Taxpayer revolt needed vs. mortgage bubble

As the U.S. economy turned the corner into recession several weeks ago, the nation's secondary mortgage markets were erupting in a flurry of activity. The secondary mortgage markets are where residential mortgages are sold in bulk to investors by large mortgage lenders, and by the government and private mortgage companies which act as the conduit between mortgage lenders and investors.

DOMESTIC CREDIT

On Aug. 3 and 4 alone, three tombstones appeared in the pages of the financial press announcing the placement of close to $100 million in mortgage pass-through certificates with institutional investors by three different private conduits. According to Bill Ross of MGIC Mortgage Marketing Corp., one of the conduits, all three plan to keep on marketing these mortgage-backed securities as often and in as great amounts as possible.

As to why there has been a spurt of activity at this moment in this abstruse corner of thefinancial markets, Ross says that in view of the dropoff in capital investment and corporate bond issues, the time is right for the marketing of real estate related securities. "After a summer of sitting on their money, the institutions are eager to commit their funds to our market," says Ross. MGIC's $50 million issue was placed with a single major life insurance company which wishes to remain anonymous.

Ross personally put together MGIC's first issue of mortgage-backed securities in 1973. Only that time, the market shifted before MGIC had lined up investors, and MGIC got stuck holding the mortgages. One reason Ross may be so confident now is that Jay Janis, the incoming head of the Federal Home Loan Bank Board, is an old friend and former employee of MGIC through a subsidiary, MGIC-Janis.

Real estate takeoff

The current flurry of secondary mortgage market activity is symptomatic of a special sort of real estate bubble now in the works. While overall mortgage lending is running around 10 percent below last year and new housing starts are sinking towards the 1.5 million unit per annum level, real estate investment is selected urban areas of the country is taking off like never before. Typically, these urban areas were only recently rundown neighborhoods or hard-core slums, and the speculative profits have been ensured by the liberal granting of federal subsidies for "urban rehabilitation," special abatements on local taxes, and other such incentives to the real estate operator. The insiders in the operation—some of New York's most prestigious investment banks, a small circle of obscure mortgage companies, and foreign financial interests—are making a killing from the runup in real estate values in areas where they got in on the ground floor.

Conflicts of interest?

It is a wonder that the continuous flow of personnel between the federal and local housing and mortgage agencies, and the private mortgage investment companies, building materials companies, and insurance companies, has escaped investigation on conflict of interest charges.

One place to start an investigation would be with the Federal Home Loan Bank Board, which is charged with regulating the nation's savings and loan institutions.

At the instigation of former chairman Robert McKinney, who left the board earlier this summer, the FHLBB has done its part to abet the urban rehabilitation operation by encouraging S&Ls to make mortgage loans to the inner cities, as per the specifications of its Community Reinvestment Program.

"Arm-twisting" would be a more precise term. According to a spokesman for one of New York City's largest S&Ls, the FHLBB has been putting enormous pressure on the S&Ls to extend mortgages for inner city rehabilitation. "If you want any concession—if you want to expand into a new neighborhood, merge with another S&L, or do anything—you have to be a good boy," he complained. "They have the switch in their hand." In addition to making life very difficult for S&Ls which are not "community minded," the FHLBB offers reduced interest rates on its advances to well-behaved S&Ls for making inner city loans. Given the duress that S&Ls are under to attract deposits and survive in the present high interest rate atmosphere, this sort of pressure works.

The urban racket

Just recently, under Acting Chairman Anita Miller, the FHLBB adopted a series of regulation changes designed to pump even more liquidity into principally urban real estate. The board gave the federally chartered S&Ls expanded authority to invest in state and local government bonds used for rehabilitation, financing, or con-

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struction of residential real estate; it liberalized the amount that S&Ls can lend to areas receiving rent subsidies from the Department of Housing and Urban Development—inner city areas; it allowed S&Ls to make mortgage loans to co-op units on up to 95 percent of the value of the unit; and it removed the $15,000 ceiling on loans for home improvement and repair and extended the term to 20 years.

Undersecretary of HUD Jay Janis, who was recently appointed by President Carter to assume the FHLBB chairmanship, is widely expected to continue these "socially minded" policies. Janis, originally a South Florida developer and co-onwer of Janis Properties, was Director of the Office of Equal Opportunity in the mid-1960s. From 1966 to 1969 he was the executive assistant to the first Secretary of HUD, Robert Weaver. During a respite from HUD after 1969, Janis went back to his private company, which was now called MGIC-Janis, having been bought up by the MGIC Investment Corp. of current interest.

It should be emphasized that the type of urban "rehab" the FHLBB has been promoting has nothing to do with creating new housing for middle and low-income families or making the nations's cities more habitable. Take, for example, a pionbought up by the MGIC Investment Corp of current interest.

"Rehabilitation" for whom?

It should be emphasized that the type of urban "rehab" the FHLBB has been promoting has nothing to do with creating new housing for middle and low-income families or making the nation's inner cities more habitable. Take, for example, a pioneer site for urban rehabilitation like New York City's Columbus Avenue, whose "renaissance" began about two decades ago with the construction of Lincoln Center and some publicly sponsored housing.

Rehabilitation has consisted of the limited construction of new, high-priced, sleazily built "luxury" apartment buildings; a much greater amount of "renovation" of run-down buildings, hotels, and tenaments—"brownstones"; and the proliferation of antique shops, natural food stores, and expensives bars and restaurants where the swinging singles and gay crowd congregate. As real estate values and rents are bid up astronomically in "chic" areas of New York like Columbus Avenue, other recently middle-income neighborhoods and black and hispanic areas are becoming uninhabitable because of the cutbacks in municipal services.

The blue collar and ghetto populations are being driven from the city to be replaced by advertising executives, insurance brokers, and other members of what someone has dubbed the "new gentry." Their ranks are now being joined by suburbanites who are fleeing back to the city because of the "energy crisis" and the collapse of public transportation.

The present phase of rehabilitation in New York, run under the aegis of Greenwich Village's Edward Koch and his newly appointed Deputy Mayor Nathan Leventhal—a Kennedy machine man who was Mayor Lindsay's rent commissioner—features drug-oriented "discos," houses of prostitution, pederasty, and plans for legal gambling casinos.

The mortgage pass-through certificates recently placed by MGIC and other private conduits were backed by mortgages on single-family dwellings. But one investment banker in the thick of things predicts that the trend is toward urban, multi-family dwelling mortgages. The model that investment banks like Lazard Freres and the big institutional investors are looking to is the rehabilitation program on the edge of Boston's ghetto, financed by Connecticut General and the Rouse Corp.

Diversion of credit

Mortgage pass-through certificates issued by private companies are patterned after "Ginnie Mae" and "Freddie Mac" securities, both of which are issued by government-sponsored agencies and are backed by government-guaranteed mortgages. Ginnie Maes carry the full faith and credit of the government and Freddie Macs carry a lesser guarantee from the Federal Home Loan Mortgage Corp. The certificates issued by MGIC and other private mortgage companies are backed by conventional mortgages which are insured only by private underwriters, such as MGIC's mortgage insurance division.

Ginnie Maes, Freddie Macs, Maggie Maes, and the other creations of the secondary mortgage market are the product of landmark legislation of the 1960s, which was explicitly designed to channel investment into real estate in economic downswings like that now underway.

A more accurate description of what has happened is that Ginnie Mae and her friends have been sucking long-term capital out of productive investment into ground rent speculation, with the lure of quick and large profits. The composition of investors in mortgage-backed securities has shifted dramatically over the last decade toward the large institutional investor—traditionally the backbone of the long-term equity and corporate bond market.

In the early part of this year insurance companies, bank trust departments, and public and private insurance companies picked up 87 percent of the bigger-than-ever new isssues of Freddie Macs, while deposit-starved S&Ls and similar institutions picked up only 13 percent. In contrast, between 1971 and 1976, S&Ls, credit unions, and other institutions directly involved in home building had purchased 95 percent of Freddie Mac issues.

The large investment banks—which determine capital flows through their function as underwriters and investment counselors to the major industrial corporations—are aggressively getting into the secondary mort-

gage market and real estate generally. This trend was highlighted by the recent announcement by Lehman Brothers Kuhn Loeb of its agreement in principle to acquire Sonnenblick-Goldman Corp., one of the country's largest mortgage-brokerage companies, with $1.5 billion in financing and sales a year. Rumors that American Express Co. is seeking to take over MGIC triggered heavy trading in the company's stock recently.

Private mortgage insurance

The Milwaukee-based MGIC Investment Corp., the holding company for a variety of real estate operations, principally mortgage insurance, has more than $38.5 billion in mortgage insurance contracts in force. "Magic," as the company is known in the trade, is the creation of one Max H. Karl, who founded a predecessor in 1956 and kicked off a revival of the private mortgage insurance enterprises.

Private mortgage insurance was a booming business in the 1920s (usually the mortgage insurance company was merely a different office of the mortgage lender) cut short only by the Great Depression and collapse of real estate values. Private mortgage insurers began to reappear on the scene in the 1950s, after the Federal Housing Administration, born in the 1930s, had stabilized the real estate market and values through putting government guarantees and taxpayers' dollars behind them. Today, a mortgage lender will take out a contract with a private insurer when the size of the mortgage and a small down payment prohibit the FHA or Veterans Administration from insuring the loan. It is the overall government underwriting of mortgages, however, that makes the operation possible.

Now, private mortgage insurance is experiencing a "resurgence" because of the wild inflation of home-building and land costs, and the relative dwindling of personal income.

Given that writing insurance on conventional mortgages is MGIC's principal line of business, Maggie Mae—its mortgage marketing division—has the inside bear on volume and source of new mortgage loans and is nicely positioned to operate in the mortgage resale market. According to one analyst in the field, the spreads that Maggie Mae garners between the mortgage rate and the certificate rate on its multi-billion portfolio of mortgage-backed certificates is phenomenal.

Next installment: Foreign investment in U.S. real estate.

— *Lydia Schulman*

How Chrysler was driven

On Aug. 8, the $100 billion U.S. commercial paper market, on which corporations trade their IOU's to raise cash, fell into turmoil. Rumors were flying that the Carter administration would reject the request by the Chrysler Corporation, which has accumulated a $207 million second quarter loss, for $1 billion in cash in the form of a :celerated tax writeoffs over the next 18 months. Chrysl :r chairman John Riccardo proposes that that much :ash is needed to keep Chrysler afloat. Immediately, tne market began boycotting Chrysler

CORPORATE STRATEGY

commercial paper, whose interest rates rose by a phenomenal ½ to ¾ of a percent in one day. By late afternoon, the Chrysler mood had spread throughout the market, and the average piece of commercial paper had its interest rate rise by 30 to 40 basis points.

By Aug. 9, the markets calmed down. While the immediate danger of significant worsening of the market eased, the scare of the previous day was simply a warning shot fired by anti-industrial financiers to demonstrate that they possess the capability to artificially trigger, at moment's notice, Chrysler's financial crisis—the ailing corporation will now have to finance its $1.3 billion in borrowing requirements through short-term bank debt—into a raging U.S. panic and depression. The key aspect of this threat is to blackmail U.S. business leaders into support for London's antigrowth energy austerity policies.

Slated for eventual collapse, Chrysler currently exists as a transform Chrysler's financial crisis—the ailing corporation will now have to finance its $1.3 billion in borrowing requirements through short-term bank debt—into a raging financial panic and potential depression at moment's notice. The key purpose of this threat is to blackmail U.S. business leaders into support for London's antigrowth energy austerity policies.

Slated for eventual dismantling, Chrysler currently exists as a functioning industrial corporation solely through the good graces of General Motors, its giant competitor, and the Mellon and Morgan banks which dominate GM's board. According to one auto insider: "GM calls the shots for Chrysler. GM decides how much market share Chrysler will get. How does it do this? By regulating how it prices its own cars. In the early 1960s, after Chrysler had shrunk to 12 percent of the market in 1959, GM did not aggressively price its medium-sized cars and let Chrysler back into a 17