'Florida Land Bubble' Collapse Returns

by George Canning

In 1926, the collapse of the great "Florida Land Bubble" gave the United States warning of the coming 1929 market collapse and the Great Depression, for the political faction that heeded it, which included a few Congressmen and the future President, Franklin D. Roosevelt. After Florida real estate prices had quadrupled in one year, 1924-25, and "everybody there was a real estate investor or a real estate agent," the bubble collapsed in 1926, producing mass foreclosures on huge mortgages. It so devastated the state's economy, revenues, and budget, that Florida's crash was complete before 1929.

Now, Florida is again leading the way in the mortgage bubble meltdown and financial crash. The state and local governments have been hit by a "double whammy" of losses, which shows how the budget collapse process, reported in the accompanying article, will rapidly worsen.

The collapse of the mortgage and housing markets is depriving U.S. counties and municipalities of a major source of income which funds public services. That is the loss of revenue before it is collected: from sinking home prices and real estate taxes, from falling home sales and consequently disappearing recordation fees, from falling construction activity, and from the economic impact of mass home foreclosures.

But a second impact—the loss of further revenue funds *after* they have been collected—was reported Nov. 16 by Bloomberg.com. In Florida, and several other states as well, the value of short-term investments of state agencies' funds collected but not yet spent—investments which government units have made into funds containing mortgage-backed securities (MBS)—is rapidly evaporating.

$50 Billion State Fund at Risk

Bloomberg.com, preparing an article on a number of states for its magazine, reports that the Florida State Board of Administration, which manages about $50 billion of short-term investments for the state, school districts, and local governments, holds $2.2 billion of debt that has been cut below investment grade to junk. (Florida rules require the state's short-term investments only to be top-rated, liquid securities, so taxpayer funds aren't placed at risk.) The funds had been invested in hedge funds and similar vehicles issuing mortgage-backed securities and related toxic issues of the collapsing mortgage bubble.

Among the state's investments which have been downgraded are: $400 million of Axon Financial Funding LLC debt, cut to junk status by Standard & Poor's on Nov. 9; $850 million of KKR Atlantic Funding Trust, cut to default by Fitch last month; $577 million of KKR Pacific Funding Trust debt, cut to default by Fitch last month; and $319 million of debt issued by Ottimo Funding Ltd., cut to default by Standard & Poor's on Nov. 9.

Part of the $50 billion in Florida government-unit investments is a $27.3 billion Local Government Investment Pool, suffering "client outflows" or withdrawals. Drexel University finance professor Joseph Mason, formerly an economist at the U.S. Treasury, is quoted by Bloomberg that the nearly 1,000 Florida school districts, cities, and counties invested in the LGIP fund, now informed of its downgraded debt, will be tempted to pull money out, and "This sets up the danger for a run on the bank."

Florida is not alone in this problem. The *Bloomberg* article is expected to report on the purchase of subprime-tainted debt by public money managers in Connecticut, Florida, Maine, Montana, and Washington. Two examples given today are Washington state's King County (where Seattle is located), which Fitch Ratings last month said may have its rating lowered on $1.5 billion of bonds, because of debt investments affected by rising defaults on U.S. home mortgages; and Connecticut, where a state fund that invests cash for more than 300 state agencies and municipalities was holding $100 million of defaulted debt sold by a structured investment vehicle (SIV) as of last month, according to an official there.

Threat to Municipal Insurance

In a closely linked piece of bad news for states and cities, there is a high and rising probability that several of the largest bond insurance companies will default, because they are facing losses on the so-called asset-backed securities that they have insured, of $400 billion or more. Again, these are overwhelmingly mortgage-backed securities and the hedge fund pools which bought them.

This is the equivalent of "20 Hurricane Katrinas" in insured losses, warned the credit officer of one insurance company, quoted by Bloomberg on Nov. 16. Trading in derivatives contracts on these insurers' own debt, indicates a 40% expectation of default by New York-based Ambac Insurance, and a 28% expectation of default by MBIA, the largest financial insurer, also based in New York.

Fitch and Moody's are close to downgrading Ambac and two others, the New York-based FGIC Corp., and CIFG Guaranty, registered in Bermuda, unless they add much more to their core capital. Downgrades of these insurance companies would, in turn, shock the whole market for state and municipal bonds, sending interest rates through the roof.