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CHAPTER 32 Bonds and Real Estate

Will Refis Help Refloat the Economy?

Equity into cash: So far, owners are spending, not paying down debt

by Stephanie Anderson-Forest in Dallas with Ann Therese Palmer in Chicago, Douglas Robson in Silicon Valley, Laura Cohn in Washington, D.C. and bureau reports

When Anton and Audrey Scholl bought their $249,000 townhouse in Itasca, Ill., a year ago, they had no idea they'd refinance their mortgage within a year. But when their broker called in January advising they convert their 30-year adjustable rate mortgage to a 30-year fixed mortgage with a lower interest rate and no closing costs, the Scholls bit. The new 7.25% rate, a reduction of 1.25 percentage points, cuts their monthly payments by $225.

Thanks to competition among mortgage lenders, falling transactions costs, and a push from the Federal Reserve to trim interest rates, mortgage rates are way down. Rates on 30-year fixed mortgages have dropped from a five-year high of 8.64% in May to 6.82%—near the lowest level in two years. And that's spurring a refinancing boom. Though there are risks in the boom—overindebted homeowners could be taking on too much debt—for now, many economists argue that it is offering a much needed boost to consumer spending. And that could give a hand to the ailing economy as well. "This is the best way to get money into people's purses and pocketbooks immediately," says Mark M. Zandi, chief economist at market forecaster Economy.com Inc.

How big is the boom? During the first quarter, the Mortgage Bankers Assn. of America estimates refinancings will account for about 50% of the $348 billion worth of new single-family home loans, more than double the same period last year. Of the $1.4 trillion in home financing expected in 2001, the MBAA estimates refinancings will account for 41%, making it the industry's second-best year in both categories.

One reason is that many homeowners want to beef up liquid assets. Mortgage lender Fannie Mae in Washington, D.C., estimates that some 70% of recent refinancings have been so-called cash-outs, in which owners take some of the equity from their homes in cash in exchange for bigger mortgages. The government agency figures refinancings will increase consumption spending by $40 billion in 2001 and boost gross domestic product by half a percentage point.

With consumer debt at a high and the economy weakening, consumers could use the money to pay off other debts. But so far, wallets remain open. "It's being used to subsidize spending," explains Diane Swonk, chief economist at Bank One Corp. in Chicago.

The question is whether homeowners are setting themselves up for bigger problems down the road. The number of borrowers behind on mortgage payments jumped in the fourth quarter of 2000. The MBAA says 4.54% of all mortgage loans are now delinquent by at least 30 days—the highest level hit since the 1992 recession. Lower payments from the refinancings could help. But if the economy goes into a lengthy downturn, the rising wave of delinquencies could turn into an avalanche of defaults.

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