

A MONTHLY COLUMN FOCUSING ON
MORTGAGE DEFAULT AND THE REAL ESTATE CONSUMER

A Shift from Thrift

In 1957, U.S. Senator Strom Thurmond was worried about dehydration. Having spent several days purging himself of fluids both through reduced intake and a series of sauna sessions, the segregationist South Carolinian took his place on the Senate floor with a stack of papers and a bowl of lemons for sustenance. And when he was recognized by the presiding officer, Thurmond stood up and began the longest filibuster in Senate history. More important, however, was what Thurmond was attempting to derail: civil rights legislation. He had already run against Harry Truman for president on the segregationist Dixiecrat ticket—and now this. Yet 40 years later, Thurmond would be known mostly for being flirtatious and, well, really old (he would retire from the Senate in 2002 at 100 years of age). When it came to race relations, he was a mentor to black media personalities, an employer of black Senate staffers, an appointer of black judges, and a supporter of both the Voting Rights Act and the Martin Luther King federal holiday. So what happened? In his eulogy at Thurmond’s funeral, Delaware Senator Joe Biden (a self-pro-

claimed Northeast liberal who ran for the Senate because of civil rights) noted that, “like all of us, Strom was a man of his time.” Thurmond’s shift on civil rights reflected a cultural shift in the South away from segregation and toward equality.

Brunt of Blame Aimed at Bevy of Sources

Another cultural shift has been occurring in the United

States for several decades, though not with positive outcomes. The results of this shift can be seen clearly in the increasing spread of blame relating to our nation’s housing finance crisis. As they have from the beginning, lenders continue to be the main focus. Indeed, no less than the Sage of Omaha himself—Warren Buffett—has

chosen to point blame at lenders. In his most recent letter to shareholders of Berkshire Hathaway, Buffett writes: “You may recall a 2003 Silicon Valley bumper sticker that implored, ‘Please, God, Just One More Bubble.’ Unfortunately, this wish was promptly granted, as just about all Americans came to believe that house prices would forever rise. That conviction made a borrower’s income and

when the tide goes out—and what we are witnessing at some of our largest financial institutions is an ugly sight.”

At the same time, home buyers are starting to file lawsuits against their real estate agents, saying they obviously paid too much for their house and the agent is to blame. Several auction companies are being taken to court by prospective buyers who claim those companies used misleading marketing tactics to draw potential bidders.

Far from Frugality

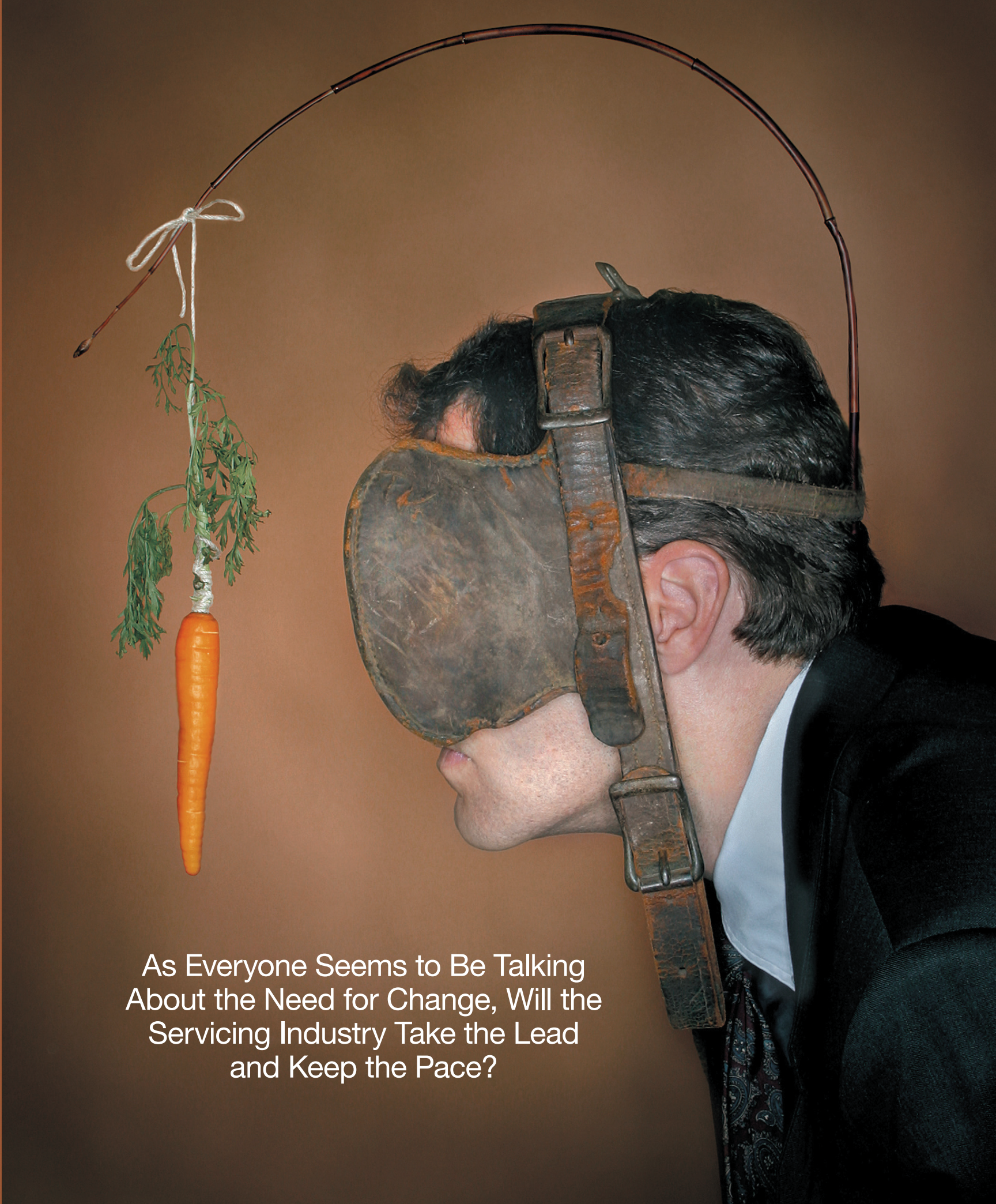
Many of the stories in *DS News* talk about the need to use different thinking and better tools and how to better manage everything from vendors to borrowers. We talk about a flawed system that only caters to speculation for real estate transactions. What lies beneath all of this for those on the other side of the American dream? A cultural shift away from thrift.

A report was recently issued by the Commission on Thrift, explaining the ways in which America has shifted culturally from a nation with built-in mechanisms that encouraged thrift and has now evolved into one with those mechanisms

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WARREN BUFFETT

cash equity seem unimportant to lenders, who shoveled out money, confident that house price appreciation (HPA) would cure all problems. Today, the nation is experiencing a widespread pain because of that erroneous belief. As house prices fall, a huge amount of financial folly is being exposed. You only learn who has been swimming naked



As Everyone Seems to Be Talking
About the Need for Change, Will the
Servicing Industry Take the Lead
and Keep the Pace?

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available largely to the upper half of income producers. For most of the 20th century, Americans who wanted to buy a home had to save, apply for a loan with their local bank, prove their documented credit-worthiness, endure the local bank's review of their loan application, and then—if everything went well—pay a 20 percent down payment. This process seems almost quaint just a few years since the height of the go-go mortgage boom. At the same time, state lotteries didn't even exist, predatory interest rates were illegal, and casino gambling was permitted in a few choice locations.

But then a funny thing happened: The banking industry was deregulated and went through about two decades of consolidation, resulting in the absorption of many of those local institutions into large national and international conglomerates. To be sure, this had tremendous benefits for American commerce. There is a reason loan rates here are dramatically lower than in many other countries—the nation's financial institutions are both efficient and professional. But there were some negative side effects, one of which was the diminished importance of the everyday individual borrower. Large banks discovered the profits to be found in wealth management, private banking, and other services that cater to Americans in the upper half of income distribution.

And as the saying goes, markets abhor a vacuum. Rapidly expanding to serve those left out of the upper half are a bevy of quick-acting anti-thrift institutions that only promulgate underperformance in wealth accumulation. The Commission on Thrift's report identifies these as “a number of highly profitable businesses: subprime credit card issuers, payday lenders, rent-to-own merchants, auto tile lenders, private student loan companies, some franchise tax preparers, check cashing outlets, and subprime mortgage brokers and lenders.” The report attributes a higher rate of nonsaving and debt to the expanding influence of this anti-thrift sector. These institutions serve their clients with the same kind of convenience and individualized service that

those of modest means used to enjoy at their banks. But unlike those neighborhood banks, this new generation of financial institutions does not offer opportunities for interest accumulation or investment but instead focuses on quick, easy cash loaned at triple-digit interest rates.

Investor vs. Lottery

The expansion of anti-thrift services has led to the emergence of two financial classes in America. The Commission on Thrift labels them the “investor class” and the “lottery class.” The investor class enjoys pro-thrift disciplines seamlessly built into their working environment, which in turn encourages wealth accumulation. If you have a 401(k), this would be you. Those in the lottery class do not have those built-in disciplines and as a result see their money siphoned into wealth-prohibitive investment strategies like high-interest loans or lottery tickets. If you are one of the 70 million American wage earners (out of 153 million total) who work for an employer that doesn't offer a retirement plan, this would be you.

So what does all of this have to do with servicing (or, for that matter, Strom Thurmond)? Most obviously, it demonstrates a shift in circumstances that may lead many into foreclosure. Rather than the greedy lender or the boot-licking appraiser or the self-interested real estate agent or the foolish borrower to blame, a broad, economy-wide shift toward anti-thrift forces that fertilize the conditions necessary for foreclosure to occur is materializing. Keeping this in mind is important for industry members as they interact with and serve those who have received the short end of the stick during a cultural shift.

Gambling with Housing

On a more macro level, this relates to the servicing industry's responsibility in how it adapts in light of this shift. One of the foremost examples of anti-thrift as outlined by the Commission on Thrift is the state lottery. As the report points out, “For seven decades, from 1894 until 1964, not a single

legal government-sponsored lottery existed in the United States. Today, 42 states plus the District of Columbia run lotteries.” This ease of access undoubtedly contributes to the culture of anti-thrift and the promulgation of the lottery class. But state lotteries are a drop in the bucket compared with the largest gambling institution of them all: U.S. real estate.

As this summer's travails for Fannie Mae and Freddie Mac demonstrated, the country is still a long way from certainty when it comes to housing. Indeed, the federal government's intervention is a tacit acknowledgment of the uncertainty backing the largest economic sector. In an age when technology never ceases to marvel, Americans still do not know what U.S. real estate is worth. They continue to buy and sell through a speculative process that ultimately benefits no one (as is evidenced in the infinitely looping housing bubble blame game).

And this is where everyone can learn something from old Strom Thurmond, who was at one time arguably the leading proponent of a failed and disastrous ideology. But, unlike many of his peers and to his credit, he evolved. And his evolution benefited those who had previously been victimized by the flawed mindset he had promoted. Those of us who have reaped the rewards of the American housing industrial complex now have a chance to not only respond to the nation's shift away from thrift, but also to lead. We can work to encourage thrift through time-tested approaches like preforeclosure sales and by continually improving our methods of service. We can evolve away from a speculative real estate gambling phenomenon in which buyers and sellers blindly shoot for current market value and max out on loans in the hope that real estate prices will continue to rise. We can evolve away from that and toward a multi-tiered real estate disposition process that delivers market value for those who don't wish to speculate. We can do all this and more. We must. To continue the status quo will leave our economy in shambles and our country a nation of debtors. Someone needs to lead. Why not us? 