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THIRD QUARTER 2005

THE END OF THE GREENSPAN FED

by Bruce White

Alan Greenspan, the 79-year-old economist who helped guide the nation's economy as Chairman of the Federal Reserve (FED) during four presidencies spanning 18 years, is retiring on January 31, 2006. Princeton economists Ricardo Reis and Alan Blinder say that Greenspan "has a legitimate claim to being the greatest central banker who ever lived." Bank of England Governor Mervyn King thanked Greenspan "for raising the respect that others give to our discipline of economics and our profession of central banking." We thought we would take this opportunity to look back at his tenure and express our thoughts for the FED's future.

Alan Greenspan presided over the nation's longest period of expansion, from March 1991 to March 2001. Inflation, excluding food and energy has fallen to 1.9% from 3.8% when he took over the FED on Aug. 11, 1987. The yield on the U.S. 10-year Treasury Note declined to 4.2% from 8.7% in that time, reflecting investors' confidence that the FED has inflation under control. (see *inflation chart*)

During the same period of economic growth, there are 1/3 more jobs than there were in 1987. (see *employment chart*)

It is difficult to grasp the magnitude of success and vitality of the U.S. economy. This growth is caused more by the hard working, productive U.S. work force, capital investors, and technological advances than anything the government or FED does. The chart below does not do justice to the reality we have lived. The growth in GDP during Alan Greenspan's tenure represents a 2/3rds increase in real products and services in our economy that we enjoy today; we drive more cars, own more homes, eat more pizza than at any other time in our lives. (see *GDP chart*)

GREENSPAN THE "MAESTRO"
The FED is notably obtuse in explaining how it makes decisions. Greenspan told a congressional committee in 1987: "Since becoming a central banker, I have learned to mumble with great incoherence. If I seem unduly clear to you, you must have misunderstood what I said." Dubbed "The Maestro," most believe Greenspan used a "price rule" to determine FED policy at the beginning of his tenure. In 1994, he listed gold, the yield curve, and the dollar's value versus other currencies as the market indicators that guided monetary policy. The price rule, whereby the FED would automatically accom-

modate shifts in the economy's money demand as determined by prices, was a more reactive system that reflected the Maestro's early libertarian leanings.

At some point Greenspan left the price rule and shifted philosophy. Recently he articulated his "risk-management" approach. The essence of Greenspan's approach has been to anticipate and accommodate possible shocks to the economy. Like the price rule, the Greenspan "risk management" approach accommodates money-demand shifts. The risk-management approach launches preemptive accommodations and tightening which require the FED to be vigilant about potential demand shocks. This system requires forward

continued on page 2

CONTENTS

REVERSE MORTGAGES: SPENDING YOUR HOME

by *Maye Albanez*

Page 3

LEGISLATIVE UPDATE

by *Ken Dike*

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IS THERE A SILVER LINING FOR NON-PROFITS IN THE HOUSING BOOM?

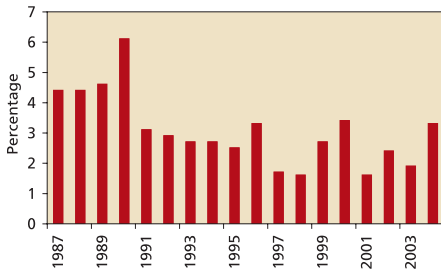
by *Jim Fox*

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**"THE GROWTH IN GDP DURING ALAN GREENSPAN'S TENURE
REPRESENTS A 2/3 INCREASE IN REAL PRODUCTS AND SERVICES
IN OUR ECONOMY THAT WE ENJOY TODAY..."**

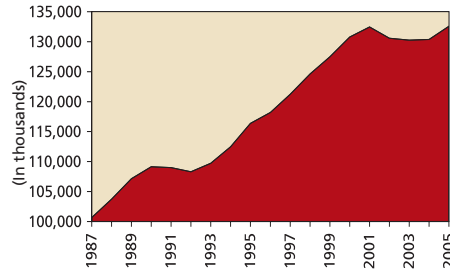
U.S. Inflation 1987—2004

Source: U.S. Dept. of Labor



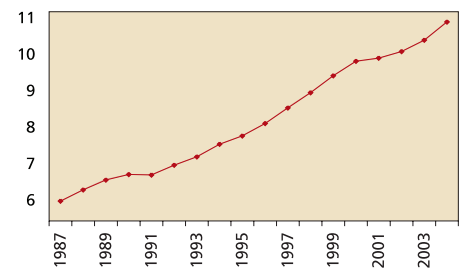
Non-Farm Employment

Source: U.S. Dept. of Labor



U.S. GDP in Billions 2000 Dollars

Source: BEA



continued from page 1

judgments about the economy. There is some irony that the former professional jazz clarinetist, a member of Ayn Rand's inner circle with a free market libertarian philosophy, has led the most proactive, powerful, central planning entity remaining in the world.

The financial markets have trusted Greenspan based on his handling of many crises during his time as FED Chairman. Just months after he arrived at the Federal Reserve, Wall Street was rocked by Black Monday on October 19, 1987, when the Dow Jones lost more than 20% of its value in a single day. The new Chairman, who had lacked private capital markets experience, acted decisively, pumping money into the markets to restore confidence. Stocks recovered, and Greenspan began to build his reputation as the man with the golden touch.

When the hedge fund Long-Term Capital Management faced collapse in September 1998, he organized a Wall Street bail-out to prevent the entire market from potential collapse.

He has not been successful in every situation, and has his critics. His support of tax cuts has angered many who felt he ventured too far into the world of politics. He has been blamed for the high-tech stock bubble at the

end of the 1990s. But after the tech bust, he slashed interest rates from 6.5% to just 1.0% over two years, avoiding a potentially long and steep economic downturn. The FED also provided excess liquidity in anticipation of the mythical Y2K bug, and then rapidly withdrew it early in 2000. This sort of activist control of monetary policy requires being right more often than wrong, with the stakes very high.

POTENTIAL REPLACEMENTS

Presidents tend to reappoint FED Chairmen, even if they disagree with them, rather than upset the markets, so the end of a FED chairman's term gives the sitting president an opportunity to mold the economy for the next 14 years.

President Bush is expected to announce his selection before Christmas and seek Senate confirmation well before Greenspan's scheduled retirement. Greenspan is working closely with Vice President Cheney to influence the selection of his successor.

President Bush may appoint a candidate with a broader background than academia and government. Greenspan was criticized for his lack of industry experience, having studied under future FED Chairman Arthur Burns at Columbia and worked in the Ford administration. President Bush

has frequently surprised the pundits with unexpected appointments. However, given the important role of building investor confidence, the next FED chairman should be a known quantity. Given the respect that Greenspan has on Wall Street, the President needs to name a candidate who instills confidence immediately.

Princeton University economist and former FED Vice Chairman Alan Blinder, said Greenspan's retirement "may in fact prove to be a traumatic experience for markets." "Financial markets are going to become uneasy about this [change] because Alan Greenspan has become an oracle," said former FED Governor Lyle Gramley, recalling the tension before Greenspan was picked in 1987 to replace respected Chairman Paul Volcker.

Alan Greenspan's successor may have to move the central bank to more openness to compensate for not being "The Maestro." A perceived weak appointment or a protracted confirmation process has the potential to cause the stock market to weaken and interest rates to rise, at least for the short term.

We do expect this greater openness by the FED to result in a more predictable interest rate environment, which should enable us, as investors, to make longer term decisions about changes in the economy and portfolio construction. §

"THE GROWTH IN GDP DURING ALAN GREENSPAN'S TENURE REPRESENTS A 2/3 INCREASE IN REAL PRODUCTS AND SERVICES IN OUR ECONOMY THAT WE ENJOY TODAY..."

REVERSE MORTGAGES: SPENDING YOUR HOME

by Maye Albanez

Retiring baby boomers, increased medical expenses, uncertain economic conditions, and record-level real estate prices have all converged to lay the foundation for what has become a reverse-mortgage boom. Market penetration is estimated at less than 1% at this point. With 20 million elderly homeowners with a combined \$3 trillion worth of home equity in the United States, this market has tremendous potential for growth. In 2004, reverse mortgages increased 39% over those in 2003, and are expected to increase 41% by the end of 2005.

WHAT THEY ARE AND HOW THEY WORK

A reverse mortgage enables homeowners 62 or older to convert part of the equity in their homes into tax-free cash flow without having to sell the home, give up title, or take on new monthly mortgage payments. Cash from a reverse mortgage can be paid out in several ways: a lump sum, monthly payments for life or as long as a homeowner lives at home, monthly payments for a fixed length of time, a line of credit, or a combination of monthly payments and line of credit.

The amount owed can never exceed what the home is worth. Since the reverse mortgage is what is known as a "non-recourse" loan, the lender cannot seek repayment from the homeowner's income or any other assets of the estate. Any money remaining after the mortgage is paid goes to the homeowner, or to the heirs.

A reverse mortgage becomes due when one or more of the following conditions occurs: the last surviving borrower passes away or sells the home, all borrowers permanently move out of the home, the last surviving borrower fails to live in the home for 12 consecutive months due to physical or mental illness, the homeowner fails to pay property taxes or insurance, or the homeowner allows the property to deteriorate and does not correct the problems.

There are default conditions which can jeopardize a reverse mortgage: declaration of bankruptcy, donation or abandonment of the home, perpetration of fraud or misrepresentation, a government agency needs the property for public use, or a government agency condemns the property. In addition, there are changes that can affect the security of the loan for the lender and make reverse mortgages payable: renting out part or all of the home, adding a new owner to the home's title, changing the home's zoning classification, or taking out new debt against the home.

APPROPRIATE USES

There are three basic types of reverse mortgages: Home Equity Conversion Mortgage (HECM), which is insured by the U.S. Department of Housing and Urban Development (HUD); Home Keeper which is Fannie Mae's conventional market alternative to HECM; and proprietary reverse mortgages which are sponsored by the companies that develop them.

HECM: The most popular and readily available program is your best

bet if your home is worth less than or about as much as the average home in the county.

The Home Keeper: This program might be appropriate if your home is worth slightly more than the average home in the county. The amount available through this program versus HECM is sometimes higher because Fannie Mae's maximum loan limit is higher than HUD's.

Proprietary lenders make sense for homeowners with expensive homes.

Reverse mortgages are very expensive when compared to conventional loans or traditional lines of credit. Two characteristics of reverse mortgages, however, make them attractive to a select group of homeowners: they do not require a minimum amount of earned income to qualify for them, and they do not require monthly repayments. When a homeowner has to have additional funds, has no other assets to tap besides the equity of his home, does not qualify for a conventional loan and does not plan to leave the home to his heirs, a reverse mortgage may just be the answer to his needs. Otherwise, trading the equity of a home for a reverse mortgage is seldom warranted.

INAPPROPRIATE USES

A reverse mortgage is not appropriate for a homeowner who intends to remain at home for just a few years. Fees are heavily weighted in the earlier years, so having to pay off a reverse mortgage during the first three years or so is extremely expensive.

continued on page 4

REVERSE MORTGAGES

Estimated Cash or Credit Line Available from a Reverse Mortgage

Age	Home Value: \$500,000			Home Value: \$1,000,000			Home Value: \$2,000,000		
	FHA/HUD	Fannie Mae	Private	FHA/HUD	Fannie Mae	Private	FHA/HUD	Fannie Mae	Private
62	169,481	48,880	71,561	169,481	48,880	147,726	169,481	48,880	305,156
70	190,876	109,453	116,411	190,876	109,453	237,426	190,876	109,453	484,556
80	220,286	166,984	188,361	220,286	166,984	381,326	220,286	166,984	772,356
90	249,227	220,301	260,311	249,227	220,301	525,226	249,227	220,301	1,060,156

Source: Financial Freedom (Reverse Mortgage Calculator)

*Best payout available indicated in colored boxes based on a Pasadena, CA home.



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continued from page 3

For a homeowner in his early sixties, a reverse mortgage is probably not appropriate either. The available loan proceeds on the home at such an early age are probably not worthwhile relative to the equity that will be given up when the loan is due some 25 years later. Life expectancy plays a very significant role in the computation of total funds available through a reverse mortgage. All things being equal, the most cash goes to the oldest homeowner.

If a homeowner receives Supplemental Security Income (SSI), Medicaid/Medical, or other public assistance, he should consult with a counselor prior to taking out a reverse mortgage. Loan advances are counted as “liquid assets” if they are kept in an account past the end of the calendar month in which they are received. Liquid assets cannot become greater than these programs permit.

KEY DECISION ELEMENTS

A counselor from an independent government-approved housing counseling agency must be consulted to learn about the pros, cons and alternatives to reverse mortgages. This is a federally-mandated feature of the reverse mortgage process designed for the protection of homeowners.

Trusted advisors in the legal, tax and investment fields should be consulted when available. It is always wise to include family, especially grown children, in the decision-making process. If inheritance is an issue, adult children may be willing to help financially.

Lastly, a family physician should be consulted. Critical to the reverse mortgage process is the time a homeowner is likely to remain at home. If the physician believes the homeowner may have to be moved to a care facility within two or three years, a reverse mortgage may not be the right answer.

If the only alternative left is a reverse mortgage, it is important to shop around and compare offerings. They can vary substantially in how much money they are able to provide, how the money is paid out, how much will be paid in interest, miscellaneous charges, and other features. Because costs vary so much between lenders, and are so difficult to compare, a standard of comparison has been developed called TALC (Total Annual Loan Cost). Study the numbers carefully prior to deciding on any

one loan. All lenders and potential lenders should provide you this information prior to signing loan papers.

ALTERNATIVES TO REVERSE MORTGAGES

Two alternatives to a reverse mortgage are the sale of a house or moving to a smaller, less expensive house and renting out the existing one. There may be significant tax implications behind either of these, so do your homework.

As long as an individual has assets and the ability to make monthly payments, another alternative is to refinance an existing mortgage over a longer period of time. A refinance may provide cash for needed repairs or urgent needs. A similar alternative is an equity line of credit or an interest-only loan, though the ability to make monthly payments is still required. One disadvantage, especially in a period of rising interest rates, is these loans have variable and therefore increasing rates.

There are less known alternatives to financial relief without the use of reverse mortgages. The California State Franchise Tax Board offers a property tax postponement service that works much like a reverse mortgage for homeowners 62 years or older who own their home and have an annual income of \$24,000 or less, at a much lower rate than a reverse mortgage. The local Housing and Redevelopment Agency may have a Senior Loan program that can help those who need to make repairs and cannot afford them. The loans do not require repayment until the home is sold or the homeowner moves out. They are offered at very low interest rates or no interest at all. Special assistance may be offered for those with special needs—blind, disabled, veterans—through these same agencies.

If after considering all alternatives, a reverse mortgage turns out to be the only possible solution, we offer a few words of advice. Although the use of reverse mortgage proceeds is completely flexible, be extremely frugal in the use and timing of the use of those funds. They represent a last source of support, and should be preserved as long as possible. Secondly, once a reverse mortgage is in place, property taxes and homeowner’s insurance premiums must be kept current, and the property must be adequately maintained. Failing to do so can lead to additional charges from the lender or worse yet, termination of the loan. §