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Lehman waited too long for rescue

By MICHAEL LIEDTKE

SAN FRANCISCO — If the mortgage meltdown is like a financial hurricane, then think of Lehman Brothers as a casualty that waited too long to cry for help.

By the time that Lehman Brothers Holdings Inc. sent out its distress signal, the U.S. government had become reluctant to lend a helping hand as it did other recent bailouts that could cost taxpayers tens of billions of dollars.

And without some government protection, other banks still trying to cope with their own risky real estate investments weren't inclined to come to Lehman's rescue.

Finally, investors and lenders have become leery of throwing more money into the seemingly bottomless pit of losses piling up as the home values securing mortgages across the United States continue to crumble.

"The first losses in a crisis are usually easier to take," said Daniel Alpert, managing director of Westwood Capital LLC. "It's the last losses that become debilitating because the well starts to run dry. There just isn't a lot of cushion left."

Alpert and other analysts contacted Sunday said it's difficult to determine the enormity of the unrecognized losses still lurking on Lehman's books, but that issue had almost become moot because Wall Street already had written the 158-year-old investment bank's obituary. U.S. Treasury Secretary Henry Paulson hammered the final nail in Lehman's coffin by steadfastly refusing to include any government guarantees in a sale of the bank.

"It became a crisis in confidence," said Steven Goldman, chief market strategist for Weeden & Co.

That lack of faith means Lehman's best customers and employees would probably have abandoned the company, destroying even the best pieces of its franchise, such as its investment banking operations and its Neuberger Berman wealth management unit.

"The fire wall has been breached," said Joseph Battipaglia, market strategist for Stifel, Nicolaus & Co.'s private client group. "Lehman is shrinking before our eyes."

Analysts said Lehman Brothers hard-charging chief executive of the past 15 years, Richard Fuld, should have sold Neuberger Berman and its real estate portfolio earlier this year, when market sentiment wasn't as bad as it is now.

Fuld "overplayed his hand" by demanding too high of a price for those assets, said Bert Ely, a banking consultant

Lehman's apparent demise adds to the alarming fallout from the real estate boom during the first half of this decade and the subsequent bust of the last two years.

Emboldened by the lowest mortgage rates since the 1950s, lenders made millions of home loans to people who either had bad credit ratings or lacked adequate income to qualify for the money under traditional underwriting standards.

The risky loans didn't blow up immediately because the exotic mortgages began with artificially low teaser rates before adjusting upward. Because the easy money encouraged more people to own property, home values soared for several years _ a phenomenon that helped borrowers refinance their mortgages when the payments became more expensive.

But things began to unravel in 2006 as more borrowers began to default. Home values then began to crater, making it more difficult to refinance and triggering a wave of foreclosures that have hammered property values even more.

Most of the toxic mortgages were packaged into securities that are now owned by a wide range of investors and large banks, including Lehman. Besides holding mortgage-backed securities, Lehman also got caught up in the real estate mania by financing some developments, such as a country-club community in Bakersfield, Calif. that is now in limbo.

To make matters worse, Lehman also is major owner of commercial real estate, a market that's also deteriorating.

As the mortgage mess widened last year, some major banks began to clean house. Both Merrill Lynch & Co. and Citigroup Inc. dumped their chief executives last year, recognized large losses and raised billions in additional capital to weather the oncoming storm.

Lehman seemed to be far better off than many of its peers for awhile, but that turned out to be a mirage.

After posting a $4.2 billion profit in its fiscal 2007 and opening the first quarter of this year with earnings of $489 million, Lehman has reported nearly $7 billion in losses in just the past six months.

And investors have no clue how much worse things might get, despite Fuld's recent reassurances. The uncertainty devastated Lehman's stock, which had plunged 95 percent from its 52-week high to $3.65 Friday. The free-fall wiped out nearly $35 billion in shareholder wealth in just 10 months.

As part of an overhaul announced last week, Fuld said he had taken steps to winnow Lehman's exposure to the residential real estate market to $13.2 billion and reduce its commercial real estate portfolio to $32.6 billion.

But it's impossible for anyone outside the company to make an educated guess about which loans are solid which are ticking time bombs. By some estimates, Lehman had more than two times its net worth tied up in exotic mortgages and other esoteric securities that are difficult to value.

"It's a little like Hurricane Ike," Battipaglia said. "You know it's going to hit eventually, but you just don't know where and how hard."

Alpert has little doubt there is a lot more pain to come throughout the financial services industry before the mortgage purge is finished. He estimates banks and lenders have recognized about $550 billion of the $1.25 trillion in losses that he expects to be attributed to the mortgage meltdown.

Lehman's fate might have been slightly different had it faced up to its troubles earlier. Rival Bear Stearns wound up getting sold to JP Morgan Chase & Co. in March largely because the U.S. government agreed to provide a $29 billion loan to complete the deal. And earlier this month the government took over mortgage bellwethers Fannie Mae and Freddie Mac.

"In this cycle, timing is everything," said Sung Won Sohn, an economics professor at California State University, Channel Islands.

Paulson insisted the efforts to salvage Lehman didn't merit government aid because the financial markets have been aware of Lehman's problems for a much longer period than the circumstances that led to Bear Stearns' downfall. What's more, investment banks can now obtain emergency loans directly from the Fed, a crutch that wasn't available when Bear Stearns was rescued.

Alpert understands why Lehman didn't attack its problems more forcefully.

"It's human nature not to want to write things down right away, especially if you believe the crisis is temporary," he said. "Fuld probably thought he could keep a steady hand on the tiller and sail though this rough patch without giving up the entire firm. Now even if (Lehman) isn't truly insolvent, the rest of the world thinks it is."