

**Real Estate**

**&**

**Mortgage Crisis**  
**Solution**

**By J.R. Smith**



## **Understanding the U.S. Real Estate/ Mortgage Crisis**

Currently the U.S. financial system is in complete disarray as the existences of poorly constructed economic theories are being exposed. These temporarily lucrative business practices are now followed by far more expensive consequences for government regulators and American citizens. Most notable are the large financial institutions that find themselves with trillions of dollars of defaulting debt and or declining collaterals. This in turn has caused a freezing within the global credit markets and has escalated fears of multiple global recessions in both developed and emerging economies.

**Part I: Troubleshooting a faltering Economy:** Below is a sequential explanation of common and customary social and business practices-- in particular the labor, real estate, and mortgage markets-- that have combined to create the current financial crisis.

**1. Lack of economic sophistication among many political policy makers, some business owners, and many economic policy makers left much room for abuses to go largely undetected until significant damages had been done.** This leads to:

- Flawed traded and business laws with financially exploitable loopholes, with ineffective and lax regulation.
- Counterproductive business practices that exploit these deficiencies, leaving government and citizens to pay the price.
- And faulty, ineffective solutions whenever these are discovered, leaving the root problems still in place.

**2. The American citizen's poor comprehension of economic and financial matters-- due, in part, to lack of easily understandable finance curriculum and vast amount of widely accepted misinformation circulating on these matters.** This contributes to the general poor financial decision making /position of the majority of American citizens-- which has led to insufficient financial stability and or wealth building, over consumption, poor credit use, over indebtedness and poor debt management.

**3 Hyper-inflated real estate prices due to improper marketing of this "utilization asset" that has a particular value as an "appreciating financial asset" with an appreciating value. This misconception has paved the way for "price inflation" to be misrepresented as "appreciation" (see price to value clarification)".** This flawed practice has existed for multiple generations hence have become a commonly accepted idea and practice. Consequently, this misleads and forces consumers (home-buyers) to make poor financing choices (i.e. rate, terms, and duration) for purchasing shelter.

**4. The escalating prices of house forces citizens to finance them over longer periods of time (30 years).** This dramatically drives up the true cost of securing shelter by disguising it within a lower face payment at the expense of one's personal wealth and effectively amounts to usurious terms (time in lieu of rate). **Due to its structure, the mortgagor will generally work for the lending institution for 22 years before he will begin to contribute significantly to their equity (ownership) stake.** This is an extremely costly way to acquire shelter which indirectly leads to higher capital demands. It also will usually leave them insufficiently capitalized for retirement.

**5. This overconsumption and additional excessive credit use leads to higher living cost which leads to higher salary demands.** Eventually, they will pass on this expense to their employer by way of higher salary demands.

**6. These poor personal finance decisions leave consumers only one way to service this maladaptive lifestyle; their employer. These higher wage demands leave employers little choice except to pass on rising wages back to consumers; thereby contributing to inflation.** This initiates an ever escalating spiral of higher and higher inflation; financed by more and more debt. Eventually, however, things reach a point at which Employers can no longer raise prices and remain competitive and or profitable. And since they are obligated to shareholders to generate profits, the only other alternative is to seek cheaper labor markets.

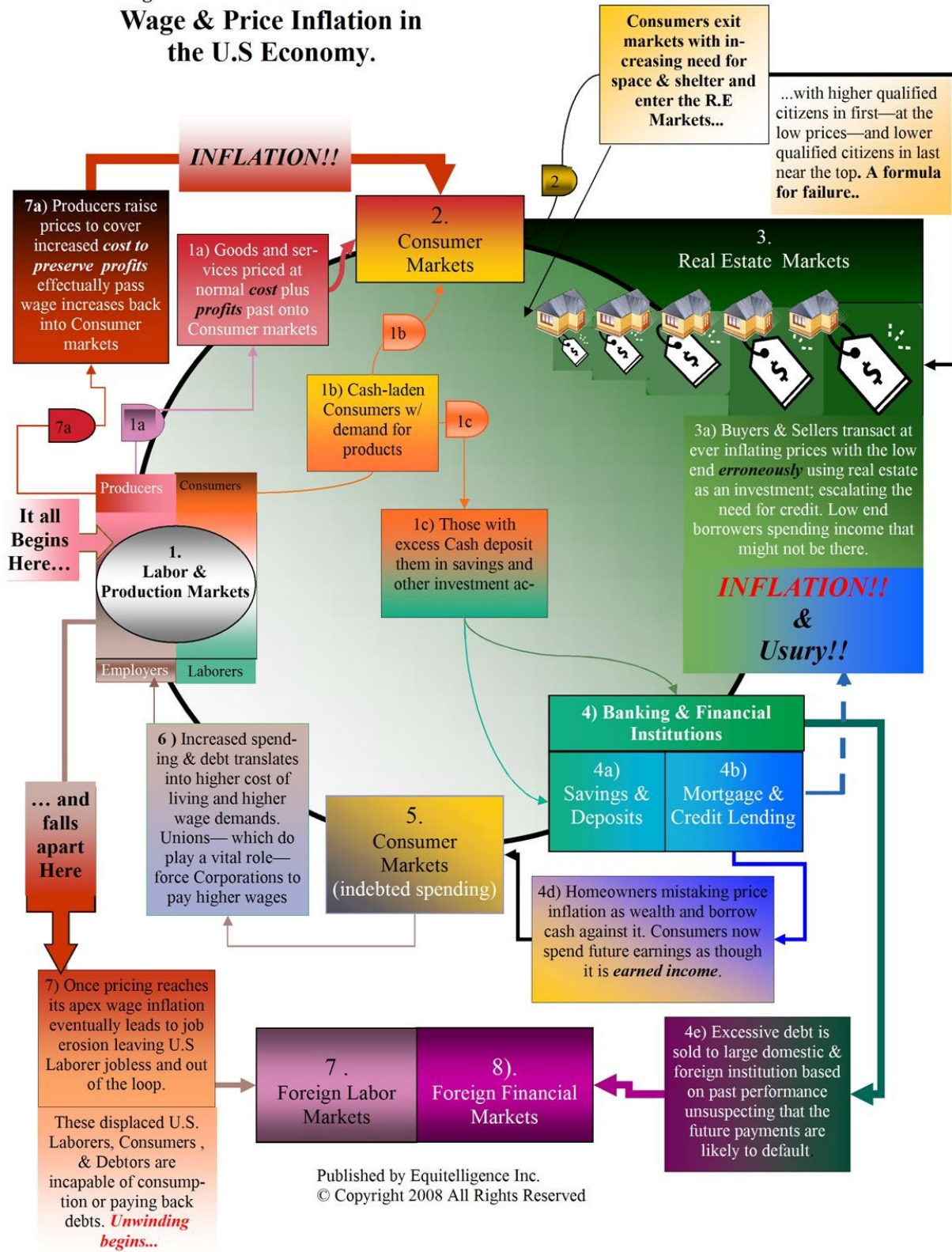
**7. As more and more employers seek "alternative labor options" the domestic job markets contracts; fueled by accelerated technology integration and outsourcing to foreign labor markets.** This initially appears to be an extremely profitable move since the attractive labor spreads allow them to acquire labor in a low cost environment and sell in a higher priced one. However the employer- employee relationship within an economy is directly tied to the producer-consumer relationship. Severance at one junction will eventually deteriorate them all. Eventually, the accelerated job loses coupled with expiring unemployment benefits beginning to hurt consumption. Most importantly it compromises the consumer's ability to pay back debt and the entire aforementioned inflation spiral begins to rapidly unwind.

**Price to Value Clarification:** Most people consider price and value to be one in the same. In fact, in regular Wall St. conversations, these terms are frequently used interchangeably. The truth is, "value" is the real tangible benefit(s) that a particular thing provides for their possessor, while "price" is the cost in dollar terms being either bid or asked by one or more persons. When ever the cost to acquire something supersedes the benefits that can be derived from it, one has overpaid for that possession. It is relevant to this volume because as the commentary and the illustration below will show U.S. Citizens have routinely been overpaying for items for decades due to inflation. This has cause a tremendous amount of wealth erosion.

In the following illustration: "*The Twisted Web of Wage & Price Inflation in the U.S. Economy*" demonstrates how this spiral of inflation has recently become decoupled in a manner that threatens--not only the U.S. Economy and the general welfare of every U.S. Citizen--but the global economy as well.

The numbers in the illustrations below corresponds with the numbered commentary above.

**Fig. 1: The Twisted Web of Wage & Price Inflation in the U.S Economy.**



## **Understanding The Nature of Debt & Labor:**

Debt, by nature is a condition that an entity finds themselves in having pledge future considerations for present ones, and Americans have a culture of spending tomorrow's wealth today. That has to change immediately. As we collectively face this massive debt obligation, it is helpful to understand that there are only two viable options for resolving debt, and more debt is not one of them. These are:

1. To forgive the debt
2. to allow the debt to be worked off.

Since, at the moment, I don't think that the world is in a forgiving mood, that leaves only one viable alternative; work! And since work is what Americans do best, the answer is both clear and solvable.

Labor is the the manifestation point of wealth creation; without which, all the great ideas are just vapor. The question,however of many ages has been “who owns the fruits of that labor” ? Up until now, the answer has secretly been government officials —since they take their tax cut first—and, in an indebted society, the rich (banker)-- because they get their interest next. This leaves just barely enough for average citizens to survive on and not nearly enough to build or preserve wealth—especially for the low earner. But that will have to change from here out. America is going to have to learn to share in this effort and prosperity, especially if we are to resolve this economic crisis which has become a sovereignty risk. This is perhaps the single largest reason for everyone to participate collectively towards a resolution.

## **Part II: A Call for Economic Patriotism:**

Every Nation's greatness rest upon 3 great pillars. Its foundation is its **Constitution** and the additional laws which confirm it and it in turn strengthen and refine them. It is flanked on one side by its **Militia**, which by its strength and might, upholds the Constitution and defends its citizen against physical assaults from foreign enemies. Lastly, it is completed by its **Economy**, which sustains its citizens and delivers them to prosperity; more or less.

For where the **Law** regulates our lives, and the military protects our lives, it is the economy by which our lives are sustained. If it fails, so have our Militia and our Constitutional right to Life, Liberty, and the pursuits of Happiness. Most important, and so does our Nation. Consequently, it is important for the citizens of a particular Nation to defend its economy with the same vigor as they would a Constitutional attack, or a Military one. In this manner we can all serve our country well and wear the title of American with the Respect and Honor of any military soldier.

In "Understanding the U.S. Real Estate and Mortgage Crisis: Part I", I outlined some internal economic developments that have weaken this nation's economy and its financial markets. The consequences of which have spilled over into all other nations of this world. As such, the same economic angst that are being felt domestically, are being felt abroad, and the fear of a global economic collapse looms large. In this, "A Call for Economic Patriotism: Part II", I outline an organized, structured plan by which these problems can be resolved.

But, before I disclose the nature of the plan, it is important for every citizen, regardless of the roles they hold in society to understand that they have a duty to contribute to the restoration of this economy. This may require some to make temporary sacrifices and or concessions, but in the end, this plan is one that will benefit everyone.

### **Recap of Part I:**

In Part I of this two part volume, I noted that the problem begins in the real estate market, more notably, in how we "price" real estate. Real estate prices are commonly established using the free market theory model, which in and of it is severely flawed in many ways. While I could produce an entire volume as to why, the nature of the problem is evident at just a few points, so let's examine these:

Real estate houses are appraised by using 3 recent and local sales of like kind and model, as the benchmark for pricing value in that neighborhood and its here where the problem begins. For one, in many cases 3 homes and buyers represent such a small percentage of total homes and individuals, that it is hardly a large enough sample to define the demands of the entire marketplace. Moreover, since the richest citizens are most likely being positioned to buy a home first, it sets the benchmark high and it can only go up from there. This means that the less capitalized citizens that need to buy a home after them will have to most likely pay more and have to commit much more of their financial resources to do so. And since they make far less, this means they will mostly go into debt to do so. From this point it is plain to see how the spiral of price inflation is set into motion. These are the "bubble creating" consequence of using faulty economic models that in theory may sound great, but in practice produces unsustainable and undesirable results.

One key dynamic that also takes place as a result of inflated real estate prices is that buyers are induced by the allure of them and see them as a sign that they are getting rich (another flawed notion). They become more prone to go into debt for their homes because they are sold to them as an investment. Setting aside for now flaws of this notion, the escalated price levels make it impossible to acquire home ownership within a short or reasonable amount of time. 30 years is the standard loan term which means individuals will generally have to work the first 20 years just to pay the interest. This is a ridiculous amount of time by which to secure shelter amounting to 1/3 of an expected lifespan and qualifies as servitude. In this advanced civilized age, we can do much better than that for our citizens.

The aforementioned "wealth effect" deceptively makes individuals feel richer than they actually are, induces overspending, and makes them far less diligent towards investing and saving and against future risk. Most importantly, since the debt is tied to a basic living requirement, housing, and citizens have no other choice but to go deeply into debt, which erodes their chances for creating any real wealth.

At the mortgage procurement level, the escalating price problems get amplified. Here, the rich get preferred rates, making debt more expensive for the lower level citizens on a relative basis. They can buy more homes at less cost than the poor, whose relative cost of living is much higher. As more and more citizens buy homes, the price of shelter (a basic living requirement) exceeds the modest to low earner's potential, and also makes wages far too expensive for employers. This forces them to lay-off workers, hire *illegal* immigrants, increase workloads on those that remain, and raise product and service prices which pass these costs back to employee when they become consumer. Eventually, when cut and price raises reach their apex, he is forced to move jobs overseas to maintain profitable operations. While initially there is a profit spike which encourages competitors to do the same, eventually the job erosion chokes off consumption and consumers begin to default on loans as well.

This system of ever escalating prices and of long term debt is a grossly inefficient way to achieve ownership which is the underlying principle of capitalism. It serves neither workers nor employers well, and yet it has become so common and customary that we submit to it. But there is a better way. To correct this problem, we must design a more practical Real Estate Appraisal Method which I will outline in another report. But, undoubtedly, some will argue that we must keep these models. For one; because we have always used them in the past and they seem to be working fine, and secondly, because they have gotten rich--in most cases unknowingly-- at the expense of the less rich and unsuspecting. But the purpose of this report is not to point fault finding fingers and or assess blame, but instead to heal and correct these faults in a constructive manner by which everyone can benefit. Next is a basic outline:

## **Basic Outline:**

### **1. Create a Super Flexible Patriot Fund for the purpose of repurchasing mortgage securities and restructuring and redistributing the underlying mortgages.**

- Raises capital and provides liquidity to a market that has become seized due to uncertainty. This will free up capital from the current credit crunch that is gripping the markets. Restore investor confidence and National credibility.

### **2. Fund this account by granting tax incentives, cost cutting concessions, and possible profit incentives to the qualified Organizational Participants (i.e. Large employers, Unions, Institutions, Municipalities, Government Agencies) in order to attract domestic jobs, to kick-start domestic production**

- Attracts and increases jobs, and restarts GDP, avoids recession
- Connects employer, unions and local governments in such a way so as to reinvigorate neighborhoods
- Creates a vibrant local economy where workers can create wealth for their labor, employers can produce goods and services at affordable competitive prices and still turn a nice profit for their shareholders, banks are relieved from the pressures of defaulting loans and declining securities, local governments have an expanding tax base with declining expenses.

### **3. Create a Regional Distribution System to separate mortgages and repackage them according to region and or states and performing or non-performing. With a wheel and spoke style system, all 50 state and connected will have access to the super-fund and the mortgages in them.**

- Allows performing loans to orderly serviced in the area of the home
- Benefit: allows non-performing loans to orderly restructured in the area of the home
- Allows a local Real Estate Management firms to manage distress vacant property or prevent some from becoming distressed
- Allows unworkable cases to orderly vacation, relocation, and reoccupation with minimum vacancy
  
- Benefits: allows existing non-performing loans with gainfully employed workers in default to get a fresh start by drawing funds from the Super Patriot Fund that will be repaid out of the mortgagors (long termed,6-10 years contracted employee) Individual Mortgage Account thereby quickly turning non-performing loans into performing ones.
  
- Rapid repayment would quickly replenish Super Patriot Fund and providing for an orderly redistribution of debt
  
- Reduced wages increase profit margins for the employer, municipalities, and other organizations that must function within a tight budget. Stable job markets provide for a vibrant working and consumption environment.
- A vibrant economy reduces the need for many social services which will reduce the national tax budget.
- Homeownership improves citizen moral and promotes peace and prosperity in accordance with our Constitutional mandate



**4. Congress should pass legislation allowing creation of " Individual Mortgage Accounts" with tax benefits that enable qualified employees the opportunity to defer up to 50% of their incomes in to such accounts, for the purpose of buying homes within current FNM, FRE limits.**

- Benefits: gives the long termed (6-10 years) contracted employee with a way to create wealth much faster with less salary (a win-win for employee and employer).
- Participants could acquire homeownership in as short as 1 to 12 years as opposed to the conventional 30 years. The remaining years could be dedicated to things like education funding, health care, and retirement.

**5. Restructure existing mortgages-- both performing and non-performing loans, according to the individual circumstances-- within the newly formed accounts.**

- Provides for an orderly process to separate non-performing loans from performing ones so that necessary restructuring and relief can occur.
- Stabilizes house prices, diminishes foreclosures, and restores homeowner confidence.
- Builds vibrant communities and sound affordable tax-base to provide civil services
- Builds individual wealth and stability that will allow citizens to afford other costly services (Health Insurance).
- Plus much, much, more.

**A message of Unity:**

One of the major problems has been the divisive nature that Americans have developed lately. We have turned into a nation of blamers and complainers, more or less. Yet given the size and ramifications of this problem, it is important that we do not spend too much time politicking about this issue, but spend most of our time and energy to work effectively towards quickly resolving this issue.

I mention this because given all the finger-pointing, fault finding, blame gaming, and "I told you so" crowing that is currently going on is sending a message that we Americans are incapable of coming together quickly to resolve this issue. While we all know is not true, the more we do it the more the markets lose confidence and value. Instead, all of this precious time and energy can be used to resuscitate this economy and resolve this issue.

Also harmful is all of the political grandstanding and flame fanning concerning the "taxpayer's money". Most of the so called guardians here have wasted enough of this already on far less nobler causes like the search for ancient star dust. Besides these monies will not be returned to the citizens that have paid it, but have been collected to be used towards the greater good and betterment of the society; and I can't think of a better cause than this one at the moment.

Lastly I must mention the lower-end citizen, who truly was the victim, but has been made to be the scapegoat in this whole mess. Many have suggested that this is their fault, since they should have known to avoid this mess, which up until now neither the professionals that he trusted or the legislators that were supposed to be regulating them, could see coming. How he could be expected to resist the temptation of late night infomercials touting the merits of riches made in real estate in a country that makes hero's out of successful risk takers is beyond me. That fact is, there is plenty of blame to go around but that won't solve the problem but will impede the resolution. So let's roll up our sleeve and lets work this problem out.

This concludes the basic framework to the plan. Obviously certain details must be added and adjustments and variations can and will have to be made. But it sets a course of action that is far different from the debt restructuring suggestions that have thus far been offered, which only pass these problems on for latter generation and delay the wealth creation for tens of millions Americans. In the next section, Part III , we discuss the finer details of the steps outlined above that will produce a unified effort to resolving the aforementioned problems and restoring a highly productive functioning economy whereby all parties will benefit.

### **Part III: The Reasons , Roles & Rewards of Qualified Participants.**

Besides the aforementioned motivations, there are many other fruitful reasons for everyone to play a critical role. Though the roles and rewards are different depending on what your position in society, everyone has a compelling motivation nonetheless. Below I have detailed certain specifics of the steps outlined above along with accompanying illustrations and figures and the Roles, Reasons and Rewards for each entity type.

#### **1. Create a Super Flexible Patriot Fund for the purpose of repurchasing mortgage securities and restructuring and redistributing the underlying mortgages ( See Fig. 2)**

There are two equally important reasons for this important step in the plan. First and foremost, it creates the structure in which funds can be collected and accounted for and eventually by which mortgage back securities can be purchased at par or below par pricing (depending on their performing status). Equally important, it will galvanize American institutions, Corporate Entities, Federal and Municipal Governments, and Patriotic Americans to take a stabilizing interest in preserving a vital part of our culture. Every participant has the same contribution—cash secured by \$1000 par value shares of the fund-- but each qualified participant has a reward unique to them. Below is a breakdown of the entity followed by the rewards that the entity would most likely realize. It should be noted, that usually growth and return on capital has been the primary motivation for making a capital investment. In this case the primary motivation is to minimize the risk of a failing economy, stabilize and improve a proven business environment

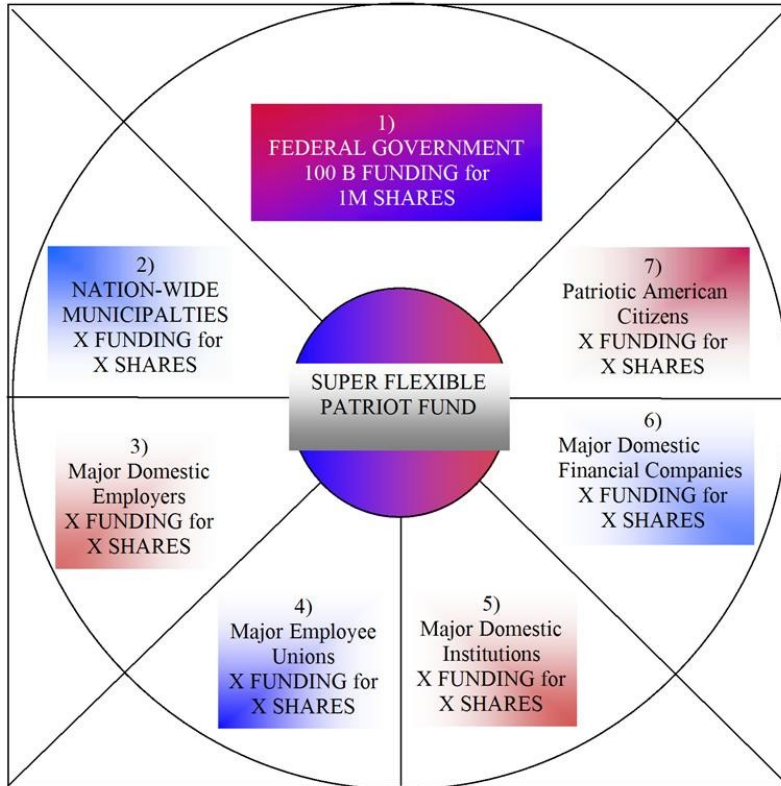
#### **Entity #1: Federal Government:**

**Reason:** Government has a fiduciary responsibility to the American citizen to maintain the viability of its currency. Nowhere is this more exemplified than its inability (or inability) to produce a stable business environment for entity to conduct fair and equitable business transactions. Having dropped the ball on this duty by failing to regulate these institutions for decades as illustrated in Part one of this volume, now is the opportunity and the way to make it right with the American citizen. Most importantly, since the primary method to resolve debt is labor they can resolve the debt problem, the energy, environmental, infrastructural, and the unemployment problem at the same time.

**Role:** Provide leadership, capital liquidity and legislative foundation for other institutions to follow.

**Reward:** Provides a mechanism to orderly repurchase debt and re-channel it equity to the American citizens in exchange for providing the labor for rebuilding our infrastructure and developing a 21<sup>st</sup> century economy that can rival any other nation. The restoration of American economic reputation as a nation of hard workers providing a robust economy with the unified efforts of some of the worlds best institutions solving some of America's biggest problems. A viable solution to America's growing homelessness and a citizenship that will evolve into more self-sufficiency and a shrinking federal services budget.

**Fig: 2 Super Flexible Patriot Fund.**



## **Entity #2: Municipal Governments:**

**Reason:** Municipal Governments have seen their local economies and tax base shrink as more and more corporations leave domestic cities for the lure of better economic conditions abroad. This leads to citizens leaving previously economically viable areas for cheaper pastures elsewhere. The a shrinking property revenue line, forces them to shift the added tax burden to those that remain making the cost of living higher. By attracting multiple viable businesses back to domestic areas by way of tax incentives and lower cost business environments they will attract workers and could pave the way for an orderly deflation in prices. Also the broadening and accelerating homeownership pace will spread the tax burden across more shoulders until necessary projects have been paid for. These efforts will revitalize local economies.

**Role:** Provide leadership, capital liquidity and legislative foundation for other institutions to follow.

**Reward:** Provides a mechanism to orderly repurchase debt and re-channel it equity to the American citizens in exchange for providing the labor for rebuilding our local cities and provide for more prosperous environment where every willing citizen can have a equity stake in the America by seeing the fruits of their labor much quicker that before. Citizens that have some skin in the game behave much better than those that do not and become much more productive and involved persons.

## **Entity #3: Domestic and Foreign w/ Domestic Operations Corporate Employers:**

**Reason:** American Corporations have gotten to lax in maintaining their leadership role in innovation and production and as a result competitive economies have made up considerable ground. While to temptation to pursue these 'greener pastures' is alluring on paper, the reality that to rapid a move in this direction can lead to cannibalization of ones corporate businesses.

On paper the reduction in labor cost seems compelling until the realization that it brings with it top line (revenue) erosion. Corporate leaders are learning that laid off workers can't consume and this will either directly or indirectly hurt their sales and earnings. Also, raising prices on wealthier clients will only go so far and a broader customer base in most cases is the best way to go. Foreign Corporations that want to compete, could also participate providing that they are providing American jobs.

**Role:** Provide a collaborated commitment to American citizen and the American citizen under terms that make wonderful sense to all parties involved. By providing the job opportunities to the citizens they allow citizens the opportunity to work off the debt, build equity, and lay the foundation for strong families and communities to evolve.

**Reward:** This will provide for a much stabler economy and and stronger Corporate brands ideal for long term growth and more profits consistent with their obligation to shareholders. They also will build stronger brands with deeper community roots that will pay dividends for generations to come.

#### **Entity #4: Employee Unions:**

**Reason:** With the erosion of American jobs, labor unions have seen memberships decline and their organizations decline. Unions, which have played a vital role in the checks and balance sense, have to remember that their strength is in their numbers, not necessarily in more dollars—especially if those dollars are losing purchasing power due to inflation, and eventual layoffs and an non-competitively priced product. They are thereby winning the battle but losing the war. More important is the total net compensation that leaves their workers more empowered after all things are considered.

**Role:** Help workers understand the concepts of total net equity as oppose to surface hourly wage number is the net best route to go. Many employee are economically illiterate and labor unions can go a long way towards not only helping them secure labor, but also helping them understand how to translate their labor efforts into more meaningful sustainable wealth.

**Reward:** The stability of jobs will lead to stronger memberships and union stability and strengthen. By helping members become more economically sustainable it will lighten the retirement, pension and living benefits load that many unions and employers share. More profitable corporations will also provide from better investments holdings that presently are in jeopardy under the current economic conditions.

#### **Entity #5: Domestic Institutions(i.e Educational Institutions) :**

**Reason:**

**Role:**

**Reward:**

#### **Entity #6: Domestic & Foreign Financial Corporations:**

**Reason:**

**Role:**

**Reward:**

#### **Entity #7: Patriotic American Citizen**

**Reason:** (see history of patriot bonds during WWII)

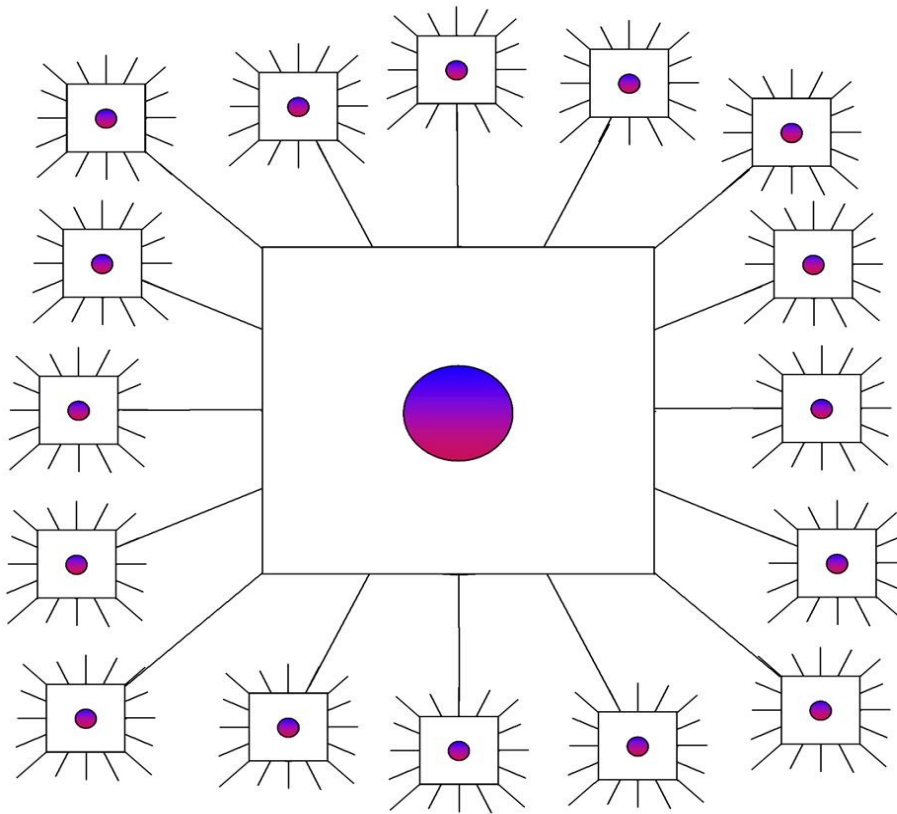
**Role:**

**Reward:**

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**A Nationwide Mortgage Redistribution System:**  
reaching all 50 States and subsequent Communities



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