

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

Disposing of the Disposition Process

35 Ways a One-Dimensional Real Estate System Leads to Multifarious Waste

THE ONE STORYLINE THAT SEEMS TO REMAIN UNTAPPED by the mass media during the current real estate meltdown in the United States is the inefficiency and illiquidity of the existing real estate disposition process. Indeed, if you look at every major financial market in our country, they all have evolved over the last 50 years toward greater transparency, greater efficiency, and less waste—except for one: real estate. While “transparency” and “illiquidity” can sound like high-flown philosophical terms, their absence has real consequences for all of us. Here are a few examples of the way our current one-dimensional, speculative disposition process leads to waste:

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1 *Declining home prices.* You can only overpay for a home for so long, and then it is going to catch up with you. At some point, markets correct themselves. And when they do, you have price declines. Americans have been driving up home prices for decades by using a system that is solely focused on driving up the listing price, rather than determining true market value. The consequence of that system is being felt not just here in America but internationally, as well.

2 *Ruined borrower credit.* If you lose your job, if the family breadwinner is injured or dies, or if a major life event strikes and you find yourself unable to pay your mortgage in a declining

market—too bad. You had better hope you’ve got a servicer who will help you with a loan modification. Millions of Americans are unknowingly staking their financial future (their credit) on an illiquid asset that cannot be easily sold by speculative means when the market is in decline.

3 *Billions of investor dollars held up in illiquid assets.* This is a truly staggering consideration. Forget all the average, run-of-the-mill homes sitting on the market right now—let’s just focus on foreclosed homes. According to RealtyTrac, in June, there were 141,866 new foreclosure filings. There were also 54,034 foreclosure sales with an average sale price of \$171,152. Just for the sake

of getting an idea of the scope we’re talking about, let’s assume (and this is a huge assumption) that the true market value of those new foreclosure filings matched the average sales price for the ones that sold. That would come out to more than \$24 billion in assets. That’s \$24 billion that isn’t being reinvested and isn’t being used to generate new jobs or expand America’s economy. That is \$24 billion just sitting on lawns all across the country, untapped and inaccessible because we insist on using the same old system of speculation for real estate disposition. And this is just for new foreclosure filings in June.

4 *The time value of those dollars for every month they remain tied*

down. Not only is that \$24 billion not being reinvested in June, but much of it won’t be reinvested in July or August either. Every month that goes by because of illiquidity, billions are wasted.

5 *Vacant homes decaying.* Most often made from wood and surrounded by earth (grass, dirt, trees, etc.), homes are organic structures and need maintenance. As the old saying goes, the best fertilizer for a property is its owner’s footsteps. Left vacant and without a steward to care for them regularly, homes deteriorate, and as they do so, they lose value. Again, the illiquidity of the marketplace leads to lost value and a diminished return on investment—it leads to waste.

6 *Time spent blaming real estate agents for the American real estate decline.*

7 *Time spent blaming mortgage lenders for the American real estate decline.*

8 *Time spent blaming appraisers for the American real estate decline.*

9 *Time spent blaming speculators for the American real estate decline.*

10 *Time spent blaming Wall Street for the American real estate decline.*

11 *Time spent blaming, well, you get the picture.* Is there anyone who hasn't been blamed for the housing meltdown in the United States? How about your kid's little league softball team? If softball didn't teach kids how to work together as a team, then maybe they wouldn't grow up to be such effective employees. And if they weren't such effective employees, then maybe they wouldn't make enough income to take out a mortgage. And if they didn't take out a mortgage, then maybe they wouldn't participate in the speculative real estate process by purchasing a home with an exaggerated price, which will eventually result in the home's value being corrected by market forces. This is, of course, a ridiculous line of reasoning. Yet untold man-hours have been wasted over the last year explaining why the housing meltdown is someone else's fault. The fault does not lie with one party, but with the promulgation of a system that was doomed to this result. Should we continue to utilize it, we might as well start betting on the futures market for the next meltdown. And while

we're at it, why not bet on who else will take the blame then?

12 *Cost of the sale, regardless of the time spent on the market.* Whether you have a property on the market for five hours or five years, you still pay the same commission to your agent. This commission has nothing to do with the reality of expense incurred to properly market the property, only with what is "fair" for the agent. If it is a quick sale, the seller has wasted money. If it takes years, the agent (or, at that point, most likely "agents") has wasted money. Unless the sale just happens to be perfectly timed, someone is the victim of waste.

13 *Time for buyers expecting the list price to decline.* A staple of the speculative selling process is the wait for a list price decline. Instead of determining the true market value and moving on, buyers sit and wait.

14 *Time for buyers and sellers during negotiations that can drag on for days, weeks, even months.* Rather than an instant negotiation (like you see on the floor of the New York Stock Exchange), real estate transactions are still centered around centuries-old bartering ritual.

15 *Opportunity to find a new home.* While the back-and-forth bartering plays out, other opportunities for stewardship are missed by potential buyer and seller alike. Homes go on the market and they go off, other offers are made, and other negotiations begin—all while the bartering continues.

16 *Opportunities available to a buyer to find a new home when a deal falls through.* And what if that negotiation fails? All the time and effort put into it and all the opportunities missed result in yet more waste.

17 *Taxpayer dollars to prop up the GSEs that are reliant on a speculative selling process.* The GSEs are hurting for the same reason many other investors are hurting: That money described above that is tied up in non-earning assets all over the country does not, as it were, come from a bottomless pit. Now, the federal government has had to step in to provide reassurance that none of the GSEs—the bedrock foundation (right or wrong) for the mortgage industry in America—runs out of funds. This is an important point, because while it is one thing to think of nondescript investors having their money wasted every month, it is quite another to think of every taxpaying American in the same position. Yet, due to Congressional policies, that may well end up being the case. Again, we need to ask ourselves: Why is this necessary? It is necessary because we rely on a one-dimensional selling system. And so long as we do, every American—regardless of whether they own a home or not—is a victim of waste.

18 *Time for sellers waiting on an offer.*

19 *Money for sellers waiting on an offer.*

20 *Other opportunities for stewardship while waiting on an offer.* You can draw down from the

macro issue of investors sitting on billion-dollar pools of assets to individual homeowners. Because of the one-dimensional selling system we employ in America, sellers list their homes and then wait. They wait for someone out there to bite, to make an offer. Doing so not only wastes time, but it also can either waste new opportunities for stewardship as possible new homes come and go from the market, or it can waste tremendous amounts of money while a borrower holds down two mortgages in the hope that someone will soon take the older one off his or her hands. Either way, unnecessary waste abounds.

21 *Other life goals left behind because of an emphasis on driving up list prices.* The conventional wisdom thrown around during the housing boom was that the limit on what you can afford is related to how much of a monthly payment you can manage. This is exactly what lured people with too-good-to-be-true option ARMs: low monthly payments (at least to begin). Rather than determining what a home was truly worth, the emphasis was (and has been) placed on how much borrowers could handle on a monthly basis. As financing became more efficient and diversified, rates decreased and home prices were driven ever upward. But what about other important aspects of life? Is a mortgage payment more important than personal development or education? These and other goals have been overlooked in the name of an "ownership society"—and with them, great waste of human potential.

22 *Money paid in rent because potential homeowners view ownership as too risky.* Because real estate is illiquid, homeownership is appropriately viewed as risky. And for more and more Americans, the easiest way to opt out is to rent. The trade-off for that decrease in risk, of course, is that renters never see a dime of equity in their home. That money is wasted.

23 *Time spent by buyers negotiating with someone who is only speculating.*

24 *Time wasted by agents marketing properties for someone who is only speculating.* We can never know how many properties out there are listed speculatively by owners in no rush to sell—people just testing the market and hoping for an offer. What we do know is that the process that exists for real estate disposition is solely focused on this clientele. If time matters for you when selling, you are encouraged to use the same system as those for whom time has no relevance. Not only does this result in time wasted by potential buyers in making honest offers to inflexible speculators, but it also wastes the time of the agents marketing them.

25 *Home equity diminished due to foreclosures in a neighborhood.* While foreclosure has a dramatic impact on the property being foreclosed—and on both the borrower and lender involved—it also has a ripple effect in the surrounding neighborhoods. Foreclosures damage neighborhood property values, leaving a wake of waste behind them. But what does this have to do with illiquidity?

26 *Investor equity diminished by foreclosures due to illiquidity.*

27 *Borrower equity eliminated by foreclosures due to illiquidity.* As anyone in this business knows, foreclosures are a lose-lose proposition. Investors see their investments diminished if not negated. Borrowers see their equity flushed away. And yet, foreclosures have become an accepted part of real estate. They need not be. If borrowers and servicers could move beyond speculative real estate disposition and toward a multipronged approach that allows for current market value to be determined more efficiently, we could reduce the number of foreclosures—possibly even eliminate them. The short sale is the most obvious area where this could take place. Until then, equity will continue to be wasted on both sides of the transaction.

28 *Municipal revenue spent managing vacant blight.*

29 *Municipal revenue reduced by declining home prices due to foreclosures nearby.*

30 *Municipal revenue reduced due to the foreclosures themselves.* Communities across America are dealing with illiquidity in real estate more every year. Not only do they become responsible for the public safety issues that arise around vacant property (crime, code violations, hazardous conditions, etc.), but they must do so with dwindling resources as property taxes decline due to decreasing property values. All of this is the result of foreclosures and their ripple effect on nearby property values.

Some cities have gone so far as to clear entire neighborhoods and designate them as green space rather than waste time and money in the hope of redevelopment. Instead of spending resources on police and fire, on streets and utilities, cities are forced to pick up the mess left behind by a real estate system that doesn't put people in homes in an efficient manner. They are forced to waste their money.

31 *Servicer man-hours spent managing REOs for months, even years.*

32 *Lender man-hours spent managing servicers managing REOs for months, even years.* Anyone reading this almost certainly knows the amount of time and effort that has to go into managing real estate assets that continue to sit on the market as a result of our speculative real estate disposition system. All that managing, and only because the assets aren't being transferred to new stewards via an efficient real estate system. This is a waste of time and energy for servicers and lenders alike.

33 *Future financial opportunity for borrower lost due to foreclosure.* As your credit goes, so go your options for the future.

34 *Future financial opportunity for investor lost due to negative return on investment.* With a diminished return comes diminished options for future investment. For investors and borrowers, future opportunity is wasted because they banked on a flawed process.

35 *Money wasted on attorneys' fees as buyers start to sue their agents, believing they paid too much for a home.* Now, as

buyer's remorse sets in around a flawed system, homeowners are beginning to turn on their most energetic spokespeople—their agents. These are lawsuits that didn't have to happen and could have been avoided if we used a better system for real estate disposition in America. These lawsuits are, like so many other things related to this system, a waste.

Debate abounds over the financial losses occurring as a result of this real estate system. But when looking over the 35-item list, what is striking is something that is not as easily quantifiable and will not be as easily reported: the massive loss of time. This can be translated into man-hours, and a dollar amount could probably be approximated by some economist, somewhere. The truth, however, is that time cannot be truly valued. Time lost cannot be recovered for all the money in the world.

What this should evidence is the need for options. As has been argued in this space before, those on the other side of the American Dream deserve better options. They deserve a real estate disposition process that allows them to speculate if—and only if—they want to. But when they don't want to speculate, when time matters and sellers only want the current market value of their home, then they should have that option readily available. Moving to this type of system will benefit borrowers, lenders, investors, agents, communities, governments, and more. There is just so much waste in the current system. For the benefit of all involved, it should and must be changed. **DS**