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Morgan leads 'revolution' for speculators

The 8 percent month to month drop in home building and 13 percent drop in monthly permits issued for future construction are minor dips compared to what is to come, housing industry economists commented when these numbers were released by the Commerce Department on Nov. 19. "The real scary numbers will be coming out several months from now," Michael Sumichrast, chief economist for the National Association of Home Builders (NAHB) hinted.

There are even more radical changes in the offing for the home-building industry; 1980 is not merely going to be another 1969 or 1974, years when housing starts collapsed by some 25 percent and 50 percent respectively over the course of the year. The traditional formula for housing finance and construction in the United States—household savings deposited in thrift institutions going to finance single-family home construction—is caput. Federal Reserve Chairman Paul A. Volcker's Oct. 6 "revolution" in monetary policy—by taking the ceiling off interest rate rises and putting the squeeze simultaneously on household savings and the thrifts—sealed its fate.

Symptomatic of the drift of developments is the present breakdown of traditional patterns of mortgage lending in the United States. In the Nov. 20 issue of the *Journal of Commerce*, former U.S. Secretary of Agriculture Earl Butz spelled out in graphic detail the initial impact of Volcker's taking the lid off the thrift institutions' cost of funds. Especially in the 22 states where state usury laws are in force, savings and loan institutions have had to carefully ration their dwindling supplies of high cost money. Among the cases cited by Butz: some S&Ls have been forced to raise down payments on homes to 40 percent—simply eliminating many prospective home buyers; twelve S&Ls in Wisconsin have completely stopped issuing new mortgage loans, and are lobbying in Madison to repeal the state's usury laws; and the First National Bank of Chicago, one of the giants of Midwest mortgage lending, has adopted the practice of giving loan appointments to its numerous applicants.

The situation is hardly any better in states where there are no usury ceilings and where the thrifts can attempt to pass on their cost of funds to mortgagees. A study on housing affordability prepared by the NAHB last month indicates that with 14 percent mortgage rates—a peak reached already in a number of states—only 8 percent of the nation's households can afford to buy a $65,000 home with a 10 percent down payment.

Whither the housing industry?

In the context of a nearly demolished home building industry, the November issue of "The Morgan Guaranty Survey" carried a truly extraordinary article, titled "The Revolution in Housing Finance," which recommends the crisis be solved by scrapping single family home construction in favor of "urban rehabilitation."

Specifically, Morgan proposes that government housing agencies such as the FHA and the VA—which have been the mainstay of the U.S. housing industry since the Great Depression—abandon the area of asingle-family home construction entirely, giving Washington an opportunity "to concentrate its limited energy and other resources on promoting improvement of the dilapidated housing and neighborhoods of the nation's poorest families." Despite the studied expression of social concern, Morgan Guaranty is proposing to hand over a multibillion dollar boondoggle in "government-guaranteed" urban real estate speculation to assorted

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foreign real estate interests, mortgage brokers, and "development companies." At the same time, it would cut off credit to new home construction—a revolution led by real estate speculators.

Typical of the real estate interests that Morgan is gunning for are obscure mortgage company fronts like the Milwaukee-based MGIC Investment Corp., known in the trade as "Magic." MGIC, which was created by one Max H. Karl in 1956, numbers among its board members Philip Morris Klutznick, the founder of the Chicago-based Urban Investment and Development Co. and the new Commerce Secretary-designate. The roster of MGIC's former employees includes Jay Janis, the chairman of the Federal Home Loan Bank Board, the regulator of the nation's savings and loan industry. Small world.

MGIC made the news last August when it marketed the first issue of privately placed "mortgage pass-through certificates," the latest in housing finance. They are long-term bonds backed by a package of mortgage pooled
try. Interest and amortization payments on the mortgages are "passed through" from the mortgagees to the investors. In the case of MGIC's first-ever $50 million issue, the entire lot was privately placed with an unnamed major life insurance company.

To date, MGIC and other private mortgage "conduits," as they are called, have been issuing packages of single-family home mortgages. In interviews conducted by the *Executive Intelligence Review* last summer (see Vol. VI., No. 32, Aug. 14-20), however, a number of principal market makers said that the trend will be toward urban, multi-family dwellings, the operative model being the "rehab" program on the edge of Boston's ghetto launched by Connecticut General and the Rouse Corporation. The fastest and biggest real estate profits are to be made on slum housing, especially when government urban renewal runds are to be had.

The home finance "revolution"

As "The Morgan Survey" article notes, housing finance has been heading in this direction for over a decade. In the mid-1960s, the savingsbank industry was already beginning to be hit with "disintermediation"—the flight of deposits out of savings banks in search of higher yielding direct money market investments. At that point, the traditional savings "intermediators" were joined by a raft of government and "government sponsored" credit agencies—the exotically named Federal National Mortgage Association (FNMA or "Fannie Mae"), the Government National Mortgage Association (GNMA or "Ginnie Mae"), the Federal Home Loan Mortgate Corp. (FHLMC or "Freddie Mac"). Fannie Mae sells its own securities and funnels the proceeds into mortgages originated by savings banks. Ginnie Mae and Freddie Mac securities are backed by pools of government-guaranteed mortgages. (The securities issued by MGIC and other private mortgage companies are modeled on these securities; however, they are backed by riskier conventional mortgages.)

Ginnie Maes have ballooned into a $60 billion a year operation. Borrowing by all the government-sponsored agencies, mortgage pools, commercial banks, and other non-savings bank entities increased their mortgage holdings by $67 billion, overshadwing the $42 billion increase at the savings banks.

Just like the family automobile, the single-family home is becoming an extinct animal as a result of the 'Volcker revolution'.

The argument that these government-sponsored mortgage companies provide the lifeline to the housing market and construction industry by injecting luqiditiy into savings banks and other mortgage lenders is a good public relations line. By placing the unlimited governmental borrowing power behind the home mortgage market, these entities have fueled real estate speculation to the point of pricing the average homeowner out of the market.

And since Oct. 6, the agencies and investment bankers who market them have begun a pull out from the mortgage market because of the widening spread between prevailing short-term interest rates and mortgage rates, which are held down by federal and state government ceilings. Securities backed by 11 percent mortgages are hardly attractive when short-term investments are yielding 12 to 13 percent. Last month in Washington, D.C., for example, Fannie Mae refused to pick up any more home mortgages after the City Council voted not to repeal long-standing usury laws. Just like the family automobile, the single-family home is becoming an extinct animal as a result of the "Volcker revolution."

—*Lydia Schulman*