

Solving the Housing Crisis

Solving the Housing Crisis Housing Could Drop Another 20% in Pricing Buy A Home, Get a Green Card A Real Stimulus Package Las Vegas, La Jolla, and the OC

By John Mauldin

This last Tuesday the *Wall Street Journal* published an op-ed by my friend Gary Shilling and Richard LeFrak. They offer a simple solution for the housing crisis: give foreigners who will come to the US and buy a home resident status (green cards). This is a very important proposal and one that deserves national attention and action. Gary was kind enough to send me two lengthier white papers offering more facts. In this week's letter we are going to look at this proposal in more detail than the small space that an op-ed can offer. And while this letter will be somewhat controversial in some circles, I ask that you read it through, giving me the time to make the case. I will also add a few thoughts as to why this could not only help solve the housing crisis, but help put the nation back into growth mode.

Long-time readers know that I have been growing more and more bearish of late. I have been writing for a long time that we are in for a long period of slow Muddle Through growth as the twin crises of the housing bubble and credit bubbles require time to heal. Today we look at a serious proposal for cutting the time to healing for at least one of those bubbles (housing), and at least keep the other (credit) from getting worse. This is the most serious idea I have seen that could actually make a real positive contribution to the economy and help put us back on a growth path.

I will post Gary's papers and a link to the actual op-ed piece for those who want to do further research, but let me make one point at the beginning that he did not emphasize: the US is already allowing roughly 1 million immigrants a year into the country (which for a variety of reasons I and most serious economists of all stripes believe is a very good thing). We are suggesting that we simply change the nature of what constitutes the conditions for acceptance, so as to jump start the housing industry and the economy. We are not suggesting additional immigrants, although nothing would be wrong with that. I will also post a link for you to send this e-letter to your congressmen and senators.

Let me put up front a few benefits of a program that would allow legal status to immigrants buying a home. Housing values would stabilize and in many cases rise. The massive losses because of bad loans that are being subsidized by US taxpayers would be stemmed, saving many hundreds of billions, if not a trillion or more dollars. The excess inventory of homes would quickly disappear and the millions of jobs that were lost as home construction fell into a deep depression would come back. If housing values rise, many families would be able to refinance their homes at lower rates and have more income left over after paying their mortgages. \$12 billion in commissions would end up in real estate agents' pockets, helping a very battered and bruised group. Hundreds of

Solving the Housing Crisis

billions will flow into local businesses, as these new immigrants will need to furnish their homes. This could mean as much as a half trillion dollars in sorely needed stimulus in the next few years, without one penny of taxpayer money and actually adding taxes back to governments from local to national. And we are not bringing in 1 million foreigners, we are attracting 1 million mostly middle-class new Americans, which, if we are smart in how we do this, will result in more jobs for all Americans. So let's jump right in and look at the details.

Housing Could Drop Another 20% in Pricing

Let's review the situation as it will be if we do nothing. Shilling shows that we built 6.7 million more homes in this country between 1996-2005 than the normal trend would have projected, partially because we underbuilt the decade before that. New housing starts average about 1.5 million in normal times but have fallen to 500,000 recently, and could fall further as unemployment rises and demand declines. Even so, Shilling estimates that we still have about 2.4 million excess homes.

This compares rather well with estimates by independent analyst John Burns, which I cited in the e-letter early last year. What they both agree on is that it will take at least until 2012 to work through this excess inventory, and that assumes that foreclosures do not increase as housing prices drop.

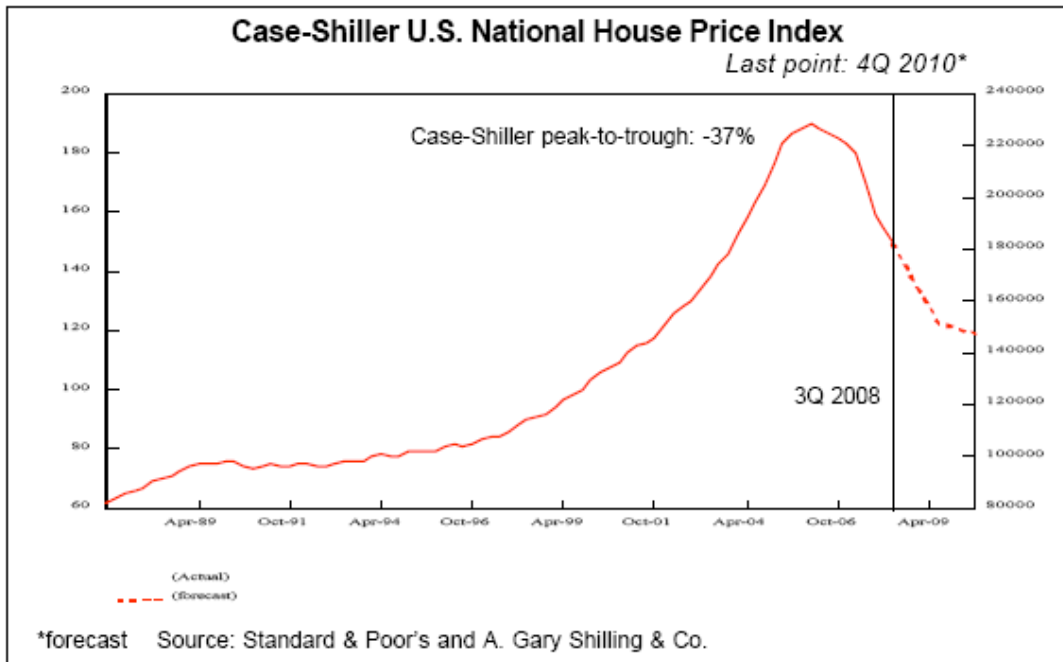
Excess supply of anything means lower and continuously falling prices, and that has certainly been the case in housing. Here is what Shilling writes:

“We believe that if nothing is done to eliminate surplus housing, prices will fall another 20% between now and the end of 2010 for a total peak-to-trough decline of 37% (Chart 1 below). The resulting further negative effects on the economy will be devastating. At that point, almost 25 million homeowners, or almost half the 51 million total with mortgages, will be underwater... That's also a third of the 75 million total homeowners, with the remaining 24 million owning their houses free and clear. It would take a little over \$1 trillion to reduce their mortgages to the value of their houses, compared to \$449 billion for the almost 14 million currently underwater.”

This is not inconsistent with similar projections by other acknowledged experts and independent analysts like John Burns and Professor Robert Shiller of Yale. If nothing happens to stimulate buying, there is a great deal more pain ahead for American homeowners.

Solving the Housing Crisis

CHART 1



For the great majority of Americans, their homes represent the largest portion of their assets. This is particularly true of Americans of more modest means, who have been hit the hardest. Watching their single biggest asset drop another 20% will be devastating and for many will mean they will not be able to retire as they had planned. More Americans own homes (68%) than own stocks (50%). This helps explain a recent poll which shows more Americans are worried about house prices than about the decline in stock prices.

Falling home prices means that consumers have to save more for retirement, which results in lower consumer spending, which translates into lost jobs and more homeowners coming under stress – a vicious spiral that is increasing unemployment. Realistic estimates of unemployment rising to over 10% within the year abound.

Two years ago I and a few others foresaw the current housing crisis (and an accompanying credit crisis), predicting a protracted recession and a slow, multi-year Middle Through recovery. Sadly, I was right about the housing crisis. Without some intervention, there is little to suggest that the prediction of a long, protracted recovery will not come true.

Lowering rates, as is being discussed in various circles, will help homeowners who can make their payments, but it does nothing to really bite into excessive inventory. Until we reduce the inventory, housing prices in many neighborhoods all across America are going to continue to come under pressure. And as Barry Habib points out, while the Fed may be lowering rates for securitized packages of loans, those low rates are not available to the average home buyer. The cost of packaging and securitization adds considerable cost.

Solving the Housing Crisis

Shilling discusses the “traditional” options for reducing home inventories, but in the end there is no real solution other than time, or massive amounts (read trillions) in taxpayer money being given to homeowners, which will be very unpopular, as homeowners who were responsible and are paying their mortgages would get no benefits. Waiting another two and a half years for the excessive inventory to sell will keep this country in a very slow or no-growth economy, and devastate the wealth of millions of homeowners.

But there is a solution. There are millions of foreigners throughout the world who would like to come to live in the US. In 2006, there were 1.1 million immigrants allowed into the US, some 63% of whom were allowed in simply because they already had relatives here. Only 13% of visas were granted to people because of their skills. While allowing relatives of current residents to come to the US may be a humane and reasonable policy, it does nothing to assure they bring more than that relationship to help them make their way in the US.

Buy A Home, Get a Green Card

What if we changed the rules for a few years? Starting as soon as possible, we should allow anyone to come into the country who would buy a home. They would be given a temporary visa which would become permanent if they had no problems after, say, five years.

While Gary proposes that they be allowed to borrow against the value of their homes, I lean toward suggesting that initially we take those who buy their homes outright (with a few exceptions). That means they have enough capital to purchase a home to begin with, which probably means they are educated and have skills. In fact, if they have enough cash to buy a home, that means they would have more actual savings than most US citizens. We would be attracting future citizens with the capital to invest in job-creating businesses and/or who have useful skills to assist in the recovery of the US economy.

Of course, there should be some rules that go along with this proposal. Background checks and references should be required. The home could not be rented for a period of time (at least two years), to help reduce the supply of available housing, and could not be resold for at least two years unless another home was purchased. There should be a minimal price, which could be somewhat different for various regions, but \$100,000 would seem to be a good minimum for most areas, with higher minimums in certain areas.

The immigrant should demonstrate the ability to support himself and his family for a period of time (at least one year, preferably two), including the purchase of health insurance. Cash or letters of credit or other guaranteed commitments would be required. Only immediate family members (spouse and children) would be allowed to come with the immigrant. Cousins and siblings must buy their own homes. The permanent visa

Solving the Housing Crisis

should be contingent on not having gone on welfare or public assistance at any time in the past five years. We are trying to solve a housing problem, not looking to create others.

I would make an exception in having 100% financing for immigrants with advanced degrees or special skills, especially those who did their schooling in the United States. If the US is to remain competitive in an increasingly technological world, we need more scientists and engineers. But getting permission to stay is becoming increasingly difficult. We are seeing a brain drain of those who would like to stay and create new jobs and technologies (and buy houses) here in the US. Shilling and Le Frak write:

“The authors of this report believe that a number of people have given up waiting for those visas or don’t want to put up with the hassle and are leaving the country. This “brain drain” is unfortunate since many of these foreigners are highly productive. In 2006, foreign nationals residing in the U.S. were named as inventors or co-inventors on 25.6% of the 42,019 international patent applications filed from this country, up from 7.6% in 1998. Studies of the authorship of academic papers show the same trend.

“U.S. educational institutions are considered the best in the world by many and are magnets for foreign students, especially at the graduate level. Many of them are inclined to settle and work in this country after completing their studies, if they can obtain permanent resident status.

“The Council of Graduate Schools survey revealed that in the fall of 2007, 241,095 non-U.S. citizens were enrolled in graduate programs. Technological progress and the productivity it generates depends on people educated in biological sciences, engineering and physical sciences, but only 16% of U.S. citizen graduate enrollment was in these three disciplines. In contrast, 55% of total non-U.S. citizen enrollment was in those fields. Conversely, 53% of graduate enrollment by Americans was in education, business and health sciences while those three fields accounted for only 24% of foreign graduate students.”

(There is a great deal more background detail in the second white paper. See link below.)

Much can be learned from similar programs already in place in immigrant-hungry countries such as Canada, Australia, and New Zealand. The United Kingdom has recently added new programs. Many countries realize that in the coming years there is going to be increasing competition for the best and brightest of the world. Again, there are more details in the white papers, but let’s turn to the effects that would result from such a program.

A Real Stimulus Package

First, upon Congressional approval, it would almost immediately stop the seemingly inexorable slide in house prices, as initial demand would be significant. Let’s

Solving the Housing Crisis

assume one million new immigrants would buy homes. At an average price of almost \$200,000, that would be \$200 billion injected into the economy. And each of those homes has to be furnished, food has to be bought, clothing will be needed, local taxes will be paid. Airplane tickets to research potential areas, hotels needed during the interim period, and other related expenditures would add up. Over two years, this could easily be another \$100 billion.

Couple 1 million new buyers with current US demand, and the excess inventory would be worked through within a year, and possibly faster. This puts a floor under the housing market, and home values could once again to begin to rise in line with a growing economy.

Such a program would have a salutary effect on the value of the dollar, as not only the initial purchases of homes and materials would need to be converted to dollars, but it is likely that immigrants would bring even more capital into the country.

By stemming the fall of home values, it would decrease the likelihood of foreclosures and help homeowners get refinancing at lower rates. Refinancing now is difficult because most lenders want a substantial slice of equity to go along with any new mortgage. If your home value has dropped 20% and is likely to fall another 20%, it is hard to have enough equity to qualify for a new mortgage. Stopping the fall in prices is critically important; and maybe if prices rise in some areas, homeowners will be able to refinance at better rates, giving them more cash each month to save or spend.

As I have written in previous letters, the psyche of the American consumer is permanently scarred. We are on our way back to a savings rates that will look more like 1987 than 2007, when it was almost zero. Just a few decades ago, we saved 7-10%. Consumer spending was only 64% of US GDP in 1987. It was 71% in 2007. It is on its way back to that lower level.

Lower consumer spending will be a drag on growth for years. But bringing in 1 million already middle-class new immigrant families will help make up for a lot of that reduced spending. If you can spend \$200,000 on a home, you are likely skilled at something and well-educated. You will find a job, or create one, as many immigrants do, and then you will add to our total consumer spending.

If you are a real estate agent, you should love this proposal, as it would result in an additional \$12 billion in commissions.

If you are a home builder, what a great way to reduce inventory and get back to the conditions where there is a demand for your product. This would help put back to work those who have lost their jobs in the home construction collapse. Home Depot and Lowe's and local stores? It would help them to increase sales, which leads to more jobs.

We are on the cusp of the Baby Boomers beginning a huge wave of retirement, both in the US and elsewhere in the developed world. There is going to be a need for

Solving the Housing Crisis

skilled workers to replace those Boomers, as well to provide services to the retirees. Further, the promised Social Security and Medicare expenditures are going to start increasing at a significant rate. We are going to need immigrants to help pay for those benefits. Given the controversy over immigration, we will look back with some irony in ten years when we find we are in a serious competition with other nations to attract skilled immigrants. We should start now. I think the concept is, let's not waste a good crisis.

Let's look at some of the potential critics of this proposal. I was on *Yahoo Tech Ticker* yesterday talking about this, and got a few irate emails and phone calls.

"Why," I was asked, "do I hate American workers? Isn't there enough unemployment? Why do we need more immigrants taking American jobs?" And there was considerable angst about illegal immigrants.

First, I am suggesting we transform the already existing legal immigrant flow, which is going to happen anyway, into a form which helps us solve a major crisis. I am not talking about adding another 1 million immigrants on top of the current legal inflow. Just change the nature of that inflow until the excess housing inventory is settled, and then we can go back to the current program, if that is what is wanted (more on that below).

Second, I am not suggesting we bring in or condone illegal immigrants. That is another issue altogether, for another debate at another time.

If we do nothing, unemployment is going to rise to at least 10%. That is certainly not good for the American worker. Home values are going to continue to fall. That is certainly not good for the American worker. The economy is likely to be stagnant for an extended period of time, which means job growth in a Muddle Through recovery will be slow and stagnant. That is not good for the American worker.

Hundreds of billions more of taxpayer dollars will have to go to banks to keep them solvent as falling home prices and increasing unemployment increase foreclosures. That is not good for the American worker and taxpayer.

And further, I am not talking about bringing 1 million foreigners to this country. I am talking about bringing 1 million future Americans, who want to work hard and live the American dream.

Let me say a few words to those who are opposed to immigration – and I have heard from you. With few exceptions, US citizens reading this have an immigrant in their genealogies. Some of mine go back to the 1600s. Some of mine were not exactly considered welcome. "No Irish and Dogs allowed" read the signs. But immigrants and their children have been the driver for growth in this country for generations. It is hard-working immigrants who leave their homes for the dream of being Americans that have been the backbone of the building of the nation – the hewers and shapers, if you will.

Solving the Housing Crisis

It is precisely that melting pot of human diversity that is the strength of the American idea. Each new wave of immigrants has been viewed with trepidation or scorn, yet within one generation they have become American. And in turn, their children's children forget that their forebears had to deal with discrimination.

America – the US – is not so much a country as it is an idea, the idea that anyone, regardless of race or religion or gender, can come here and with hard work and determination make their own way. Some end up owning the local deli, and some end up founding Google. Some 25% of Silicon Valley start-ups, I am told, are by immigrants, creating jobs at the bleeding edge of technology. They see the US as a land of opportunity. That is why so many want to come and that is why we can attract a new generation of affluent, self-reliant immigrants who can help us solve a problem that we created.

I can see no downside to changing our immigration policy for a few years. We solve the housing crisis, stabilize home values, bring hundreds of billions in stimulus to the US, and with no taxpayer outlay. For a short time, we substitute one class of immigrant for another, to solve a serious crisis. It is not a matter of immigrants or no immigrants, just which immigrants

So which do you want? 10% unemployment and a decade of lower home values and increasing foreclosures, with a slow, Muddle Through, jobless recovery, or a stable housing market and home construction back to trend?

If you agree with me, I suggest you contact your Congressman. You can go to <http://www.visi.com/juan/congress/> (selected at random from many such sites) and type in your address and get the name of your congressperson and senators. Just tell them you like this idea, and cut and paste the link where you read this into the letter. And tell them to get into gear! I would like to point out that this proposal is not Republican or Democrat, it is just common sense. I hope we can get broad bipartisan support.

The link to the *Wall Street Journal* editorial is:
<http://online.wsj.com/article/SB123725421857750565.html>

The links to the white papers are:

http://www.frontlinethoughts.com/pdf/Housing_Whitepaper_1.pdf

http://www.frontlinethoughts.com/pdf/Housing_Whitepaper_2.pdf

Las Vegas, La Jolla and the OC

I expect I will get a few new readers from this letter. Normally, at the end of my regular weekly letter, I make a few personal comments. I write this free weekly letter to my 1 million closest friends, and you can add yourself to the list at www.frontlinethoughts.com. You can find out more about me at www.johnmauldin.com.

Solving the Housing Crisis

Parts of this letter have been written in New York and Dallas, and as I write this I am on a flight to Las Vegas to speak at a conference on natural resources. I am sure the recent Fed actions will be at the center of conversation. There is not enough space now to comment on that; but I did do a few segments on Yahoo *Tech Ticker* (one of which evidently made the Yahoo home page), which you can listen to at the following links.

Links to the Yahoo segments:

D.C. to America: You Can't Handle the Truth
<http://bit.ly/10rUiF>

Plan to Solve Crisis: Let Immigrants Buy Houses
<http://bit.ly/WOXLq>

Fed Strategy: Spread Economic Pain Over Multiple Years
<http://bit.ly/wgGjA>

I will be in La Jolla for my annual Strategic Investment Conference in two weeks, as well as hosting the Richard Russell Tribute Dinner. The dinner is shaping up to be a big event, with hundreds of attendees and many of the brightest lights in the investment writing world present to honor Richard for 50 years of brilliant commentary.

I really enjoyed my trip to NYC. I had a great steak dinner with Art Cashin, everybody's favorite commentator on CNBC. Breakfast with Tom Romero and then a meeting with Jim Cramer, who I found to be very personable and genuinely likeable. Meetings in the afternoon with business partner Steve Blumenthal, then breakfast the next day with Barry Ritholtz, Yahoo at the NASDAQ, and then a speech at noon, back on the last flight and up writing – and then this plane, which I hope ends up in Las Vegas.

In addition to being with old friends Doug Casey and David Galland (and their posse), I intend to see the inside of the gym and spa. I need it. Tiffani has been gone for two weeks, working on our book, and will get back on Monday; and the new chapter I was supposed to have for her has disappeared in a reboot from this laptop. I am quite distressed, but evidently the book gods decided it needed a major rewrite.

Have a great week, and find a few friends and share some laughs and your adult beverage of choice.

Ok, the computer crashed again, and this letter is going out on Saturday rather Friday night. But I did get to see the Jersey Boys (The Story and Music of Frankie Valli and The Four Seasons) here in Vegas last night. One of the best shows I have seen in years. See it when it comes near you.

And if you are in Las Vegas, eat at Wolfgang Puck's new place, called Cut. One of the best pieces of steak I have inhaled in years. And now it really is time to hit the send button and go attend the conference.

Solving the Housing Crisis

Your wondering if we can actually get some action analyst,

John Mauldin