Save Housing: Put Financial System Into Receivership

by John Hoefle

You can hardly look at the news these days without hearing about the U.S. housing crisis. Foreclosures are at an all-time high and the rate is accelerating, home prices are falling all across the nation, and the number of homeowners who owe more on their homes than they are worth is rising. This is a national problem which must be solved.

At the same time, however, this housing crisis is being used in a heartless and cynical way by the big financial institutions, which are seeking to have themselves bailed out under the guise of helping homeowners. Proposals abound in Washington which are aimed at protecting not the homeowners, but the mortgage-holders, and the holders of trillions of dollars of mortgage-backed and mortgage-related securities. Under all the posturing and spin, the American people are being thrown to the wolves by the bankers, in order to protect the fictitious values of speculative financial paper.

To sell their bailout, the financiers constructed a phony story about how the subprime problems developed, painting themselves as the victims of unscrupulous subprime lenders and greedy home-buyers. They got away with it because a year ago, when they started pushing this scam, the cracks in the banking system were not nearly so visible as they are today. The bankers knew, but the public did not, and the bankers played on that ignorance.

One year later, the financial markets are in panic, and the bailout process has begun. If we continue down this road, not only will the housing crisis worsen, but the economy will explode in a hyperinflationary blowout the likes of which the United States has never experienced.

Housing Meltdown

Bad, and getting worse, sums up the situation for homeowners. Foreclosures rose to a all-time high in 2007, according to the Mortgage Bankers Association, which noted that 40% of all foreclosures involved people with prime or subprime mortgages who walk away from their homes *before* their adjustable-rate-mortgage interest rates reset, and another 23% involved people who walked away from their homes after receiving some sort of beneficial loan modification. Late payments rose to a 23-year high, with 5.8% of all home loans more than 30 days late, a rate not seen since 1985.

Nationally, some 29% of all subprime loans were in trouble at 2007 year-end, as were 35% of all adjustable-rate subprime loans. Subprime loans accounted for about 13% of the total number of mortgages. Troubles with prime loans are also increasing, with 4.5% of all prime mortgages delinquent or in foreclosure nationally, as were 8.7% of adjustable-rate prime mortgages.

The net worth of households fell in the fourth quarter of 2007 for the first time since 2002, decreasing by $533 billion, with housing-related net worth falling by $176 billion, according to the Federal Reserve. That net loss would have been almost three times bigger, had the Fed used the figures from S&P/Case-Shiller instead of those from the Office of Federal Housing Oversight, according to J.P. Morgan Chase.

The drop in housing prices, combined with the refinancing wave of the past several years, means that as a whole, the amount of equity Americans own in their homes has dropped below 50%, Federal Reserve statistics show. Since about 35% of homeowners own their homes outright and have no mortgages, the 65% who do have mortgages owe a lot more than 50% of their homes' value.

Freddie Mac projects that sales on new and existing homes in the United States will probably fall to 5 million this year, down a third from the all-time high of 7.5 million in 2005, and even that number reflects increased government bailout activity, since the private mortgage-backed securities market has collapsed.

While foreclosures get most of the press coverage, the effects of the housing crisis are also hitting people who are still making their payments. The exorbitant prices for homes in recent years have put many families in the position of having to pay far more for housing than they should, and the combination of high mortgage and rent payments, high gasoline prices, and the rising cost of food and other essentials due to the falling value of the dollar, has put households in a terrible bind.

The Cause

The fact that subprime loans are at the bleeding edge of the housing crisis does not mean that subprime loans were the *cause* of the housing crisis. For the cause, one has to look at the banking system and the creation of the largest speculative bubble in history.

Far from being caused by subprime lenders on the periphery of the financial system, the real estate bubble was the creation of Wall Street. The game was to run up real estate values, and use the "wealth" created by the higher valuations as fuel for the bubble. The debt created by the mortgages was then used as the basis for the creation of an even larger market in mortgage-backed securities and even more mortgage-related securities such as collateralized debt obligations and other forms of insanity. As the bubble grew, it required ever larger amounts of fuel, which in turn, required more, and bigger, mortgages.

As housing prices rose, they began to outpace the ability of the population to pay the mortgages, so the banks began to loosen loan requirements. Over the last few years, with prices so high that buyers were increasingly difficult to find, the lenders opened the floodgates, issuing adjustable-rate mortgages, subprime loans, low-documentation loans, no-documentation loans—basically doing whatever they had to do to keep the mortgage debt flowing. By design, and intent, the banking system was selling mortgages to people who could not afford them.

The idea that this was the fault of the subprime lenders is a myth, for two main reasons. The first is that the subprime lenders were just middlemen—they originated the loans and then immediately sold them to larger institutions which would combine them in pools for mortgage-backed securities. Had the big banks not bought the loans from the originators, the originators would have quickly run out of capital and ceased to exist. The second reason is that many of the subprime lenders were allied with, or even owned by, big banks.

This whole business was run by the big commercial and investment banks from the top down, and they in turn fed a steady stream of mortgage-backed paper into the hedge funds, the mutual funds, the money market, pension and other investment vehicles. It was a giant pyramid scheme which was—seemingly—enormously profitable when real estate prices were rising, only to be revealed as an even bigger disaster when that price-growth peaked.

The homebuyers, far from benefitting from this process, instead found themselves paying huge amounts of money to the bankers through artificially high mortgage prices. Many individuals profitted from this speculative game while it was growing, but from a systemic standpoint, and, after the dust clears, it will be seen as one of the most destructive boondoggles of all time.

Crash, and Bail

To casual observers, the cracks in this system began to appear in early 2007, when the banks pulled the plug on the subprime lenders and began to portray themselves as victims. That Summer, the cracks split wide open with the Bear Stearns hedge fund crisis, and the death of the market for mortgage-backed securities. As the panic deepened, the market for other asset-backed securities, such as those backed by credit-card receivables, also seized up. By year's end, the whole securitization system had ground to a virtual halt, and the central banks were pumping liquidity like crazy, keeping the system on life-support.

With the new year came the next phase, the banking crisis; though called a "credit crunch," the real problem was *insolvency*, among banks with huge amounts of worthless paper on their books.

Now, things have deteriorated to the point that the talk about the insolvency of the banking system is out in the open, and the Federal government is openly discussing measures designed to save financial institutions. It is a far cry from a year ago, when all the experts were confidently assuring us that everything was under control, that the damage from the mortgage sector was containable. Today, the public statements are even more foolish, and far less confident. Panic is in the air, as is the toxic smell of a bailout.

Have no illusions about what is happening. The international banking crowd is doing what it always does in such circumstances, which is to dump as much of the losses as possible on the public. The bailout schemes before Congress vary slightly, but all have the goal of having the Federal government, and the U.S. taxpayer, buy the bad paper from the banks, so that the public takes the hit. Given the enormous amounts involved and the pitiful state of the U.S. physical economy, such a move would not only destroy the economy, but trigger a hyperinflationary collapse of the dollar, which would spread worldwide. It is insane, and it is coming, unless we stop it. If you think you have problems now, just wait. Better still, help LaRouche pass the Homeowners and Bank Protection Act and put a stop to the bankers' insane wet dream. (See *National* for news on the HBPA.)