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The Freedom Recovery Plan

By JOE NOCERA

O.K. — so maybe the title is a little hokey. Maybe Daniel Alpert of Westwood Capital should have named his proposal the "How to Keep Underwater Homeowners in Their Homes and Save the Economy Without a Massive Government Infusion." Since that's what he is trying to do.

My column this Saturday is an attempt to grapple with the core problem: the fact that housing prices are continuing to decline. Until that decline is halted, bad things are going to continue to dominate this country's — indeed, the world's — economic life. As I also mention in the column, there are plenty of proposals floating around to shore up falling home prices and keep people from being foreclosed on. I must get a half a dozen a week. But Mr. Alpert, who has been a guest blogger here at Executive Suite, has a plan that I believe makes a ton of sense. It's core idea has underwater homeowners turning over the deeds of their homes to their lenders, in return for which they get to stay in the homes for five years, and pay prevailing market rents. Here is an eight-page paper he wrote, in which he detailed the Freedom Recovery Plan, and the thinking behind it. And below, I'm reprinting a shorter set of notes that Mr. Alpert sent to me a few days ago, outlining the core problem. As I say in the column, I encourage you to read both of these documents. Please let me know what you think of Mr. Alpert's plan. And if you have a better idea, I would love to hear that as well. Once the votes and ideas are all in, I'll report the results in another post.

Comments on The Freedom Recovery Plan
By Daniel Alpert

1) If you believe that the housing crisis is cyclical in nature or the result of oversupply, none of what we are talking about will make any sense.
a. Housing prices were bid up to unjustifiable heights by virtue of a flood of cheap — almost free — money in the form of debt.
b. Prices had nothing to do with the value of the shelter itself.
c. Prices disconnected from rental costs and from the ability of incomes to support the cost of homes on a sustainable basis.

2) Consequently, home prices are no more likely to "recover" their bubble era values than are real estate prices in Japan likely to recover their bubble era values, now some 65% below their highs, 18 years after the Japanese bubble burst.

3) So what you are left with is a pile of debt that exceeds the value of the collateral supporting it and cannot be repaid. And even among those borrowers who sincerely wish to stay current on their debt — the forces of recession threaten to limit their ability to do so. On a broader level, even those altruistic enough to want to stay current will eventually ask themselves why they are throwing good money after bad on an asset that won't be worth anything to them.

4) Now that we have gotten realistic about saving our global banking system — which is comparatively easy in that all that is happening is the printing of more money by, or the extension of more credit to, sovereign governments for the purpose of recapitalizing

institutions — it is time to tackle the decline in housing prices.

5) However, the government recapitalizing of banks is an open ended – and out of necessity MUST BE an open ended — commitment that will be very challenging to limit unless we immediately start about the real challenge of settling the losses on the massive amount of "primary" underlying debt. Failing to do that, the support obligation vis-à-vis the banks will literally or practically start to bankrupt nations (just think of the size of the US budget deficits over coming years and the potential impact to the credit of the US — not that the US will face bankruptcy, don't interpret the comment in that way). While we are all out today praising the speed at which western nations have been able to turn on a dime from one policy initiative to another, the fact is the TARP and other initiatives won't stop continued losses to our financial institutions.

a. All of the derivative impacts — Mortgage Backed Securities, CDO's and CDS's — are being driven by the facts on the ground: the actual home mortgages themselves.
b. This is all very different from the early 90's commercial real estate crisis and much more difficult to solve – simply because the collateral we are talking about is the place our citizens go to rest their heads and raise their families. This is a crisis like none other.
c. Moreover, the amount of leverage in the financial system is still horrifying – much of it derived from the housing and other financial asset bubbles (Marc Faber of the Gloom and Doom report noted in a CNBC interview today that "The U.S. economy's debt to GDP has grown from 130 percent in 1980, to 350 percent at the present time," — all with regulatory blessings). The deleveraging will continue and foster addition stress on asset and loan values
d. We can't just foreclose and liquidate.
e. Soros pointed this out clearly in his op-ed piece in the FT on Monday – although he didn't present any specific suggestions. Others, Wilbur Ross, for example, have also focused on the needs in this regard.

6) What must happen is threefold:
a. We must strive to keep people in their homes not only for the social and societal implications but for the simple economic reality that further increasing of the number of vacant homes as sale inventory will bring about a crash that will take values well below the necessary readjustment to pre-bubble historical measures of home value.
b. In order to minimize the open-ended commitment to support financial institutions, still only part way towards absorbing all of the eventual losses, we need to work to maximize recoveries and stabilize prices in a long term sustainable fashion so that we put this tragedy behind us and can get on with the business of real economic growth.
c. With the taxpayer now essentially on the hook for all the major banking institutions, we need to develop a method of private transaction settlements that do not increase the burden on the taxpayer, but rather possibly reduce that burden.

7) The Freedom Recovery Plan does not seek to postpone the resolution with artificial government prices supports – that just makes it a problem for another day. The FRP seeks to bring in private investment capital as owners of homes leased to borrowers who have little to no (or negative) equity remaining. And, most importantly, the FRP seeks to give all existing homeowners a chance to get back into the ownership of their homes when they've gotten their financial houses in order. It is American to the core — fair, equitable and dependent on individual initiative to fully realize its benefits – help for all (lenders and borrowers) but more help to those who will help themselves.

8) There's an element of the Plan — the surrendering of deeds to homes — that may at first strike some as though we are Bedford Falls and old Mr. Potter is buying bargains from distressed sellers for fifty cents. Hardly the case. The homes involved are economically without value to the existing homeowners and the Mr. Potter's will be taking significant losses in the settlements under the Plan, What the Plan buys is time to

heal for both sides in a fairly equitable and controlled manner.