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The Housing Bust Continues…
Any End in Sight???

Just a few short years ago, everyone and their brother seemed to be making a fortune in real estate. Folks were quitting their day jobs to become investors (and/or speculators) as virtually every property in virtually every region of the country experienced dramatic valuation surges. In fact, between 1997 and 2006, average home prices almost doubled and many first time homeowners and investors/speculators realized they could participate (some multiple times) in the "American Dream" with very little money down, less than stellar credit, and no real income source that would require verification.

Unfortunately, in most "ponzi schemes," the last on board are the ones who reap the worst of the misfortunes. In reality, over the past two years, the entire country has suffered as…

- the housing boom turned bust;
- real estate property valuations declined across the board;
- borrowers (and not just subprime) struggled to keep up with their payments, particularly when they owed more than their properties were worth;
- major financial institutions were forced to write-down billions in assets as they held worthless (or, at least, very underwater) investments on their books;
- more than a few corporate giants were victimized with record losses (or worse);
- consumer activity came to a standstill as individuals worried about losing their jobs (as well as their homes);
- other sectors of the economy were negatively impacted as the housing debacle spread like wildfire;
- the equity markets declined significantly as the dire housing outlook began impacting manufacturing, retail, labor and the investors' desire (ability) to buy (hold) positions during this period of uncertainty.

While some analysts had been targeting the second half of 2008 as a time for a housing rebound, the most recent related data seemed to indicate otherwise. During the summer, construction spending fell for the 16th consecutive month and activity dropped to its lowest level in seven years. The median home price had declined by about seven percent over that prior 12-months as most major metropolitan regions experienced valuation downturns. The Mortgage Bankers Association reported that a record nine percent of American homeowners with a mortgage were either behind on their payments or in foreclosure as of the end of June as damage from the housing crisis continued to mount.

A Potential Light at the End of the Tunnel (but at what price?)

While new and existing homes sales have experienced a bit of a reprieve (dare we say, rebound?) as of late, much of the activity has represented bargain hunters looking to take advantage of the pricing decline and skyrocketing inventory of available houses. However, any small silver lining should be well-received by homeowners and investors alike. For example, in Southern California, one of the regions that experienced the greatest (negative) reversal in fortunes over the past few years, July residential sales climbed to a 16-month high as buyers found value in certain depressed or foreclosed properties.

And in early September came what some consider to be a watershed event in the housing debacle and relate credit crisis. The federal government announced a “bailout” of Fannie Mae and Freddie Mac, the leading financial institutions that fund about three-quarters of new home mortgages. The US Treasury is prepared to inject up to $200 billion to support these companies so critical to the nation’s housing sector and the global financial markets. While the taxpayers will undoubtedly face much of the burden of the bailout, many analysts hailed the move as the “beginning of the end” of the housing bust.

A Brief History Lesson

Initially created to add liquidity to the domestic housing industry, these two pseudo-governmental agencies allowed many homeowners the ability to borrow mortgage funds at more affordable rates. While both entities were public companies whose shares traded on the New York Stock Exchange, many investors thought of them as less risky and their debt carried an “implied” backing of the “full faith and credit” of the US government.

Through the years, both Freddie Mac and Fannie Mae have made more than their fair share of news headlines (accounting irregularities, ineffective management, lax oversight) and have long been targets of certain politicos who have warned about a “too big to fail” mentality. Ultimately, the Administration agreed that insolvency would create far more dire consequences for the financial markets and the global economy than any enhanced burden placed on taxpayers. The risk of a financial system collapse were simply too great to bear should Freddie and Fannie be left to work out their own “challenges” without any government intervention. Even before the announced bailout, both stocks traded significantly lower and have since become virtually worthless; weeding through the fine print, most of the bondholders appear to be protected.

Boom to Bust to Stability?

The jury is still out about the ultimate futures of Freddie and Fannie and what structures and roles the subsequent entities will maintain. Undoubtedly, the next President and Congress will help shape the future direction. Still, many analysts see some positives for the housing market developing in the aftermath of the recent bailout:

- The government should offer far greater oversight over mortgage lending which should add stability to the process.
- Mortgage rates could decline for home buyers as loans will now be backed by the federal government (and do not just carry an implied guarantee).
- The uncertainty about the future of the financial giants (at least those that remain) will come to an end (though the specifics of the plan still need to be worked out).
- Investors (specifically institutions and international) should have greater confidence in buying and holding mortgage securities backed by the US government (as opposed to Fannie or Freddie).
- Likewise, additional write-downs of currently held Freddie and Fannie mortgage securities should begin to subside, thus, helping to shore up the ailing financial sector.

Should interest rates decline and investor confidence increase, the overall housing sector will ultimately begin showing signs of a real rebound (or, at least, greater stability). Meanwhile, the government should ensure that folks have every opportunity to realize the American Dream (while guarding against those with very little money down, less than stellar credit, and no real income source that would require verification).

A Call to Action

The news about Freddie and Fannie has been confusing at best. While many analysts expect positive developments for the housing sector and the overall financial markets, much uncertainty remains. Let your advisor help dissect the latest headlines and make sure your financial position is sound and your investment portfolio is allocated in the most appropriate manner.