Daniel Alpert Managing Director • dalpert@westwoodcapital.com • +1-212-953-6448

Today's Housing Bill

Highlights

So, here we are—another Sunday night...

If *Variety* were writing a headline, it would read: "Paulson Pressures Peers; Pelosi Punts."

We've gone from the three-page Paulson Plan to a 110-page bill that, shorn of its legalese, is essentially the American people's mass blessing upon whoever becomes Treasury Secretary in the coming years—wrapped in language that's little more than a resolution of Congress' intent. This is not a bill promulgating new law, as much as a series of good-natured suggestions to make the best of a more-than-bad situation (and providing political cover to all parties).

This is clearly not Sen. Dodd's bill, which offered defined rules and mechanisms for the bailout's conduct. It's a reflection of a markup process that had the Treasury Secretary in attendance nearly round the clock, rebuilding the goodwill and trust he lost in last week's Alice- in-Wonderland hearings. Evidently, he has persuaded some very experienced legislators in private of what he failed to do in public: that this meltdown requires the Secretary to have all options open to him (or his successor). I believe Paulson enhanced his bona fides to more than a few congresspeople when he and regulators last week wiped WAMU off the map, perhaps demonstrating he was not in a gift-giving frame of mind vis-à-vis troubled financial institutions. Or, perhaps he finally succeeded in terrifying enough people while the usual Asian market opening, Sunday deadline did its potent thing as in past weeks.

Whatever the impression or reason, Speaker Pelosi ultimately punted with her "let's reckon the tab in 5 years, and it'll be someone else's problem to figure out how to fairly recoup losses" solution. Legislative patina aside, that's pretty much what we're dealing with here. The TARP can be pitched to tent the financial industry in pretty much whatever configuration the Secretary, Fed Chairman and a few other executive branch chiefs feel it should be. They will need to be on Capitol Hill a bit more frequently than they may like, but they will pretty much have all the flexibility they had originally requested. At some point in the deliberations, I can only imagine that the Secretary and

Chairman said to opponents, “Look at what we’ve done to shareholders of foolish institutions to date. We’re the taxpayers best friend here.” And wouldn’t you know, they’d have been right! How can you argue with that? And, ultimately, no one really did. Godspeed, Paulson and Bernanke. They are now carrying the trust of the American people and the world. May they wake up each day pledging their allegiance to this huge constituency.

Now, back to the impact on the markets, about which we are supposed to be writing (although the politics is certainly interesting). Given the latitude of discretion the Treasury has with this bill, it’s not unlikely that the impact on individual financial institutions (FIs) will not be clear for a while. So much depends on the deals Paulson offers to relieve FIs of their current problems. The truth is, if history is any guide, he and he colleagues will be quite tough on those who need the most help. As we said in an earlier piece, why would the markets expect him to do a 180 and take undue advantage of the potential “santa clauses” in this bill (i.e., the embedded powers to do as he feels is appropriate in the spirit of the bill)? It may be going way out on a limb here, but giving gifts to former colleagues on the street just doesn’t seem to be Paulson’s destiny (please, let me be right).

The situation to date and the environment fostered by the bill would seem to mitigate in favor of survival of the fittest and/or biggest. Treasury and the Fed will likely continue to shut down institutions deemed expendable, their toxic assets will find their way under the TARP, and the shells will be acquired by Messrs. Dimon, Blankfein, Lewis and Pandit, among a few others. Some debatable situations may escape the gauntlet, to be sure, but I wouldn’t be bidding up the prices of marginal FIs with discredited management (though I’m sure I’ll be ignored short term on that note). The banking sector will consolidate, and the big guys will benefit (and don’t be shocked if Merrill decides that it wants to be its own big guy rather than B of A’s, under the new regime—assuming it has a loophole through which to exit.

What the bill will not do is suddenly end the housing crisis and avoid the deleveraging recession, although it will mitigate both noticeably. American homes are inexorably repricing themselves to historical, pre-bubble norms. This will continue despite the return of liquidity to the capital markets. Several people have intimated that an unfreezing of the capital markets will underpin home prices. I don’t agree. There is, even today, access to home mortgages by borrowers with good (not even excellent) credit willing to put 15% to 20% down to buy a home. To argue that an unfreezing of the markets will somehow justify higher home prices than are presently justified is to assume that the existence of the TARP will encourage a new bout of aggressive (read, unwise) lending. Let’s hope this is not the case.

As for the receding economy, the continued pressure posed by systemwide deleveraging will impact consumption, employment and growth in pretty much the same ways as before this bill.

So, we can hope this Armageddon-stopping act will save the global financial system and give the U.S. economy some wiggle room it sorely needs. But even if executed in the most high-minded, moral-hazard-preventing manner, we will still need to get real assets (commercial, as well as residential) repriced to sustainable levels and help keep folks in their homes to the greatest extent possible in order to pare down the unwanted inventory. This will be the subject of later initiatives in Congress and elsewhere.
