

# The Housing Bubble

Examining the home price boom and its effect on owners, lenders, regulators, realtors and the economy as a whole.

December 3, 2007

## [Another Sign Of The Collapse](#)

Some [housing bubble](#) news from Wall Street and Washington.

CNN Money, "In another sign of the collapse of the market for new homes, builder Lennar Corp. has dumped a portfolio of 11,000 properties for 40 percent of their previously-stated book value. Lennar, the nation's largest builder in terms of revenue, is selling the properties to a joint venture it has established with the real estate arm of Wall Street bank Morgan Stanley."

"It is selling the properties for \$525 million, even though it said their book value as of Sept. 30 stood at \$1.3 billion."

"The sale raised the possibility that Lennar's results in the just closed quarter could again be hit by a large charge for the reduced value of its holdings. Lennar took a \$847.5 million third-quarter hit for valuation adjustments and writeoffs of options."

The [Wall Street Journal](#). "'There is a lot of money out there right now trying to do deals like this,' says John Burns, who consulted with Morgan Stanley on the sale. 'The problem has been the gap between what the buyers are willing to pay and what the sellers are willing to accept. This sends a strong message that somebody is willing to part with land at a significant loss.'"

## About Me

Name: Ben Jones

Location: Northern Arizona,  
United States

To donate by mail, or to  
otherwise contact this blogger,  
please send emails to:

[thehousingbubble@gmail.com](mailto:thehousingbubble@gmail.com)

Ben Jones

PO Box 1764

Flagstaff, AZ 86002

Photo Submission:

[hbbphotos@gmail.com](mailto:hbbphotos@gmail.com)

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“Tax considerations are pressing builders to do deals that involve losses. The builders can only claim losses on land that has lost value once the assets are sold.”

“When the housing market sank, the builders got stuck holding the land. The land that Lennar sold includes 11,000 home sites in California, Colorado, Florida, Illinois, Maryland, Massachusetts, Nevada and New Jersey. At the end of its fiscal third quarter, Lennar owned 86,412 lots.”

“‘Land is a nonearning asset. The builders have to get it off their balance sheet’ says Jeffrey Gault, CEO of a land investment company that has raised \$350 million to buy land from builders across the country.”

From [Bloomberg](#). “Moody’s Investors Service is preparing the biggest credit rating cuts since subprime mortgages contaminated the bond market, foreshadowing losses for investments that pay Florida teachers and money market funds.”

“Moody’s may lower ratings on \$105 billion of debt sold by structured investment vehicles after the average net asset values of SIVs sponsored by firms including New York-based Citigroup Inc. declined to 55 percent from 71 percent a month ago, Moody’s said in a statement Nov. 30. The assets were valued at 102 percent in June.”

“‘In recent weeks, Moody’s has observed material declines in market value across most asset classes in SIV portfolios,’ the ratings company said in the statement.”

“Values on Citigroup’s six SIVs under scrutiny fell as low as 56 percent, Moody’s said. Orion Finance Corp. has a net asset value of 54 percent, down from 61 percent on Sept. 5.”

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“An [analysis](#) for The Wall Street Journal of more than \$2.5 trillion in subprime loans made since 2000 shows that as the number of subprime loans mushroomed, an increasing proportion of them went to people with credit scores high enough to often qualify for conventional loans with far better terms.”

“In 2005, the peak year of the subprime boom, the study says that borrowers with such credit scores got more than half – 55% – of all subprime mortgages that were ultimately packaged into securities for sale to investors, as most subprime loans are.”

“The surprisingly high number of subprime loans among more credit-worthy borrowers shows how far such mortgages have spread into the economy – including middle-class and wealthy communities where they once were scarce.”

“They also affirm that thousands of borrowers took out loans, perhaps foolishly, with little or no documentation, or no down payment, or without the income to qualify for a conventional loan of the size they wanted.”

The [Arizona Republic](#). “It’s hard to talk about the mortgage meltdown without mentioning Countrywide Financial Corp. The nation’s largest residential lender, with 22 retail offices in Arizona and a major operations center in Chandler, has become a poster child for the crisis.”

“But senior Countrywide officials in Arizona insist the company remains viable for the long term. ‘It sounds like an oxymoron to say we’re growing while laying people off,’ said Lisa Farrar, a Phoenix-based executive VP for Countrywide.”

“‘The recent layoffs were designed to right-size the company to what’s happening in real estate,’ Farrar said. ‘We’re



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geared to grow in a smaller market.'"

All [headline](#) News. "Analysts say that problems in the nation's fractured housing market is so far-reaching that a proposed Bush administration-backed plan will not help borrowers or bankers from escaping increasing foreclosures and defaults."

"Christopher Thornberg, a principal with Beacon Economics in Los Angeles said in an AP report, 'It's not the mortgage that's the problem,' adding that homebuyers paid too much for their homes in a soaring market and now they are facing the dire consequences."

From [Fortune](#). "The weekend papers were full of reports about the Treasury Department and Federal Reserve Bank meeting behind closed doors with mortgage lenders, servicers and investors to work out a plan for a voluntary freeze in interest rates for some subprime borrowers."

"As I read, though, a niggling thought took over my brain: If anyone is getting their rate frozen on their adjustable-rate mortgages, I want mine frozen too."

"The harm I suffer by this measure is philosophical. The impact on others is clearer. A group called the American Securitization Forum, which represents hedge funds who bought repackaged subprime loans, appears to be resisting the most the 'voluntary' freeze proposal because its members stand to lose a lot."

"A rate freeze would cut into their returns. Who'd be helped? Lenders and servicers who can keep collecting on the mortgages they sold."

National [Mortgage](#) News. "The big event in Washington is the

Office of Thrift Supervision summit on the mortgage mess...

officially, OTS is calling it National Housing Forum. There is plenty of talk in the media about Treasury unveiling a big plan where servicers will 'reset' subprime ARMs."

"One mortgage executive told us that the big problem is payment-option ARMs where the consumer has a rate of 3%. A rate that low cannot be artificially maintained by servicers. In other words, if Treasury thinks a servicer (or end investor) will roll over a 3% rate, the government is dreaming."

"One industry veteran — requesting his name not be used — raised another issue: 'OK, so you keep the rate the same for the subprime borrower. Then the prime borrower who has been current all along and who also has an ARM says, 'Hey me too. Keep my rate the same.'"

"This industry vet said Treasury has to either come up with a plan where all ARM rates are frozen or none are. 'Think about the lawsuits,' he said."

"Loan Abuse Story Of The Week: 'We had a client come in to us a month after closing with another broker because she thought she was ripped off. The client was recently divorced and had to refi her ex-husband off the deed and mortgage. She had not worked for several years being at home raising the kids.'"

"'We reviewed her closing docs and realized that this other broker put her in a stated-income subprime loan, created a job for her as an attorney working for the closing attorney's firm, and the attorney verified her employment. They charged her one point on the front and two on the back (YSP) on a \$600,000 loan.' — R.S., Mass."

The [Seattle Times](#). "Frances Taylor was 93 when she took out

a high-cost, high-interest mortgage against her home of more than four decades. Within months, her lender foreclosed. More than one in three borrowers in King County who got loans from the same lender that foreclosed on Taylor were 50 or older, and one in seven was 60 or older, according to a Seattle Times analysis of more than 4,000 loans by Ameriquest Mortgage."

"Not only that, nearly all of those borrowers already owned their houses."

"Taylor refinanced her home three times in just three years. Those loans stripped away more than \$50,000 of her home equity in fees alone and eventually obligated her to mortgage payments that were nearly three times her monthly Social Security check of \$761."

"Her loans, like many subprime mortgages, came with hefty fees, prepayment penalties, and interest rates that adjusted upward."

The [Sydney Morning Herald](#). "The prospect of home owners being hit with another interest rate rise increased yesterday after the newly merged Bendigo and Adelaide Bank became the first lender to push up borrowing costs by an extra 0.25 percentage points."

"The cost of these loans has soared in recent weeks after the financial damage caused by the subprime loans meltdown in the US. In particular, the Commonwealth and NAB have both warned they will soon pass on these higher costs to customers."

"Analysts at Goldman Sachs said yesterday that market rates on 90-day and 180-day bills were now up to a half of 1 per

cent higher than the RBA's official cash rate of 6.75 per cent.

'It's purely because the global cost of funds has increased and we've been absorbing it since August and we've just had to pass some of it on,' said a bank spokesman."

"The [cost of borrowing](#) pounds for a month surged by the most in more than 13 years. The London interbank offered rate that banks charge each other for such loans due after the end of the year rose 63 basis points to 6.72 percent, the highest since December 1998, the British Bankers' Association said today."

The [Associated Press](#). "Mortgage financier Freddie Mac said Monday it will not sell a reference mortgage bond in December. The company did not provide a reason for the move."

"The market for mortgage-backed securities has withered in recent months amid a worsening housing slump and a spike in defaults on subprime mortgages. Some \$360 billion in subprime mortgages are slated to reset next year, leaving investors leery of buying any mortgage-related securities."

From [Reuters](#). "Fannie Mae, the largest U.S. home funding company, on Monday said it plans to sell \$3.0 billion of three-month benchmark bills due March 5, 2008, \$1.5 billion of six-month bills due June 4, 2008 and \$1.0 billion of one-year bills due Nov. 28, 2008 on Wednesday in a Dutch auction."

"In such uniform price auctions, successful bidders pay only the price of the lowest accepted bid rather than the actual price as in a conventional multiple-price auction."

Minnesota [Public Radio](#). "Ray Kvalvog thinks it's a no brainer. Farmland is the best investment going. 'We're kind of in the heyday of farming right now. It's about as good as it's

probably ever been and is going to get for awhile,' says the Fargo farmer and real estate investor.' "

"Kvalvog is among more than 30 people crowded into a large room at Pifer Auction Service in Moorhead. Ray Kvalvog is the top bidder at \$2,500 an acre. He says he wouldn't have been surprised to see the land reach \$3,000 an acre. Last week he paid \$5,000 an acre for land near Austin, Minnesota."

"Kvalvog says he owns about 10,000 acres across Minnesota and Eastern North Dakota. And despite the rising prices, he's still buying. Kvalvog says he expects only about a five percent annual return on his land investment. But he says the land value is rising by up to 20 percent a year and he expects that trend to continue."

"Farmland values increased 14 percent nationwide in the past year. Experts say high quality farmland has increased in value much more rapidly."

"Farmland prices exploded in the 1970s driven in part by speculative investors. Those high land prices played a role in the farm crisis of the 1980s."

"Knowing that history makes the rising land prices a little unnerving for North Dakota State University Agricultural Economist Skip Taylor. 'It never ends well,' says Taylor of rapid rises in farm land prices. He says rising land prices in the 70s were often driven by emotion, not logic and he worries this may be the same scenario."

"University of Minnesota Economist Steve Taff agrees there are many reasons for caution. But Taff is not convinced the land market is overheated."

" 'Some days I can convince myself there's no sign of the

bubble bursting, unlike in the housing market,' says Taff.

'Because I don't think the land market shares some of the risk prone behavior of the housing market in the past several years.' "

"Taff says land prices can be driven as much by psychology as by economics. 'They're fortune tellers, they have to be. They have to think about how this is going to be not just this year or next year, but in 2010 and maybe 2015,' says Taff. 'It's not a science, it's an art that everybody has to be engaged in.' "

Posted By: Ben Jones @ 9:48 am

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' Also [needed](#) — to prevent a recurrence of today's problems — are tighter restrictions on mortgage lending, said Robert Toll, chief executive of luxury homebuilder Toll Brothers Inc. '

'Toll said home prices 'may not have stopped falling yet,' adding that it may not 'be the best time to buy a home.'

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