REAL ESTATE Connection
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A Lawyer's Perspective

Workouts

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From our view here in the trenches, it appears to us "Main Street" real estate people that the solution to the current financial crisis starts with stabilizing the real estate market, particularly for single family homes. The "$700 Billion Dollar Question" is why not workouts for "the folks," as Bill O'Reilly calls us, instead of bailouts for Wall Street? One foreclosure causes severe social disruption to a single household. Massive foreclosures cause severe economic disruption to the entire real estate market.

What would you do? Let's talk about the issues one at a time. First, why workouts have not been more prevalent and, then, why wholesale foreclosures will cause more economic problems.

Thomas Campbell, Mortgage VP of the First National Bank of Absecon, believes that mortgage securitization is the reason for the difference between mortgages created today and when my father was an Atlantic County Realtor in the 1960s, '70s and '80s. Back then, you could track down the holder of the mortgage to negotiate a workout, even if the loan had been sold to another lender.

To start off, mortgage products have become much more complicated than when my father sold real estate. Plus, back in the 1960s, '70s and '80s, you didn't get a loan without putting up some equity.

Most current day single family loans are part of a package of loans that are bundled together and which have exotic financing mechanisms. Tranches are one such mechanism and they are like pockets on a fisherman vest. In one pocket goes principal, into another goes the interest payment. In an ARM, the vest has more pockets because interest for the initial term may go into one pocket while interest for the first interest bump-up goes into another pocket and so on. The various tranches may be owned by different investors. Often, these mortgage securities transactions are highly tax-driven and have strict contractual obligations that make it difficult to renegotiate one loan without affecting the rest in the securitization.

Here's the effect of the above. A homeowner is behind on her payments, tries to negotiate a workout with a national lender/servicer but she can't get anyone at the mortgage company to agree to a deal. The loan is foreclosed, the homeowner leaves and moves into a rental. Three months later, the lender/servicer calls her and says, "How would you like to buy back your old home? We'll give you a 100 percent loan for the appraised value, much less than your old mortgage balance, with a great rate and terms." After several deep breaths, the woman expresses her true feelings to the caller.

In our example, the lender/servicer originated the loan, packaged it and sold it. Now, they service it and probably have no idea to whom the loan was ultimately sold or how the loan was packaged.

There is not only zero incentive for a workout, it is often necessary for a foreclosure to take place to restructure the multiplicity of rights, and parties, holding the original mortgage. It's like when you ask the car sales person if you can buy out the lease on your car and she says that it's easier to buy a new one. Same principle.

Now, let's talk about the effect of massive foreclosures. You have been nominated to be Treasury Secretary and will have $700 billion to buy non-performing mortgages. Current "asset disposition" wisdom says, "foreclose and turn those houses around for resale, pronto". Congress is pressuring you to do that and talking heads are saying that the taxpayers may even make a profit on the bailout.

As a South Jersey real estate-savvy person, you have seen too many "For Sale" signs when you drive around Little Egg Harbor Township, or Ocean City or Bridgeton. You know that there is far too much supply on the market already and that it is going to take a couple of years for the market to absorb the existing inventory.

In your confirmation hearings, you explain to Congress how the real estate market for single family homes works, just as I did to my daughter, when she was a baby, and I was studying for an economics exam. When the supply goes uppppp, the price goes downnnnn!

You explain that the market tanked because of oversupply when speculators and developers could not sell their products because lenders had capped out their loan to asset ratios, due to mark-to-market accounting, risky loans and damaged financial instruments. Given that economic principle, you say, no self-respecting, real estate-savvy person would suggest widespread foreclose on $700 Billion of non-performing loans in this over-saturated market.

If the federal bailout of Wall Street results in the continued widespread foreclosure of Main Street mortgages, you explain, the housing market will take even longer to recover. You emphasize that the Wall Street Bailout must emphasize workouts to minimize further increases of inventory. You predict that this will help stabilize prices and shorten the pipeline to economic recovery for everyone.

I hope that you are confirmed because we need people like you to tell Washington how to stabilize the real estate market on Main Street.

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