Domestic Credit by John Hoefle

Brady threatens real estate market

Is the administration serious, or is this a power play to get more funds? Either way it's doomed.

The Resolution Trust Oversight Board, headed by Treasury Secretary Nicholas Brady, has, as part of its so-called "strategic plan," ordered the Resolution Trust Corp. to immediately try to sell all of the real estate acquired from the 283 savings and loans seized during the first nine months of 1989.

"It is important that the RTC proceed and continue to actively dispose of assets immediately," the Oversight Board said. "The RTC should avoid deferring the marketing of properties. Holding properties off the market for an extended period of time may increase the ultimate cost of asset disposition."

The Oversight Board claims that it will not "dump" the 30,000 properties it seized from the 283 failed thrift institutions seized during the first nine months of 1989, but such claims ring hollow. In order to sell that quantity of real estate in a reasonably short time span, the RTC would have to lower the prices significantly below even the current depressed market values.

Even at substantial discounts, it would be difficult to move the properties quickly. At market prices, it would be impossible.

The administration is caught in a bind, albeit one of its own making. The Reagan and Bush administrations have, as part of their perception management scenarios, consistently downplayed the seriousness of the financial crisis facing the nation.

The Financial Institutions Reform, Recovery & Enforcement Act (FIRREA) of 1989, the so-called thrift "bailout" bill, was doomed from the start because it was designed to fit the political line projected by the administration, and the needs of Wall Street, rather than the reality of the S&L crisis.

FIRREA appropriated only $50 billion to close insolvent thrifts for the first three years, a mere fraction of the funds actually needed.

William Seidman, the chairman of both the Federal Deposit Insurance Corp. and the Resolution Trust Corp., publicly stated recently that no more insolvent thrifts can be rescued until Congress gives the agency another $50-100 billion in operating funds. The RTC has sold only four of the nation's 600 insolvent thrifts in the last 10 weeks.

The problem facing Seidman is that the RTC must pay off depositors and absorb huge quantities of real estate and other assets when it seizes a thrift, meaning that it has a substantial cash outlay at the time of the seizure. The RTC, so the theory goes, will get much of this money back when it sells the acquired assets.

The problem is that the RTC has to pay out money up front, and try to get the money back down the road. As a result, the RTC quickly ran out of funds and simply does not have the funds to close all of the nation's already-bankrupt thrifts, much less the hundreds of newly-bankrupt thrifts.

The operating funds Seidman is calling for would be to cover the gap between payout and payback. However, voting further funds for the S&L bailout so soon after the passage of FIRREA is something that few in Congress wish to touch.

The Bush administration's proposed "solution" to this problem, selling off seized properties immediately in order to raise the funds to pay for the next round of thrift seizures, will backfire spectacularly if implemented. By dumping 30,000 properties on an already depressed market, the government will drive prices for *all* real estate even lower.

These lower prices will, in turn, reduce the value of real estate holdings by banks, S&Ls, insurance companies and other financial institutions, as well as other businesses and individuals—at a time when many of them are desperately trying to sell those holdings to bolster their own weakening financial positions.

In other words, it will send a deflationary shock wave throughout the entire economy, and complete the real estate blowout even more quickly.

What is likely is that the administration is running a bluff, intending to use the threat of dumping its real estate holdings to force Congress to vote up the operating funds demanded by Seidman. The mere floating of the idea of dumping was enough to set off howls in the banking and real estate sectors, who understand the disaster of such a policy.

Whether the administration is actually serious about dumping the real estate, or is merely engaging in some sort of political power play, the result will ultimately be the same.

Real estate values across the nation are collapsing in a deflationary spiral due to the continuing collapse of the physical economy. None of the administration's games and scenarios can prevent the looming real estate blowout—only an American System economic policy can, but that's not one of Mr. Bush's scenarios.