You have been nationalized. That didn't hurt….did it?

Submitted by Steve Bogen

This letter is the first in a series taking a look at how government intervention affects our economy. If you were to think of the weak sectors of our economy as sagging roofs, with government guarantees, bailouts and "money creation" the poles placed under the eaves to prop-up the roofs, what is the inevitable result of the roofs being propped-up rather than repaired? As a roof continues to deteriorate, there will be fewer places where props can be placed, until the roof collapses. We all know the only solution is to replace or repair the roof.

Before reading the rest of this letter, I suggest you put yourself in the proper mood by visiting www.usdebtclock.org. There, in real time, you can watch the growth of various measures, such as the national debt, federal revenue and "money creation" (I shudder to think of the implications of that term) change too fast to comprehend. Frankly, as I see the numbers change, I feel a level of primal fear, like being locked in a runaway bus. It makes me wonder, "is this machine out of control?" At least there is hope somewhere: In the time it took to write this paragraph, the US added 3 new citizens. Let's hope they turn out to be net producers rather than net consumers.

Our focus in this article is on how the Federal Government props up the home mortgage market. "*For all intents and purposes, the United State home mortgage market has been nationalized without anybody noticing. Last September, reportedly over 95% of all new loans for single-family homes in the U.S. were made with federal assistance, either through Fannie Mae and the implied guarantee, or Freddie Mac, or through the FHA,*" according to Andy Miller of the real estate consulting firm, Miller Frishman Group.

Why should we be worried that most of the financing in single-family homes is being facilitated by government guarantees? What the government gives it can take away. When an implicit or explicit promise of government (taxpayer) support for a loan exists, the cost of the loan (interest rate) is almost always less than it would be without that promise. How much will the financing costs rise when—not if—those promises can no longer be paid for? Are we getting close to the point when the government can't afford the promises? Consider that around 24% of FHA-backed loans in 2007 and 20% in 2008 are in default, and the FHA is broke, and "Fannie Mae", the largest buyer of residential mortgages, had a $19 billion loss in 3rd quarter 2009 and is in receivership (along with "Freddie Mac").

When the promises and "guarantees" end, financing costs will go way up, while fewer homes are built and bought and sold, and fewer families can refinance their loans, especially those with adjustable rate mortgages. Consumers already carry too much debt, and many count on the ability to refinance to improve their cash flow. When rates go up, don't be surprised to see another pullback in consumer spending. If you have been contemplating refinancing, you might consider getting the process started sooner rather than later, but expect it to be more difficult than ever. Why? Almost every mortgage nowadays has to be sold to one of the government or quasi-government agencies, and being shakier than ever, those agencies impose much higher lending standards and more stringent documentation than before. Still, those inconveniences are a small price compared to the much larger price we may pay when the mortgage market can no longer be propped up. Next month we deal with a much bigger loan problem, the commercial real estate market.

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