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## Housing Bubble 101

### Sub-primal Scream

by Joseph L. Elkhorne

**08/15/07 "ICH"** -- --About last October I started taking note of suspicious clues surrounding the American housing bubble. None of these that I saw were in the mainstream media. Rather, it was like working a jigsaw puzzle: looking at miscellaneous comments in alternative sources, finding "this piece goes with that", and so on.

Now, after reading countless hundreds of articles on the housing bubble, and comparing it to the leadup to the Great Depression, which my parents and I lived through, I still find the MSM lacking.

#### Here's why:

The mainstream media went along for some time with a "What, me worry?" attitude. And even when Henry Paulson said on July 21 that "we were about at the bottom of the housing slope" MSM parroted that 'wisdom'. Whistling in a graveyard, more like.

Since the shakiness of the market, however, there are any number of commentaries about problems. Many of them are still in the recent past: it's about the sub-prime sector. Ha!

In point of fact, the bubble is well past that point. The rot has spread to Alt-A loans, and now a significant percentage of prime loans, and even jumbos. Now, the seeds of this potential disaster were planted in 1970 by the Department of Housing and Urban Development.

Asset Securitization is the name of the game.

From the Comptroller of the Currency Administrator of National Banks, 1997, "Asset Securitization Controller's Handbook":

"Asset securitization is the structured process whereby interests in loans and other receivables are packaged, underwritten, and sold in the form of "asset-backed" securities."

'In the day', when someone bought a house, a bank usually supplied the loan and held the mortgage. After World War Two, demand outpaced supply and investment banking hit on the plan of developing mortgage pools. This was a way to spread risk over a range of securities and seemed like a good idea at the time.

HUD's Government National Mortgage Association (GNMA or Ginnie Mae) issued securities collateralized by a portfolio of mortgage loans.

Later, auto loans became part of such security schemes. And then credit card debt. By 2004, Asset Securitization had grown into an 800-pound financial albatross: credit card-backed securities, 21%, home-equity backed, 25%, auto backed, 13%, collateralized debt obligations (CDOs), 15%. Also, student loans, 6%, equipment leases, 4%, manufactured housing, 2%, small business loans and aircraft leases.

And then the housing boom took off.

*"Asset securitization is the structured process whereby interests in loans and other receivables are packaged, underwritten, and sold in the form of "asset-backed" securities."*

The problem is, the **true value** of those assets.

With easy credit courtesy of the Federal Reserve System, low interest rates on loans, and new homes being built at an increasing pace, issuing loans took on a more creative aspect. 'Interest only', the amusingly labelled 'covenant-lite' (a.k.a. liar's loan), the ubiquitous sub-prime loan, all became standard.

As the market hotted up, not only banks were providing blue-sky loans but even construction companies. "Come buy our home and we'll give you the money to do so!"

Prices continued to rise and speculation became rife. Hey, if you're flipping burgers and you see a chance to grab the brass ring of the American Dream, why not? Buy for little or nothing, ride the rising market and sell for a handsome profit. The

'greed is good' attitude flourished and already lax standards became even more so.

A sub-prime loan has the highest risk factor, due to the fact that those getting such loans were already assessed as a credit risk. But who cares if they default later, so long as you, the loan issuer, can sell that mortgage on.

The Alt-A class of loan is intermediate, a marginal problem for many people. And a prime loan is issued to, usually, someone with an excellent credit rating. The problem with the latter is that all is well, until the borrower loses a job. The usual quick fix is to try to refinance, why not, with excellent credit rating to that point, shouldn't be a problem? Wrong!

For example, woman buys a house in 1998, up to date on mortgage payments, maybe even ahead. Job gone. Innocently, she goes to bank to discuss the problem. Nothing to do with them. They've sold that mortgage on. And many others.

Now, she and her lawyer are trying to find out WHO does hold the mortgage. No one knows, it's been passed through many hands.

Or, another case: couple receives a foreclosure notice, sure, they're in arrears. Only the paperwork comes from some outfit that cannot even prove they own the mortgage. Crazy stuff.

Yeah, it's easy for some people not in strife to look at the housing bubble crisis casually and say, foolish, naive and greedy people, let them rot. But isn't the root of the problem those who initiate questionable loans? And it's not only 'liar's loans' but construction companies into corruption and fraud. Falsifying loan applications, or doing a 'bait and switch'.

And then we get back to the aspect of 'asset'.

What started out from a reputable bank as a prime loan is leveraged. Same principle as fractional reserve banking. Loan money that doesn't exist and create a debt plus interest to be returned. And sell that mortgage on so your fingers don't get burnt.

Then the mortgage broker takes a bunch of these and passes them on. Because the risk is spread, allegedly, the value is reckoned at maybe 10:1 and ultimately, a hedge fund has many of these 'assets' in the kitty. All well and good while the bubble continues to inflate. But when the merry-go-round stops rotating and then starts to run in reverse, it's oops time.

For some. One of the Gordon Gecko-like Wall St. heroes sucked \$1.6 billion out of this Ponzi scheme as his reward.

Meanwhile, hard working Americans invest in pension funds, building a good future retirement. Except ... the fund managers are heavily into hedge funds and sure-thing stocks. Uh huh. Probably enterprises run by more "smartest guys in the room".

The housing downturn has hit suppliers: hardware, Home Depot, insulation, Owens Corning, USG, largest manufacturer of drywall in the U.S. Their prices are down, production has been cut by 18% and they've laid off 1,100 workers in the past year. More to come. None of this was hard to predict.

At the beginning of the year, the pool of new homes for sale in California was a three-week total. Now, it's one year.

Ohio and Michigan fare ever worse, due to plant closings. There are whole subdivisions looking like ghost towns. Texas and Florida also lead the pack of problem areas. Even so, three major highrise condo projects continue to go up in Miami. But who will buy?

Even the affluent are seeing hard times, comparatively. Now, you wouldn't think any couple anticipating buying an \$850,000 home in Washington DC would have a financial problem. But the recent 'correction' in the stock market brought on a rise in interest rate of the jumbo loans. Overnight, their buying power dropped by 10% so it is time for second thoughts. Jumbo loans have no guarantee protection, so even low-risk is now not so low.

And it's not only individuals in all walks of life -- the big boys are feeling the pinch. Citicorp, Bear Stearns, Goldman Sachs and more -- imagine finding you've underwritten billions of dollars of corporate loans, only to find no one wants the bonds you expected to sell!

And if the domestic economy weren't shaky enough, Paulson is asking for a new cap on the national debt, \$9 trillion isn't enough. And our glorious leader plans billions of dollars of arms 'sales' to several questionable regimes. As well, Mexico's Calderon now needs help on the 'war on drugs' which will probably cost the U.S. five hundred million.

But let's leave that for another time. A final visual of the housing market here.

Residential mortgage backed securities. Note the government guarantees 48.6% of

these. Only a small percentage of the \$3 trillion+ is at risk but ...

Here's the big picture as of July: [Chart](#)

which linked from [this site](#):

Btw, in two examples of 'how to lie with statistics' ... one clue was the Fed dropping the M3 last year, 'the money supply'. And dropping energy and food from the inflation figures, with those two items showing 25% and 33% increase respectively. Uh huh.

And when the Dow drops 387 in one debacle of trading and at the same time, the price of gold falls? What's going on?! So there appear to be lots of cracks in the economic edifice. But why should we worry about threatening the Chinese, who own \$1.3 trillion of our debt? Never mind Japan and India who have A significant stakes as well.

"Don't worry, be happy."

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