



New 20% Down Payment Makes Savers From U.S. Spenders (Update1)

By Bob Ivry



[+ Enlarge/Details](#)

July 16 (Bloomberg) -- The U.S. housing crisis may accomplish what years of parental hectoring couldn't: Turn Americans from **spenders into savers**.

Spending will fall because homeowners can no longer use rising real estate values to **borrow cash** -- \$837.5 billion in 2006, according to a report by former Federal Reserve Chairman **Alan Greenspan** and senior Fed economist **James Kennedy**. With mortgage lenders requiring down payments of 20 percent, the average household, which puts away less than 1 percent of after-tax pay, will have to save 10 percent for 10 years to buy a home.

The housing market shaved almost 1.6 percent off gross domestic product growth in the first quarter and cut in half the growth rate of consumer spending, which accounts for more than two-thirds of the economy, said **Mark Zandi**, chief economist at Moody's Economy.com in West Chester, Pennsylvania.

"The loss of housing wealth is the difference between a recessionary economy and a growing economy," said Zandi, an adviser to presumptive Republican presidential nominee Senator **John McCain**. "Consumers have powered the global economy for the past 25 years. For the foreseeable future, maybe the next 25 years, the savings rate will move higher."

The worst housing crisis in at least a quarter century still has a long way to go, Zandi said. It will take until 2015 for the **median home price** to return to its July 2006 peak of \$230,200, while **home sales** and residential **construction** will never again reach the record highs of 2005 and 2006, he said.

Fewer Loans

Lenders will issue 53 percent fewer purchase mortgages this year than in 2006, making home sales difficult and delaying a housing recovery, said **Guy Cecala**, publisher of industry newsletter Inside Mortgage Finance in Bethesda, Maryland.

Getting a home loan may also be made more difficult by plummeting investor confidence in **Fannie Mae** and **Freddie Mac**, which own or guarantee 81 percent of the mortgages issued this year, according to the Washington-based Office of Federal Housing Enterprise Oversight.

Fannie Mae, the largest U.S. mortgage finance company, and **Freddie Mac**, the second-biggest, have both lost more than 50 percent of their market values since July 7.

"You've never seen the mortgage industry this passive in lending in the past 50 years," Cecala said. "They don't want any more missteps creating any more losses. The flip side is it's not helping anybody stay in homes or buy homes. You can't have a housing recovery without financing."

'Painful Process'

The residential housing decline will "change the structure" of the U.S. economy by forcing Americans to save, said **Neal Soss**, chief economist at Credit Suisse Group in New York.

"The days of wine and roses are over," said Soss, who worked at the Federal Reserve for former Chairman **Paul Volcker** in the 1980s. "We were drunk on money. Getting sober is a painful process."

Consumer spending, which rose 7.5 percent since the beginning of last year, will fall into negative territory after Americans run through their tax rebate checks this summer, said **Bill Hampel**, chief economist for the Madison, Wisconsin-based Credit Union National Association.

U.S. consumers spent at a record annual rate of \$10.2 trillion in May, in part helped by the federal rebates, according to the Commerce Department. That won't last, said **Christopher Thornberg**, president of Beacon

Economics LLC in Los Angeles.

Delaying the Inevitable

``Throwing out a stimulus check does nothing but put off for a brief period of time the inevitable," Thornberg said.

Two years ago, lenders made \$2.7 trillion in mortgages, \$600 billion to subprime borrowers with bad or spotty credit histories. Now, financial firms, responding to \$415 billion of real estate-related writedowns and credit market losses, are forcing even the most creditworthy buyers to make higher down payments.

Sixty percent of lenders said they made it more difficult for the most qualified buyers to secure financing in the first quarter, according to a Federal Reserve survey.

``The mortgage industry always works like a pendulum," said **Rick Sharga**, vice president for marketing at **RealtyTrac Inc.**, an Irvine, California-based foreclosure database. ``Two years ago they were giving loans to anyone who could fog a mirror. Now you need perfect credit and a significant down payment."

Tougher Lending

Tougher lending guidelines are more prevalent in areas such as California and Florida where home prices have fallen the most, said **Chris Hutchens**, a mortgage planner with Alpha Mortgage Corp. in Wilmington, North Carolina. Loans with a 3 percent down payment from the **Federal Housing Administration** are available in his area, where home prices are more stable, he said.

``Banks are tighter than they were, so you have to work harder to get the loan you want," Hutchens said. ``It's in the declining markets where it's more difficult."

As many as 500,000 borrowers will get FHA purchase mortgages or refinancings, U.S. Housing and Urban Development Secretary **Steven Preston** said in a July 10 Bloomberg Television interview.

The bundling by banks of residential mortgages into securities that are sold to investors and are used to fund home loans was a \$1.15 trillion market in 2006, according to **Inside Mortgage Finance**. In the first half of this year, banks issued \$46 billion of the so-called private label securities.

'Big Sideshows'

``Housing and finance are big sideshows," said Thornberg of Beacon Economics. ``The main attraction is consumer spending."

Saving enough money is the only thing stopping Nick Ruiz from buying a house. The 22-year-old paramedic said he has steady work, good credit and can verify **his income**. He's even found foreclosed houses for sale in his price range in his hometown of Hialeah, Florida, a suburb 12 miles northwest of downtown Miami.

The only missing ingredient is the \$30,000 down payment.

``I'm getting married in August and we wanted to have a house when we came back from the honeymoon," Ruiz said. ``We'll have to live with my parents."

Ruiz said he and his fianc e have **credit card debt**. Ruiz said he made a decision to postpone saving for a down payment until he can pay off the \$12,000 he said he owes.

Rising Consumer Debt

``I figured it makes no sense to put money in the bank because no bank will give me the interest rate that these credit cards are charging," Ruiz said.

Consumer debt was at an all-time high of \$2.59 trillion in the first quarter, according to the Fed.

When real estate prices were rising, the debt was easier to pay down. Homeowners were able to refinance their mortgages and borrow cash equal to the difference between their old mortgages and the new, higher values of their houses. Mortgage debt, unlike credit card debt, is tax-deductible.

So-called **equity extraction** peaked at \$256.9 billion in the second quarter of 2006, just as the median home price reached its all-time high of \$230,200, according to the National Association of Realtors in Chicago. In the first quarter of 2008, with the **median home price** down to \$200,100, equity extraction dropped 72 percent to \$72.8 billion, according to an estimate based on the study by Greenspan and Kennedy.

Cautious Spending

More cautious spending by consumers has already begun to hurt the U.S. economy, said **Patricia Edwards**, who

helps manage almost \$15 billion at Wentworth Hauser & Violich in Seattle.

Retailers selling non-essential items to middle-income consumers, such as [Sharper Image Corp.](#), [Lillian Vernon Corp.](#), [Linens 'N Things Inc.](#) and [Whitehall Jewelers Holdings](#), were the first to suffer from the housing slump, Edwards said.

[Macy's Inc.](#), [J.C. Penney Co.](#), [Kohl's Corp.](#) and [Dillard's Inc.](#) also are affected, Edwards said.

For companies such as [Chico's FAS Inc.](#) and [Coldwater Creek Inc.](#), the main customers are women 45 years old and up, Edwards said. ``If those women have a spending issue, their kids get clothes before they do," she said.

The New York-based [International Council of Shopping Centers](#) expects 144,000 U.S. retail stores to close this year, a 7 percent rise over 2007 and the largest increase in 14 years, according to a July 11 report.

[Wal-Mart Stores Inc.](#) will do well because it has low prices and offers consumers a way to reduce their gas bills because they can buy most of their household items at one stop, Edwards said. The Bentonville, Arkansas-based company also generates about 20 percent of its revenue from overseas, and that's ``a fast growth area," she said.

With less money available for homeowners to borrow and bigger down payments needed to buy a home, more companies will have to look outside the U.S. for customers, said [Andrew Laperriere](#), managing director at International Strategy & Investment Group, a research firm in Washington.

``That process is already under way," Laperriere said.

To contact the reporter on this story: [Bob Ivry](#) in New York at bivry@bloomberg.net.

Last Updated: July 16, 2008 11:19 EDT

