



Housing's Drug of Choice: the Federal Treasury

If there was ever any doubt that the US housing market was being artificially supported by the federal government, new statistics dispel this. A recent Bloomberg article highlights how dependent the US housing market has become on federal assistance.

Fanny Mae and Freddie Mac, already financial wards of the state, may ultimately require \$1 trillion dollars in federal bailout funds. This sobering statistic belies the very notion that the US housing market operates as an efficient, free-market enterprise, and that housing values are based on arms-length transactions.

The fact is, the housing market is currently anything but arms-length or free-market. Gross price valuation distortions have occurred within many asset classes in the last 10 years, including commercial and residential real estate. These distortions occurred for many reasons, but were primarily due to the near freefall of credit standards that now threaten our banking system. Easy money distorted prices, and now threatens the survival of hundreds, if not thousands, of banks.

Fannie and Freddie own or guarantee 53 percent of the nation's \$10.7 trillion in residential mortgages, and have sold \$1.4 trillion in mortgage-backed securities to the Federal Reserve and the Treasury Department since the crisis began. The liabilities assumed by the housing giants remain off the federal balance sheet, an accounting fiction that grossly underestimates the government's long-term debt exposure.

The fact remains that unless housing prices quickly rebound, a proposition that is highly unlikely, private investment in the securitized mortgage markets will remain anemic, at best. With home prices continuing their decline, mortgage default rates accelerating, and housing inventory increasing, the housing market will continue in virtual freefall.

Fueling this pessimism are recent reports that home starts fell by 17 percent in May, and that the rental market has strengthened as the homeowner-renter calculus has shifted favorably to rentals. This subtle change in psychology will seriously challenge, for at least the next decade, the notion that homeownership is always preferable to renting.

The US's near-neurotic obsession with home-ownership is largely to blame for this mess, and lawmakers consider this issue the third-rail of politics. Fanny and Freddie were only able to increase the percentage of people who own their homes by significantly lowering credit standards, a fact conveniently ignored by housing market pundits and legislators.

The reality is that for many people, renting a home is the far preferable choice. This notion, though, would turn the "American dream" on its head, and become an admission of social and cultural failure. Americans have wailed over this home-ownership ideal for decades, and held it out as the

gold-standard and benchmark to other Western societies. This ideal, though, has been revealed for the failure it is.

The coming months and years will see ever increasing delinquencies, defaults and foreclosures. Fanny and Freddie will continue to draw on ever-increasing resources for their survival. Lawmakers, facing re-election pressures this year, will continue to emphasize the broken ideal of homeownership for all. The Federal Reserve and Treasury will continue to print money and subsidize the vast homeownership machine.

The market, though, may finally realize that there is no end in sight to federal support, and recognize that the housing giants' liabilities have actually become liabilities of the federal government. This end to the accounting fiction will be painful, as recognition of this liability may ultimately downgrade the financial viability of the dollar and of the US government. Practically, there is no end to this quagmire. We're stuck.