Banking by John Hoefle

Reflating the real estate bubble

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When other sectors of the economy were being destroyed during the speculative binge of the 1980s and early 1990s, the financial parasites of Wall Street had no sympathy. Too bad, they said, that's free enterprise. Now, however, faced with their own destruction, these same financial interests are running to Washington, demanding that the government bail them out.

Naturally, since bailing out bankers in an election year, in a depression, is a heavy political liability, the battle is being waged under the euphemism of saving the real estate market—the speculative bubble whose collapse has been a major contributing factor to the bankruptcy of the banks.

What the bankers are planning is to have the federal government guarantee hundreds of billions of dollars worth of the banks' commercial real estate loans.

The Resolution Trust Corp. is the laboratory for this scam. The RTC has begun a pilot project to create a secondary market in commercial real estate loans by packaging loans it has acquired from failed savings and loans, and selling them as securities. The initial offering is $528 million, but the RTC holds nearly $20 billion in such loans which are allegedly current on their payments.

If this initial test is successful, the *Wall Street Journal* gushed Feb. 12, it "could blaze the trail for an expanded secondary market for commercial real estate loans."

What the bankers are aiming for is a Fannie Mae-type agency for commercial real estate. More than $1 trillion in home mortgages have been bought by government-sponsored enterprises such as Fannie Mae and Freddie Mac. These agencies buy mortgage loans from banks, thrifts, and other financial institutions, package them as government-backed securities, then sell them on the open market. Now the bankers want to do the same thing for commercial real estate loans, like loans for office buildings and shopping centers.

From the bankers' point of view, it's a pretty good deal. The bankers could sell their increasingly worthless commercial real estate loans to the government, then buy them back as government-guaranteed securities. With government securities on their books instead of bad loans, the banks would have to set aside less capital and less reserves for loan losses, allowing them to pretend they were solvent.

By shifting the losses to the taxpayers instead of the bankers and the investment community, so the thinking goes, the crisis could be averted. Throw in a few tax breaks for developers and real estate investors, keep the interest rates low, and, as President Bush said, real estate will lead us out of this recession.

To help sell this to the public, and to provide political cover for their behind-the-scenes armtwisting, the bankers have formed a group called the Economic Growth Alliance (EGA), whose slogan is, "It's time to appreciate real estate."

The EGA is launching a series of slick print and television ads, designed to sucker the public into believing that the collapse of the speculative bubble is responsible for the depression, and that the recovery depends upon raising real estate levels back to their exaggerated pre-bust levels.

The centerpiece of the EGA's deception campaign is a study by DRI/McGraw Hill, which purports to show how the collapse of the real estate bubble hurts local governments and their taxpayers. The study raises the specter of closed schools, lost pensions, higher taxes, and reduced services. To avoid this fate, the EGA says, we must "put value back into real estate."

The study, authored by former Federal Reserve economist and Bank of England economic adviser David Wyss, is a carefully devised fraud. The usurious policies which led to the formation of this speculative bubble are what destroyed the economy. Money which should have gone into large-scale water projects, transportation and power grids, research and development and similar infrastructure projects—projects which increase the productive value of the surrounding areas—was instead diverted into useless real estate speculation. Eventually, this real estate pyramid scheme collapsed, and prices began their inevitable decline.

The U.S. banking system currently has some $850 billion in real estate loans, and hundreds of billions more in loans backed by real estate as collateral. Real estate values have dropped by as much as 50% from their peak in some areas, and by some 20% nationwide, and the slide is accelerating.

No matter what the bankers think, however, this plan won't work. Trillions of dollars of the alleged value of U.S. real estate has evaporated, and no amount of accounting tricks will bring it back. The bubble has burst.