *merchants'* enticements and to God for His guidance. It's not merchants but we who decide! That's why we need God's PhD.

God's PhD

You are a believer, you live in the city, your income is low, your credit bad, you are a perfect candidate for a subprime loan. But is this God's best for His child? Ask Him to help you be **P**atient (Isaiah 30:18) to wait on *His best,* which you might not think is *your best!*

Waiting calls for **H**umility (1 Peter 5:6). Ask Jesus to help you accept what you have. Don't look at your neighbours who buy homes, cars, big screen TVs. Often, their *nice* cars, *nice* homes mean *nice* debts!

To complete the PhD ask God to help you **D**epend on Him, not governments, bankers and others. Isaiah 26:4 says, *"Trust in the LORD forever, For in GOD the LORD, we have an everlasting Rock.* And Psalm 118:8, *It is better to take refuge in the LORD than to trust in man.*

Don't listen to TV preachers and others who tell you to give them funds on your credit card and then claim stuff. God knows your needs, loves His children more than we can imagine, and wants us to work with Him to do His will. He is committed to us, and will never leave us (Matthew 28:18-20, Hebrews 13:5). Do you believe?

You might be thinking, "this isn't practical; I want to buy a house now." Sure it is practical! God knows the future; ask Him if you should buy: when, where, and how to pay for it!

The issue isn't housing but your *worldview*. Do you believe: Jesus is who He says He is? He will take care of your needs? He has set preconditions before He takes care of those needs?

His love isn't conditional, our salvation isn't works-based, but He asks His children to seek Him first and He will take care of our needs (Matthew 6:24-33). Let's ask Him to show us areas in our lives we need to deal with and to teach us to be good stewards.

It's God's money–all, not just a tenth. Like early believers (Acts 2, 2 Corinthians 8 and 9), let's present 100% and let Him show us how to use 100%. But beware of *Vultures* in the Christian community: http://www.thestar.com/News/article/187986

While you pray before spending, you might find useful the *Affordability Index*: *http://www.managinggodsmoney.com/essentialtools/affordability.php*:

I pray Apostle Paul's words in Ephesians 3:20-21 will help you hear God's message to you today:

> Now to Him who is able to do far more abundantly beyond all that we ask or think, according to the power that works within us, to Him be the glory in the church and in Christ Jesus to all generations forever and ever. Amen.

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[2] A *Merchant* produces goods and services to sell *Me*, often using coercive means, with *Money* as the bridge between the merchant and me. The merchant's uses the bridge as bait: he presents financing arrangements to me so I think they are manageable and insignificant. He uses no down payment, no payment for many months or years, low early monthly payments and so on to disguise the full cost effect.

