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CEO's Message

By Parnell Black, MBA, CPA, CVA, Chief Executive Officer

Some months back I had an idea that seemed so good, I thought it must be flawed. So, in my head I put it aside. But it was one of those ideas that just kept on burning. Finally, I could not hold back anymore and wrote the following article which as of this publication has been sent out through the Business Wire and other media outlets in hopes that this idea might take hold. Please feel free to share with me your thoughts and comments at parnell1@nacva.com.

— A Possible \$1.43 Trillion Stimulus Plan We Cannot Refuse —

I happened upon an idea to stimulate our economy, an idea so simple, straightforward, with potential for massive and positive impact along with multiple and pervasive ripple effects, that my idea seems almost too good to be true. And as soon as I begin my story, for many of you the light bulb will glow, and you too will instantly see the beauty and simplicity of this plan.

Economics 101:

Before beginning, however, I want to review some basic economics, as I recall from my formal education more than 30 years ago. I must qualify that I am not an economist, though I have taken classes on the subject. My degrees are in accounting and finance.

There is a concept in economics that I refer to herein as “bang for the buck.”^[1]

From a government's economic stimulus^[2] point of view, this means if the government spends \$100 billion, how much bang for the buck will they get? If it is spent on roads and bridges, they'll get exactly \$100 billion worth of bang for the buck by creating \$100 billion in construction jobs to grade and prepare foundations, mine gravel, make cement asphalt and iron, form steel girders, etc. which are then put into place to create new roads and bridges. I refer to this type of stimulus as a 1 to 1 (\$100 billion ÷ \$100 billion) bang for the buck.

Alternatively, the \$100 billion could be used as farming subsidies, to buy tractors, irrigation equipment, land, seeds, etc. to grow \$500 billion worth of crops, requiring employing workers to harvest and transport crops to plants and warehouses for processing. The final product is then packaged and transported to stores for ultimate consumption. In this scenario, \$500 billion in jobs are created because that is what the ultimate value of the \$100 billion in government grants produce. I refer to this type of stimulus as a 5 to 1 (\$500 billion ÷ \$100 billion) bang for the buck.

The difference between these two types of stimulus is that the \$100 billion spent on roads and bridges has an immediate economic impact with the work usually occurring within a 2 year time period. The \$100 billion stimulus spent on farming may be spread over 5 years before its full \$500 billion impact is felt in the

may be spread over 5 years before its full \$500 billion impact is felt in the economy. It takes time to cultivate, grow, and harvest crops.

Tax incentives, given by reducing an individual's or company's tax rate, are often used to produce an economic stimulus, but have a less predictable impact. That is because once the reduction in tax is given, no one really knows how the recipient of that reduction is going to use his/her tax savings. For example, if a business owner receives a \$75,000 reduction in tax, he could simply put that in a savings account, thus creating no new jobs. Or, he could hire an assistant to take on some of his more mundane, less productive tasks, freeing up his time to play more golf, thus creating one new job. Or, he could hire a business development manager or salesperson who might be able to bring \$750,000 of new revenue into the business thus allowing, even necessitating, he hire 9 additional employees (for a total of 10) to accommodate this new growth. In this later instance, I refer to this type of stimulus as a 10 to 1 ($\$750,000 \div \$75,000$) bang for the buck.

But as you can see with the business owner, the tax reduction of \$75,000 may have the effect of zero economic stimulus (only enrichment) to a 10 to 1 bang for the buck stimulus. So, a tax stimulus can be unpredictable.

Here is my idea:

A few weeks ago, in a casual conversation with my executive assistant, Diana, she mentioned that "if she just didn't have to pay on her student loan, she could buy a house, which was a long way from happening." As I thought about her comment, I wondered how typical Diana's situation was. I chatted with friends and acquaintances to see what their personal experiences were, and from this anecdotal information, came up with a hypothetical-Diana—whom I'll still call Diana—who embodies the typical college graduate, with student loans to pay. From this point forward, all references to Diana are hypothetical.

Hypothetical Diana: Diana's student loans total about \$40,000, with 9 years remaining, paying \$265 per month (which gradually increases over the term to about \$800 per month), and carry an average interest rate of approximately 5.7%. If our government were to simply allow her to defer payment for, let's say, five years, she could use that money to buy a \$95,000 home based on a 30 year (360 payments) mortgage, 4.00% mortgage rate, and monthly payments of \$265.00 (\$95,000 is approximately the present value of 360 payments of \$265 each month discounted at the annual rate of 4.00%).

Factoring in federal tax savings based on Diana's 15% tax rate^[3], Diana could currently afford a \$312 ($\$265 \div .85$) monthly payment. With this new payment and applying the same present value calculation as I have above, she could afford a \$112,000 home.^[4]

In this scenario, the government has forgone (not forgiven) \$3,180 ($\265×12) in the first year and Diana has stimulated the economy by purchasing a \$112,000 home. This translates into a 35 to 1 ($\$112,000 \div \$3,180$) bang for the buck investment into our economy for our federal government.^[5]

Note: I am not suggesting the government write off Diana's debt, so essentially the receivable from Diana remains on the books. If her loan continues to accrue interest, the cost to our government is nothing (other than temporary loss of cash flow—\$3,180 in year one). Alternatively, interest could be forgiven during the five year term (with the principle remaining intact), whereby the cost to our government would be interest forgiven equal to \$11,400 ($\$40,000 \times 5.7\% = \$2,280 \times 5$ years). This still translates into an enormous out of pocket bang for its buck economic stimulus. _

A second scenario: If Diana was paying a flat payment (which is the case with many student loans) on her \$40,000 debt over the remaining 9 year term at 5.7%, her payment would be \$371 per month. Factoring in tax savings based on a 15% tax rate she could afford a payment of \$436 ($\$371 \div .85$) per month, which means she could afford to purchase a \$156,000 home. Again, this translates into a 35 to 1 ($\$156,000 \div [\$371 \times 12 \text{ or } \$4,452]$) bang for the buck stimulus by merely deferring the repayment of the loan._

Economic Impact:

Let's say there are 100,000 Dianass who take advantage of this stimulus plan based on my second scenario, that would translate into an overall stimulus of \$15,600,000,000 ($\$156,000 \times 100,000$). Let's say there are 1,000,000 Dianass—that translates into \$156,000,000,000 (\$156 billion) in economic stimulus, and 1 million home sales and purchases.

What is the Potential Impact?

My illustrations above only show one side of the equation. Diana currently pays \$500 a month rent. If this was converted to a mortgage payment and tax affected as I have done with her loan payment above, this translates into \$588 [$\$500 \div .85$] per month. Add to this the tax affected loan payment of \$436 per month via the student loan deferment, she can actually afford \$1,024 ($\$588 + \436) per month for a mortgage payment. Assume Diana allocates \$224 per month to pay real estate taxes and any increase she sees in utility costs, this leaves \$800 per month for a mortgage payment. With this amount, and applying the same present value analysis as above, Diana can now afford a \$286,000 home.

Now, the bang for our government's stimulus buck is 64 to 1 ($\$286,000 \div 4,452$). Assuming there are 1,000,000 Dianas out of the estimated 30,000,000 to 40,000,000 people that currently have student loans who take advantage of this home purchase opportunity—that would translate into a \$286,000,000,000 (\$286 billion) economic stimulus, and for virtually no or very little cost to our government^[6]. And if 5 million, or less than one-sixth of those carrying a student loan, choose to purchase a home under this deferral plan, the overall economic stimulus from this program could be as much as \$1.430 trillion, with 5 million home purchases and sales. This is double the dollar amount of any stimulus plans our leadership is currently tossing around, and at a fraction of the actual cost._

A Good Question?

Some of the Dianas might ask: Why can't I buy a house now without this help; I pay \$500 per month rent and could use this towards a mortgage and still make payments on my student loan? There are two possible answers to this question:

1. Yes, you may qualify and should look into it, or
2. The reason(s) you do not qualify could be one or a combination of the following:
 - a. Lack the required down payment.
 - b. Poor credit history or lack of sufficient credit history to give the banks the confidence they need to make you a loan.
 - c. The combination of a student loan debt and a mortgage debt (and any other debts in Diana's picture) is too much for a bank to make the loan based on pre-defined debt to earnings ratio requirements.
 - d. Due to the weak economy, depressed housing market, excessive foreclosures, and unpredictable near term prospects for economic recovery, banks have raised the bar, so to speak, on with whom they will make a mortgage loan. In other words, six years ago, Diana may have qualified given her same circumstances.

The point of this whole plan is to find a way to help Diana buy a home. Deferring her student loan may just be the way to make that happen. To succeed, this plan requires support from the government and the banking industry, as well as the participation of all the Dianas throughout America.

Facts About Outstanding Student Loans:

Based on my research, the total amount of student loans outstanding is close to \$1 trillion, with around 80% allocated to federal debt and 20% to private debt. In recent years, the average debt balance on *newer* loans has risen to \$27,200. I looked for but could not readily find information on the average debt of *all* student loans, the number of loans, number of people with loans, average term remaining, average monthly payment, average overall interest rate being paid, total annual receipts, and total annual interest received. This information may add further perspective to the feasibility of this stimulus plan, but in my opinion, likely not. My earlier estimate of 30 to 40 million student loans outstanding was based on simple math, dividing \$1 trillion by an average loan balance of \$25,000, which equals 40 million. In all likelihood, the number of outstanding student loans is greater than 40 million as the overall average loan balance of *all* student loans is undoubtedly less than \$25,000.

Fine-Tuning the Plan:

1. In this plan, I would recommend that no or very little down payment be required for Diana to buy a home for three good reasons:

- a. She may not have the necessary money saved and this could be a huge impediment to people like her, who otherwise qualify to buy a home.
- b. If she does have the money saved, she might then use it to buy household furnishings providing further economic stimulus.
- c. Bank exposure is lower now on home purchases than it has been in many years because values are close to bottoming out, if they haven't already. Meaning, the downside with property depreciating further than it already has is very low. (One of the primary reasons for requiring a down payment is to protect the bank's security [which is the property being purchased], should it decline in value.)

In lieu of a down payment, the government could guarantee the banks 5% to 20% of the purchase price.

2. I would suggest that the length of deferment of student loan payments be based on the individual's housing transition and range from maybe 4 up to 8 years. For instance, if one is upgrading from an existing home to a more expensive home, I would suggest that transition carry a shorter term of deferment than when one is upgrading from an apartment. Purchasing a newly built home may qualify for a longer term of deferment than buying a previously built home unless, say, the seller of that home is buying a newly built home. The idea here is that the variation in the length of deferral should be designed to incentivize purchases that will likely have the greatest positive impact on the economy. For instance, a newly built home purchase is guaranteed to put the construction industry to work. A previously built home purchase may not put construction workers to work if the seller of that home is moving into an apartment.
3. A cost to the government that is not addressed in my scenarios above is the loss of tax revenue from home buyers, like Diana, who are now deducting a mortgage payment, whereas before were not able to deduct payments for their student loan and rent. For instance, in Diana's case, assuming she purchases the \$286,000 home and is paying \$800 per month, she would be able to deduct \$9,600 ($\800×12)^[7] in interest per year. With Diana's 15% tax rate, she would pay \$1,440 less in taxes each year.^[8]
4. For simplicity, I have ignored mortgage loan costs which can equal 1% to 2% of the total amount being borrowed, excluding points. In this plan, I would intend that those costs exclude points and be bundled into the total amount being borrowed to minimize or eliminate the need for these Dianas to come up with money out of pocket to purchase a home. I would also suggest that the government gain special support from the banks to keep these costs to a minimum, because the banking industry will be a huge beneficiary in a reinvigorated economy.
5. Realistically, Diana is probably not going to use all of the money she has available in this plan towards a mortgage payment. In other words, she is not going to obtain an \$800 per month mortgage, because she will likely see this as an opportunity to improve her lifestyle. She might only spend \$600 on a mortgage payment and put the extra \$200 per month into savings or better yet, buy a new car. In either case, her extra \$200 per month is going back into supporting the economy.

In this plan, I would stipulate that in order to obtain the student loan deferment, the monthly mortgage payment needs to be at least as much as the payment on the student loan.
6. I suggest it be stipulated that to qualify for a deferment, one must have graduated from college and have held a job for a reasonable period of time, maybe two years (and, of course, be current with payments on their student loan). This is for a couple of reasons:
 - a. It is well documented that a college graduate is more employable and has a higher earning capacity than someone who did not graduate from college. Thus, individuals in this group are at less risk for default.
 - b. The longer someone has been with one employer, the more likely he/she is to remain employed. This suggests stability and thus less risk for default.
7. In this plan, I can see the banks wanting to tie the mortgage interest rate to the amount of down payment applied towards the home purchase because it

reduces their risk and demonstrates a certain wherewithal that someone is committed and ready to purchase a home. For instance, zero dollars down would carry a 4.5% annual rate, five percent down would carry a 4.25% annual rate, and ten percent down would carry a 4.0% rate. I do have mixed thoughts on this, however, because incenting people to make a down payment by rewarding them with lower interest, punishes those who may not be able to afford it. Additionally, if one can afford to spare the money for a down payment, I would rather see him/her spend that money on furnishing a home or buying a new car because that action will provide further economic stimulus. Thus, I would suggest the mortgage interest rate not be reduced for someone making a down payment, but rather, keep the rate the same for all applicants.

8. A question you might be asking is where will the banks get the money to make these mortgage loans? Currently, our banking institutions are collectively sitting on over \$1.6 trillion in excess reserves above and beyond what is required by law (from the Federal Reserve Bank of St. Louis, November 10, 2011 report on Aggregate Reserves of Depository Institutions and the Monetary Base). This is for a few reasons:
 - a. One is the Federal Reserve is currently paying them interest on these reserves (this is paid for with your income taxes). This program was instituted as one measure to shore-up the banking system after its collapse in 2008.
 - b. Banks are reluctant to part with this cash and are waiting for the economy to rebound before they ease their credit policies for making loans.
9. Something to consider in this plan would be for the government to provide some benefit to all the Dianas who, down the road, and after seeing their homes appreciate, choose to refinance their homes and pay off their student loans. (Undoubtedly, home values will rebound and begin to appreciate.) For example: Let's say 5 years down the road when Diana has to resume making payments on her student loan, her \$286,000 home has appreciated to \$326,000. Under this plan, I would suggest she be allowed to refinance 100% of its value at the then current mortgage rates, over a 30 year term to pay off her \$40,000 student loan debt^[9]. As an incentive for Diana to do so, it could be at this point in time that the government can offer to write-off the interest that accrued on Diana's loan over the prior 5 years or \$11,400^[10] ($\$40,000 \times 5.7\% \times 5 \text{ years}$). The incentive to our government is immediate payback on Diana's student loan. The cost to them is \$11,400. Their gain and the gain to our economy, is the \$286,000 economic stimulus Diana has provided by purchasing a home.
10. Qualified applicants who want to take advantage of this program, might be concerned about their finances once the student loan payments resume. As with Diana, when her payments resume in 5 years, I would suggest the payment schedule she currently has in place carry over. In other words, she

would pick up with payments of \$265 per month and gradually increase to about \$800 over the loans remaining 9 year term. If the government chooses to accrue interest on Diana's loan (versus forgiving the interest), I would suggest this interest be carried over to extend Diana's term, which would mean extending her term to somewhere between 10 and 11 years. The idea here is that over the next 5 years, Diana will very likely see increases in her compensation that will allow her to afford resuming payments on her student loan.

I would suggest building some flexibility into structuring her payment schedule 5 years down the road when payments resume, to give Diana confidence that she can work this back into her budget. This could be achieved with flexible terms, graduated payments (like she currently has), and allowing her to pay down a portion of the student loan through a no or low cost refinancing of her home mortgage.

Converting Student Loan Payments to Home Purchases Can Turn Our Economy Around and Create Millions of Jobs:

It is estimated that it takes approximately 5,000 skilled-man hours to build a small home (under 2000 square feet)^[11]. Another way to look at this is it is equal to two and a half full-time jobs for one year. That is what these hypothetical Dianas can do for our economy. And actually, it is more than that: think how many hours it requires to manufacture all the component parts of a house—wood.

many more are required to manufacture all the component parts of houses: bricks, pipe, wiring, shingles, faucets, furnace, air conditioner, doors, windows, screens, cabinets, flooring, countertops, lighting, etc. I have to imagine at least another 2,000 hours, probably more, are required to manufacture all these component parts. That is another one or more full-time jobs for one year, totaling at least three and a half jobs for one year that Diana could create if she purchases a home. If only 1,000,000 Dianas purchase a newly built home, that equates to 3.5 million jobs.

When I consider what it would require for my business (I am a small business owner) to allow us to hire even three people for one year, I can say "I'm not sure the government could do anything, given the resources it has to work with, to incent me to hire 3 to 4 people." (My company and related enterprises currently employ about 50 people.) The only thing that could truly motivate me to begin hiring aggressively is a revived economy. Then the government would not need to provide me any incentive to expand.

Diana's home purchase achieves many other economic goals, stimulus and otherwise, including: increased income for real estate and mortgage brokers; pushing real estate prices higher and thereby increasing America's wealth and purchasing power; moving the banks' excess reserves back into the economy reducing the cost (many billions) paid them by our government to hold these reserves and increasing banks' strength and profits through higher rates being earned on mortgages; reducing the inventory of home foreclosures with a wave of new home purchases; ripple down home furnishing/improvement purchases of everything you can imagine; and let's not forget, additional federal and state tax revenues generated through income tax on earnings of the newly employed, and real estate taxes on newly built homes and foreclosed homes taken off foreclosed status.

The economic crisis began with the collapse of the real estate market, and everything crumbled from there. It is common sense to see that to turn the economic crisis around, we need to start with what caused the problem to begin with. This plan will not succeed if we keep waiting for some government body, or somebody, to do something first. Congress, our banks, all the Dianas, and those who employ them, need to get on board because if we all do, we can turn our economic woes around in short order. And with this plan, what is there to lose?

The potential of this plan and its ability to turn the economy around is just too hard to ignore. If it is not already apparent, the solution to America's economic woes will require a truly united team effort. This plan is just that: an effort of the people to facilitate the American dream for all the Dianas who want to own a home, with the ultimate goal—getting our economy back on track.

If you like/agree with this idea, or could qualify and would purchase a new home under this plan, I suggest you forward your thoughts along with the article to your local people in Congress. I bet that if enough people voice their approval of this idea, our elected leadership will take action, an action that just might make a sizable dent in fixing our Country's economic crisis.

Sincerely,



Parnell Black, MBA, CPA, CVA
Chief Executive Officer

^[1] Term was used by Senator Chuck Schumer, D New York, on Meet the Press, on 11/27/11.

^[2] It may go without saying, but economic stimulus means money put into the economy for the purpose of creating jobs.

^[3] For simplicity, state income tax is ignored in all illustrations.

^[4] This concept is best explained with a simple example: assume our hypothetical Diana has \$40,000 in taxable income and pays \$6,000 in taxes ($\$40,000 \times 15\%$ ($.15$) = \$6,000). As a renter she cannot deduct payments for rent, but as a homeowner she can deduct her mortgage payments. Deducting one payment of \$312 from her \$40,000 taxable income brings it down to \$39,688 in taxable income ($\$40,000 - \312). Times \$39,688 by her 15% tax rate, her taxes are now \$5,953 ($\$39,688 \times .15$), for a savings of \$47 ($\$6,000 - \$5,953$). Add this tax savings to the \$265 the government allows Diana to defer, Diana now has \$312 a month ($\$47 + \265) to spend on a house that she did not have before.

^[5] The 25 to 4 hour for the book title is based on an average of student time

[\[5\]](#) The 35 to 1 bang for the buck ratio is based on one year of student loan payment deferral, though the term of deferral in this illustration is five years. All bang for the buck ratios, herein, are based on the first year deferral only.

[\[6\]](#) One might argue that the exodus from apartments and rental units could hurt that industry and its investors. I would debate this point. Let's assume 1,000,000 people take advantage of this plan and 70% are renters; this equates to 700,000 renters. Currently, according to the National Multi Housing Council® 2011 Current Population Survey there are 40.12 million people renting; 700,000 equates to a 1.75% decline in renters. Such a decline would seem nominal. But more relevant, the real estate research firm Reis Inc., as reported by Reuters in October 2011, reports that the U.S. vacancy rate is the lowest it has been in five years at 5.6%. Thus, meaning there is healthy shortfall in available rental housing. Given this perspective, the loss of 700,000 renters would likely have no impact.

[\[7\]](#) In the first few years of a 30 year mortgage, nearly all of the payment applies towards interest. For simplicity, I applied all \$800 towards interest in this example.

[\[8\]](#) Using the same basic assumptions found in footnote #4, if Diana deducts \$9,600 from her \$40,000 taxable income, her taxes will drop from \$6,000 to \$4,560 ($\$40,000 - \$9,600 = \$30,400$; $\$30,400 \times .15 = \$4,560$). Her total tax savings is \$1,440 ($6,000 - \$4,560$).

[\[9\]](#) If Diana were to refinance her home for \$326,000 over 30 years, assuming an interest rate of 4.0%, her monthly payments would be \$911, up from the previous \$800.

[\[10\]](#) The interest that accrues on Diana's loan deferred over 5 years would be greater than \$11,400 because additional interest would accrue on the interest being deferred. I used \$11,400 in this example to keep it simple and consistent with prior examples.

[\[11\]](#) The construction of 1,000 single-family homes generates 2,448 jobs in construction and construction-related industries. Source: National Association of Home Builders—found on the Home Builders Institute website. Five thousand (5,000) hours was extrapolated from this and other sources found on the internet.

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