

Reality Bursts Mortgage Bubble And Greenspan's Fantasies

by Richard Freeman

On Oct. 6, U.S. Federal Reserve Board chairman Ben Bernanke warned that the U.S. housing market was presently undergoing a "substantial correction," which would be "going into next year as well."

This minuscule acknowledgement of the slightest glimmer of reality was too much for certain financial circles. Immediately, former Fed chairman Alan Greenspan was hauled from his bubble-bath, to put on the robe of fake oracle, and intone on the very same day that, with respect to the housing market fall, the "worst may well be over." Greenspan continued, "we are coming to the end of this downtrend."

But just one day before, on Oct. 5, the Federal Deposit Insurance Corporation (FDIC) had released its "State Economic and Banking Indicators, Fall 2006," which cuts through Greenspan's claims. Assessing the conditions of banks and the economy of each state, the FDIC profiles the housing situation in particular. Among the states with the largest problems reported by the FDIC:

Florida: Florida home and condominium sales declined 25.8% during the first half of 2006, compared with the same period a year earlier. "Exotic" mortgages (such as interest-only mortgages) comprise a staggering 47% of the state's non-prime mortgage loan originations.

Virginia: Virginia home sales fell 24% during the second quarter of 2006, compared with the same quarter a year earlier. Exotic mortgages comprise 51% of all Virginia non-prime mortgages that were issued thus far this year.

Michigan: Michigan home sales fell 14.6% during the year ending June 30, 2006, compared with the same period for the previous year.

California: California home sales fell by 25% during the second quarter of 2006, compared with the same period a year earlier. The FDIC quotes a DataQuick report that states that notices of defaults filed against California borrowers surged 67% during the second quarter of 2006, compared with the same period a year earlier.

Massachusetts: Massachusetts sales of existing homes "fell sharply" during the second quarter of 2006, compared with the same period of the year before, according to the FDIC. In August 2006, compared with August 2005, sales of single family homes in Massachusetts fell 21.6%.

At the same time, banks are seizing homes right and left, because homeowners, who are losing their jobs or taking pay

cuts, are unable to pay their mortgages. Today, many homeowners are defaulting on mortgages that they took out only six months or one year ago. Foreclosure.com, the online tracker of distressed properties, currently lists more than 1.27 million home properties in the United States in some stage of foreclosure, bankruptcy, or bank auction. Approximately 5,000 properties are added to the listings each day.

Meanwhile, the American banking system, seeking easy record profits, has greedily leapt into the embrace of the real estate market. The banks made themselves hopelessly exposed to the vicissitudes of the U.S. real estate market. The same FDIC report cited above, stunningly revealed that during the second quarter of 2006, the insured U.S. lending institutions—meaning commercial banks and savings and loan institutions—earned a whopping 49.3% of their total gross income from real estate loans. The term "real estate loans" represents the combined loans to residential and commercial real estate. Half of all the banks' earnings come from real estate.

During the second quarter, in Florida, lending institutions derived 56% of their gross income from real estate loans, while in Virginia, the comparable figure was 64%. With such heavy dependency, the real estate market collapse pulls the banks down into systemic collapse. This ensures the world financial system's disintegration.

A Fallen Wizard

Alan Greenspan is a rather barren fellow. To the extent that he fathered anything, he is the father of the housing bubble. Recall that in March 2000, the Information Technology bubble burst, as the NASDAQ stock index plunged by two-thirds over four months. A frenzied Greenspan engineered 13 successive cuts in the Federal funds rate—the rate at which banks lend each other money overnight—bringing it to 1% by the start of 2003; this was the lowest level it had been since 1961. Deliberately, Greenspan built the housing bubble: Home-buyers were able to borrow mortgage money at very low interest rates, either to buy a new home or to refinance an existing home. Home refinancings exploded. "Non-traditional" or exotic loans, and speculation proliferated on an unprecedented scale.

Believing the hype that he was a wizard, Greenspan defended this. Speaking before the Senate Banking Committee

July 16, 2002, Greenspan boasted that his money-pumping had created “very low levels of mortgage interest rates,” which have been instrumental in “buoying spending.” Greenspan said, “The very low level of mortgages interest rates . . . encouraged households to purchase homes, refinance debt . . . and extract equity from homes to finance expenditures.” Now, the thoroughly discredited Greenspan is brought out to defend his absolutely bankrupt housing bubble. But the magic has vanished.

Home-Builders Slammed

Simultaneously, those involved in the physical infrastructure of home-building are being hit. Contractors and home-builders are seeing order pull-backs. Consider some leading names in home-building, whose orders have fallen in the range of 25 to 51%:

D.R. Horton announced that for its fiscal fourth quarter (which ended Sept. 30, 2006), its orders fell 25%, compared to the same quarter last year. Moreover, its cancellation rate surged to 40% during its fourth quarter, indicating that households that actually ordered homes from Horton are cancelling them at some stage of the pre-construction or construction process.

K.B Homes reported that its orders plunged 43% during the third quarter of 2006, compared to the same quarter last year.

Beazer Homes USA announced that it posted a 49% decline in orders in its fiscal fourth quarter (which ended Sept. 30, 2006), compared to the same quarter last year.

M/I Homes declared that its orders plummeted 51% during the third quarter, compared to the same quarter last year.

Meanwhile, luxury home-builder Kara Homes filed for bankruptcy. It had been offering potential home-buyers massive discounts of \$256,000 plus one year of no payments on mortgages, but still it couldn't sell homes.

A Falling-Out Among Rogues

Many of the homes that have been “sold” during the past five years could only have been sold by means of dubious, highly speculative loans and outright fraud. Among the type of suspect dangerous exotic mortgages are interest-only and minimal option payment.

Leading physical economist Lyndon LaRouche asserted two weeks ago, that what is becoming unsalable now is the mortgage speculation in the housing bubble, rather than the homes themselves. “It's not the houses that won't sell, it's the mortgages that won't sell,” he observed Sept. 26. (See “It's Not the Homes, But the Bubble Loans That Won't Sell,” by Richard Freeman, *EIR*, Oct. 6, 2006.)

In the mortgage industry, as common operating practice, often a lending institution that makes a mortgage loan, sells that mortgage loan to a secondary housing group, either Fannie Mae, Freddie Mac, or an institution with no semi-government connection. These secondary lending institutions, in

turn, package a group of several mortgage loans into a single bundle, put a guarantee on the bundle, and then sell that bundle, called a mortgage-backed security (MBS), to an investor, whether it be an insurance company, pension fund, foreign bank, or private individual.

However, in an article entitled “Bad Loans Draw Bad Blood,” the *Wall Street Journal* reported Oct. 9 that because an increasing share of the exotic mortgage loans are defaulting early, the investors who bought mortgage-backed securities which contained these bad loans, are presenting the mortgage-backed securities to those institutions that issued them in the first place, and demanding their money back. In a prominent case, H&R Block, Inc., suffered a \$131 million loss for its quarter that ended July 31, because its subsidiary, Option One Mortgage Corp., had to buy back the mortgage-backed securities that it was involved in packaging and selling, because they contained defaulted loans. Option One had to absorb the losses from the defaults.

There are increasingly contentious disputes and lawsuits between the institutions of the different stages of this process, and as the defaults increase, so will the disputes; and the whole process by which liquidity has been provided to the housing market for the last several decades could break down.

On top of that, the multi-trillion-dollar U.S. commercial real estate market is experiencing serious problems. Speaking Oct. 11 at the British Bankers' Association Tenth Annual Supervision Conference in London, U.S. Federal Reserve Board Governor Susan Bies warned of dangers to the U.S. banking system from investments in U.S. commercial real estate, which she called “a highly volatile asset.”

Reality Bursts In

The valuation of the financial paper of the combined U.S. commercial and residential real estate markets, including the financial paper of Fannie Mae and Freddie Mac, totals more than \$20 trillion. There are multiple stresses in the system that will rupture it.

Lyndon LaRouche has presented the necessary steps for bankruptcy reorganization of the entire world financial system, through which one could address and correct the housing market. The pathetic, discredited Greenspan can deliver all the ritual incantations he wants, proclaiming the housing bubble sound. They are of no merit; reality has passed him by.

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