Fed Warned: Housing Collapse Is Much Worse Than Bernanke Says

by Paul Gallagher

The LaRouche Youth Movement (LYM) Democrats who carried an "FDR" resolution on the housing crisis, through the Massachusetts Democratic Convention on May 19 (see article in *National*), won a debate which convinced the delegates there, that solving the "foreclosures crisis" requires a massive writedown of mortgage-based assets by banks and hedge funds; a banking reorganization.

The truth behind the April reports on the American housing sector, released on May 23 and 24, is driving the LYM's point home. And a growing handful of other economics teams are looking at these recent months' reports and sounding a public warning: The U.S. housing-bubble collapse is much worse, and hitting the financial system much harder, than Federal Reserve Chairman Ben Bernanke insists on claiming.

The April reports showed that U.S. mortgage-asset "values" may have fallen, around the country, by $300-400 billion in a year, a rate of asset-value disappearance which is still increasing. Some 24% (about $3 trillion) of the U.S. banking system's assets are based on the bubble in the residential mortgage sector, built up at an historically explosive rate since 2000. And the estimates, ranging up to $75-100 billion, so far made by financial institutions, of the actual losses hitting the mortgage-backed securities markets, are much too small.

In addition, in late May, for the first time, warnings appeared from Wall Street, that the subprime mortgage-security crisis is spreading into the "leveraged corporate takeover" bubble, threatening to cut off the huge flow of funds going into these buyouts.

The Cost of Falling Prices

The May 23-24 reports on U.S. housing sales for April showed an accelerating loss of "market values" in the U.S. housing bubble, which may have shrunk by $300-400 billion in mortgage assets over the past year, undermining huge volumes of mortgage-backed securities and bank assets based on mortgages, and driving a growing wave of foreclosures nationwide.

The National Association of Realtors (NAR) on May 24 reported an "unexpected" drop in April existing-home sales, of 2.6% below the March level, and down to the lowest level since early 2003, combined with an approximately 1% fall in median home price of these home re-sales. On May 23, the Commerce Department had reported an 11% plunge from a year ago in the median price of new homes sold.

Taking the relative weights of new vs. existing home sales in the U.S. housing market, these price drops mean that the median price of all homes being sold has dropped 3% in a year, from about $228,000 to $221,000; and the total value of homes being sold has undoubtedly dropped by more than that median. This has not occurred since the Great Depression in the early 1930s.

If this drop in prices in homes being sold, is reflected in a drop in "values" of all owned homes in the nation, American homes have lost about $600-700 billion in value in a year, and (leaving aside fully paid-off homes) $300-400 billion in "values" of home mortgage assets have disappeared.

Nearly half—49%—of the total assets in the U.S. banking system are based on these mortgage values: one-quarter on residential mortgages, and one-quarter on commercial mortgages. On the latter, a team of economists from two Texas universities, which had forecast a residential mortgage crisis in early 2005, warned on May 23 that it will hit the commercial mortgage segment imminently; its head, Prof. Nancy Wallace of the Haas School real estate group in Houston, called the entire $475 billion commercial MBS

EIRNS/Stuart Lewis

A whole "block for sale" in Loudoun County, Virginia. The loss in home values as the sales/foreclosure crisis continues, is the key to the threat to the financial system as a whole.

market "a house of cards."

And the drop in values is clearly still accelerating: Homebuilders are now imitating the "Big Three" automakers, giving bigger and bigger discounts to make sales, and writing off inventory; existing-homes inventory for sale is at 8.4 months worth, and rising, with foreclosed-home sales driving prices down.

The PIMCO bond-investment firm has already estimated that $75 billion in losses are hitting this year on the mortgage-backed securities market; but clearly, the losses in the financial system will be much larger, in the hundreds of billions. They will have to be written off in a bank reorganization.

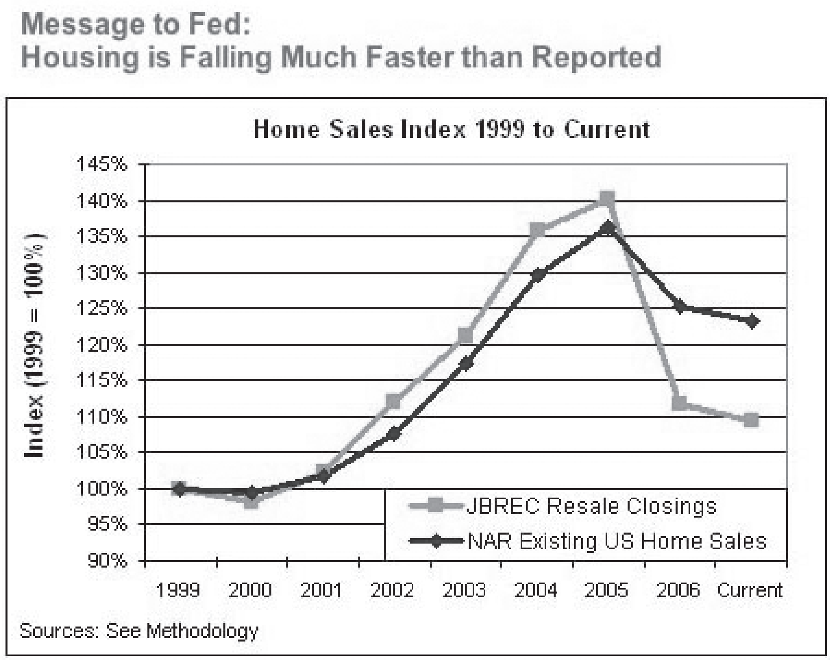
As for the Commerce Department's report of a 16% one-month jump in the *number* of new homes sold—even the National Association of Homebuilders (NAH) publicly debunked it. "There's some skepticism of the reliability of the numbers," said NAH chief economist David Seiders. "Other indicators at hand don't suggest this kind of snapback. I wouldn't be surprised by downward revision of April figures and some downward numbers in May."

'The Fed's Own Economists…'

A real estate investment and analysis firm, John Burns Real Estate Consulting, said on May 21 that it is "going public with our concerns" that the national sales information for both new and existing homes, is misleading and covering up a deep plunge of the housing sector. "We believe that the Fed should know that the housing market correction has been quite steep, and is also not showing signs of bottoming out," concludes JBREC.

The firm reports that having purchased and compiled actual home-sale *closing* data for 55% of the country, it finds existing-home sales down, not 8-9% as the National Association of Realtors (NAR) reports, but: 22% in May 2006-April 2007, compared to May 2005-April 2006; and much more than that on a simple year-to-year comparison of February, March, and April. It found that existing-home sales have fallen every bit as much as the new-home sales of the biggest homebuilders D.R. Horton and Lennar, which are down 37% and 27%, respectively. It found that home brokerage transactions by Realogy Corp., the nation's biggest realty company, which owns Century 21, Coldwell Banker, and ERA, fell 18% from 2005 to 2006; and that mortgage applications for home purchase have fallen 18%, even though many buyers now have to fill out several applications in order to get a mortgage.

Taking the states with the worst housing sales/foreclosures crises, JBREC found Florida home sales down 34%, not 28% as NAR reported; Arizona sales down 38%, not 28%; and California's down 37%, not 24% as NAR reports. This strong underreporting of the collapse by NAR, the firm



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John Burns Real Estate Consulting went public May 22 with this warning of the worsening real estate crisis, including a chart showing that careful data collection showed a much worse collapse of existing home sales since mid-2005, than "official" figures of the National Association of Realtors. The sales level now, is back to that of early 2001.

says, only dates from the beginning of 2006—and the chart shows that that is when the divergence suddenly expanded between its data and the NAR reports—it doesn't claim any intentional misrepresentation by NAR.

As for new-home sales, JBREC reports the Census Bureau is continuing to take reported sales without subtracting later cancellations, giving sales figures which are much rosier than the grim reality, and are reported publicly by the Commerce Department and the Federal Reserve.

And they are not alone: A report on subprime mortgage securities and associated "credit derivatives," by economists at the Cleveland Federal Reserve, was reported by seeking alpha.com on May 23 under the headline, "Subprime Derivatives Say Bernanke Will Be Wrong." "Perhaps Chairman Bernanke doesn't expect it," the author notes, "but reports in the field, credit derivatives indexes, and Fed Bank's own research economists are warning of deepening U.S. mortgages woes."

Private Equity Takeovers Next?

Often ignored in the current hunt for "whom to blame" for the national tsunami of foreclosures, the housing price bubble itself, generated by trillions in speculative funds' capital flooding into housing securities, *is* the cause of the crisis. Having reached the limit of possible household indebtedness—and far beyond it, generating a five-fold increase in subprime mortgage debt securities in four years—the bubble has started shrinking, and the "reverse leverage" of its collapse is unstoppable.

Now, tracking firms report nearly 600,000 foreclosures in the first third of 2007, suggesting two million homes may enter foreclosure *this year*. A Wall Street firm reported May 18 that while total foreclosures, at all stages, are up 60%-70% over last year so far, foreclosure notices—the front end of the process, when a mortgage is typically 90 days delinquent—are 127% higher. It said that foreclosed homes being resold by banks or lenders, are hitting the housing market with an average price drop of 30% nationally.

Now, according to a late May report by Merrill Lynch which reportedly represents worries by two other Wall Street investment banks as well, the big tightening of credit conditions in the market for subprime mortgage-backed securities, is also hitting the junk bonds in the leveraged corporate buy-out bubble. The report warned that while the cost of leveraged buy-outs is rising higher and higher above the stock values of the target firms, the interest-rate spreads for default-insurance derivatives on private-equity takeovers, have gotten significantly wider. That is, the markets fear the approach of the default wave from the mortgage markets.

This is reported in the *Financial Times* for May 25. It signals the "financial disintegration" spreading from the U.S. housing bubble collapse, of which Lyndon LaRouche has been warning.