

## **“Economic Update: This Situation Will Get a Lot More Desperate Before It Improves”**

**by Dr. David Eifrig, Jr., M.D., M.B.A.**

Yesterday, my new assistant, Laura, and I went to the Baltimore County courthouse steps to watch the auction of about 40 foreclosed homes and properties. As the rain remnants of Hurricane Ida forced us flush against the building, we watched property after property auctioned off.

It's an everyday occurrence in Baltimore and around the country. And if you have cash and know what you're doing, you can make a fortune buying these homes and fixing them up.

I wanted to see firsthand if these auctions are attracting bidders. Normally, a few people show up trying to buy back their family home or farm, but not yesterday. Other than Laura and me, only four other guys showed. Apparently regulars on the steps, they all knew each other too. One guy wore a suit and nice coat. The others were in ball caps and sweatpants and looked like contractors.

They huddled and talked about each property as it came up. For an hours, all we heard was “nope...nope...too much....no way.” They sat like vultures perched on a limb, waiting for water buffalo to fall over dead. The guy in the suit told me he bought nearly 500 properties this way in the past four years...but not now, “Things are too expensive.”

This same scene (minus the hurricane) is playing out everyday at court houses around the U.S. Properties for sale are backing up on the front steps like planes during a storm at La Guardia airport. Just last October there were 332,292 new foreclosure filings and yet only 48,845 sales. And the numbers just keep growing. In fact, there were more than 3.3 million new filings in 2009. It's not good.

If you've never been to a property auction like this, let me explain what's happening. Auctioneers, who represent the banks, have a list of properties the county says are to be sold at auction, literally on the front steps of the courthouse. The list includes properties whose owners have stopped paying their mortgage for various reasons. In order to get back its legal title, the bank must buy the property back at these public auctions.

So one of the bidders, (in the form of the auctioneer), is the bank. And its opening bid starts right around the current value of the mortgage. You see, if the property sold for less than the current mortgage amount, the bank would have to take an immediate loss on its books. Think of it this way: If before the auction, the bank lists the mortgage as an asset of say \$300,000 but buys the house at auction for \$200,000, then it can book the new asset (the house) at only \$200,000. Since it would simultaneously remove the old asset – the \$300,000 mortgage, from its books, the bank would immediately incur an asset loss of \$100,000.00.

But the thing is banks don't really want these properties at any price. They'd much rather have someone take it off their hands. The banks are not in the property management business. Worse, as these pile up in the bank's portfolio of assets, the bank finds it harder and harder to sell properties at the prices it paid at auctions. But right now, just like at the Baltimore auction, banks are finding few other bidders for these properties.

Normally, local developers or contractors attend these auctions hoping to pick up a property or two for a song. During good times, only a few properties get auctioned at a time. Back in 2005, you might have seen 10 in a week. But yesterday, nearly 40 were on the block. Another 30 went today and the banks bought back every single home.

This is terrible news for banks and the housing industry. As the number of properties sold by banks keeps increasing, the home prices will have to go down. This means even more losses for the banks. And the situation is going to get a lot more desperate before it improves for the banks.

You may not know, but the Obama administration has forced local governments to delay foreclosures. It also created a "loan modification" plan as part of the stimulus package to help forestall the process. (Not that it seems to be working – pre-foreclosures keep piling up.)

Don't get me wrong. When the bank forecloses on a family's home, it can be devastating. And I have compassion for those in that situation. But remember, many, if not most, of the loans blowing up are from speculations in real estate. For those liars and thieves, I have no sympathy.

Overall, the foreclosure process is a necessary business practice for the banks and our economy. It's the only way the market can clear out bad loans and return a bank's balance sheets to health. Banks and lenders must be able to clean away the financial "deadwood" as soon as possible, so money can be offered to others for more productive uses.

Instead, the money and capital is being destroyed. Denying its existence and pretending the problem will go away if you make banks slow down the foreclosure process is a bad idea. It's like keeping the wound open too long – eventually it will get infected and the patient could die.

And as bad as it is now, there's more building up in the pipeline. Banks are now buying more (so called REOs for real-estate owned) and more of these at auctions. Since selling real estate is not their business, the glut of for-sale properties is building. And that will mean lower and lower prices as banks finally realize they have to get rid of the assets to stay out of bankruptcy themselves.

The silver lining is that it also means opportunities for us the future. I've been watching markets in Florida, California and now Maryland for opportunities. I've started to see a few deals in Florida, but I'm waiting for property start going for less than \$150 to \$175 a

square foot – (they’ve been running about \$225 to \$250 a square foot in Florida right now). I’ll let you know and perhaps I’ll run into you on the county courthouse steps somewhere.

I hope you took advantage of my recommendation in October to earn extra interest on your cash. I found a local credit union willing to pay me 3% on my money and I’m sleeping better at night. I can’t stand loaning my money to Fidelity or TD Ameritrade for 0.01% in my brokerage accounts. The way I see it, by banking with a local credit union, I’m giving my capital to local people and businesses instead of the huge Wall Street firms that steal my taxes and pay their cronies big fat bonuses.

Wall Street bailouts were supposed to revive the economy by producing money in the form of loans to all sectors and industries. Of course, we know that was a load of bull. Instead, the big money-center banks hoarded those dollars and used them to plug holes in their balance sheets.

But putting your money with local credit unions will help stimulate your local economy in the way banks should operate. These institutions don’t keep plush offices or send their board members on luxury island trips. They exist solely to turn deposits into small business loans, home mortgages and car loans.

Keeping your money local, you’ll support small and local business ventures near you. I don’t know about you, but I don’t want to pay for any more golf trips, big bonuses or million-dollar office decorations. Together, let’s stop the fraud of Wall Street and support our local community banks and credit unions.

Also, in addition to the tools I gave you in the original issue, I find this site helpful in locating credit unions I may be qualified to join: [www.findacreditunion.com](http://www.findacreditunion.com).

The stock market seems to be holding up well amid 2009 third quarter earnings announcements. Companies have cut spending so much and fired so many people that bottom-line earnings looked reasonable. But for most companies, revenue (so-called “top-line” growth is plummeting faster than a skydiver without a parachute. This doesn’t bode well.

If you look at the past five recessions, the employment bounce we usually see by now is missing. No new jobs are opening up, and no consumers are showing up to buy anything. In fact, 7,000 people a day are losing their unemployment benefits and going off the “dole.” And since they don’t have jobs, they’ll have to count on friends and family or steal to eat and sleep. This is looking more and more like the patterns of the Great Depression.

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