A "Lost Decade" Ahead For Housing

Shadow Inventory

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In its effort to rescue the housing market, the Obama administration has created a Frankensystem which neither allows the market to clear nor solves the intractable social problems of lost equity and foreclosure. Obama needs to step-back and take a look at the mess he's made by following the advice of financial industry reps and bank lobbyists. Housing is in a shambles. The market is presently stitched together with buyer-assistance programs, loan modifications programs, new homebuyer subsidies, foreclosure abatement programs, principal reduction programs, historic low interest rates, "easy-term" financing, and government-backed loans. It's a veritable dog's breakfast of inducements, giveaways and bandaids all designed with one purpose in mind; to keep the banks from taking a bigger hit on their garbage mortgages. To get an idea of how desperate the situation really is; take a look at this eye-popping article in the Wall Street Journal:

"The U.S. government's massive share of the nation's mortgage market grew even larger during the first quarter. Government-related entities backed 96.5% of all home loans during the first quarter, up from 90% in 2009, according to Inside Mortgage Finance. The increase was driven by a jump in the share of loans backed by Fannie Mae and Freddie Mac, the government-owned housing-finance giants….

The collapse of the mortgage market in 2007 steered more business to the Federal Housing Administration, which insures loans, and Fannie and Freddie, which were taken over by the government in 2008 as rising losses wiped out thin capital reserves. Congress also increased the limits on the size of loans that Fannie, Freddie and the FHA can guarantee, raising the ceiling to as high as $729,750 in high-cost housing markets such as New York and California. ("U.S. Role in Mortgage Market Grows Even Larger" Nick Timiraos, Wall Street Journal)

There is no housing market in the U.S. apart from the government. The Potemkin banking system is still on the rocks, so Fannie and Freddie have been forced to pick up the slack. But if the government is going to put up all the financing, then it should have a bigger say-so on the way things are run. The emphasis should be on helping people, not on more handouts for the banks.

The first order of business should be the launching of a National Bank that would help support the privately-owned banking system. This would ensure the availability of credit for prospective homeowners and small businesses without putting more pressure on Fannie and Freddie. The National Bank would operate as a public utility run by government employees. That would help to control salaries, eliminate the problem executive compensation and incentives, and reduce the incidents of fraud.

Naturally, the banks will oppose the move tooth and nail, so its up to Obama to guide the legislation through the congress. This is matter of national security. The banks now pose a threat to the materiel well-being of everyone in the country. They're a menace. While a National Bank won't undo the massive damage that's already been done; it will put the economy on the road to recovery by creating a reliable source of credit for any future expansion without inflating another humongous asset bubble.

As the WSJ's report reveals, the banks don't have the capital to function as banks. So, what good are they? They're merely wards of the state. Obama should bypass this sclerotic system of corruption-plagued institutions altogether and do what needs to be done while the economy is still weak. That way, the new National Bank will be up-and-running by the time economic activity begins to pick up again.

SHADOW INVENTORY; There's a 9-year backlog of distressed homes

Here's another stunner from the Wall Street Journal. The article is titled "Number of the Week: 103 Months to Clear Housing Inventory" by Mark Whitehouse. Here's an excerpt:

"How much should we worry about a new leg down in the housing market? If the number of foreclosed homes piling up at banks is any indication, there's ample reason for concern. As of March, banks had an inventory of about 1.1 million foreclosed homes, up 20% from a year earlier….

Another 4.8 million mortgage holders were at least 60 days behind on their payments or in the foreclosure process, meaning their homes were well on their way to the inventory pile. That "shadow inventory" was up 30% from a year earlier. Based on the rate at which banks have been selling those foreclosed homes over the past few months, all that inventory, real and shadow, would take 103 months to unload. That's nearly nine years. Of course, banks could pick up the pace of sales, but the added supply of distressed homes would weigh heavily on prices — and thus boost their losses." ("Number of the Week: 103 Months to Clear Housing Inventory" Mark Whitehouse, Wall Street Journal)

Got that? There's a 9-year backlog of distressed homes. The banks are deliberately fudging the numbers to hide how bad things really are. The number of homes in late-stage foreclosure is not 1.1 million, but nearly 6 million— 5X more than the banks are admitting. Housing will be in the doldrums for a decade or more. It's shameful that people can't get basic information like this to help them make their investment decisions. The banks couldn't pull off this type of information warfare without the help of government officials pulling strings from inside. Bernanke and Geithner must be involved.

So, what's the objective?

The banks are trying to keep prices artificially high to avoid writing-down millions of mortgages that would force them into bankruptcy. It's called "extend and pretend" and its poisonous for the broader economy because it distorts prices and keeps a broken banking system in place that can't perform its social purpose.

WSJ housing editor James R. Hagerty verifies Whitehouse's claims and fills in some of the blanks. Here's a clip from his article:

"To get a sense of how many more households will lose their homes to foreclosures or related actions, Barclays tallies what it calls a shadow inventory, consisting of homeowners 90 days or more overdue on mortgage payments or already in the foreclosure process. At the end of February, 4.6 million households were in that category.

Barclays expects 1.6 million “distressed sales” of homes—mainly foreclosures or sales of homes for less than the mortgage balance due—both this year and in 2011, then a slight decline to 1.5 million in 2012. Last year, Barclays estimates, such sales totaled 1.5 million. About 30% of all home sales this year and next will be foreclosure-related, forecasts Robert Tayon, a mortgage analyst at Barclays, who says that would be only about 6% in a normal housing market.” (“Foreclosure Estimate Falls”, James R. Hagerty, Wall Street Journal)

Why would Barclays think that only 1.6 million “distressed” homes would be sold in 2010, when they openly admit that there’s 4.6 million homes already in the foreclosure pipeline? What does Barclays know that the public is not supposed to know?

Clearly, the banks have worked out a deal with Geithner and Bernanke to sell distressed inventory in dribs and drabs rather than all at once. That keeps prices high and makes their losses more manageable. But isn’t that collusion or, at the very least, price fixing? The government definitely HAS a role to play in helping people keep their homes or providing assistance when they lose them, but they have no right to scam the public by stealthily manipulating the market to save underwater financial institutions.

The problem is not housing. The problem is the banks. The banks do not have sufficient capital to fund the mortgage market, nor do they provide the bulk of the financing for auto loans, student loans, small business loans or credit card debt which is gathered into pools and chopped up into tranches for securities that are sold to investors. (Securitization generates wholesale funding for the credit markets) Not only are the banks unable to fulfill their primary social purpose–which is extending credit–they’re also increasingly dependent on revenue from high-risk speculation. A recent article in the Financial Times exposed the fraud behind the 12-month surge in equities pointing out that retail investors have largely stayed on the sidelines. Here’s an excerpt:

“…surveys show that the usual investors in major rallies – pension funds, hedge funds and retail investors – have not been net buyers of equities. And he says the most likely explanation for this anomaly in the biggest stock market rally since the 1930s is that major investment banks are the anxious buyers.

“Their buying would appear to be for one of two reasons. Firstly because they think the authorities will prevail in their (so far unsuccessful) efforts to inflate their way out of debt liquidation; or secondly because they are too big to fail and so can afford to take a huge gamble that enough buying will convince others to rush in and buy their inventory of risk assets at even higher prices.” (“Equity Rally Not Driven by the Usual Investors”, Financial Times)

Many people already suspected that the soaring stock market had more to do with “easy money” and bubblenomics, than they did with “green shoots”. Still, the FT article does help to underline the fact that the bank’s business model is broken and badly in need of repair. But, what is to be done? The banks already own just about everyone on Capital Hill, and their lobbyists are now writing large sections of the reform legislation. So how can they be stopped?

The root of the problem is political, and that's the best place to start. The banks' lethal grip on government has to be broken. The rest will be easy.

Read Michael Whitney's chapter on the Shadow Banking System in the following title:

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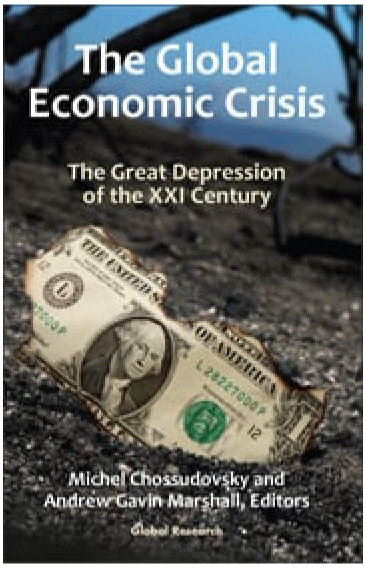

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