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Banking on recovery

By Peter Monroe, Special to the Times

The Public-Private Investment Programs may answer the call and remove one of the most serious obstacles to resolving the world's economic crisis.

In September 2008, then-Treasury Secretary Henry Paulson submitted a 2 ½-page presentation to Congress for a \$700 billion bank bailout. Flawed legislation was rushed through a Congress that was more focused on campaigning than governing. This bank bailout scheme, combined with the \$170 billion bailout of AIG and the \$200 billion bailout of Fannie Mae and Freddie Mac, reflected the absence of a coherent bailout program. Thankfully, the federal government has recently proposed a smarter strategy to assist the banks by creating a market for the banks' toxic assets.

From its inception, the bank bailout was intended to prop up banks by overpaying for distressed assets or injecting taxpayer capital into banks. This approach was used in Japan, and it resulted in a decade of economic decay. For months, the panicked Bush administration veered from asset purchases to capital injections. It settled on capital injections - not just into banks, as we know them, but into institutions on Wall Street such as Morgan Stanley and Goldman Sachs.

The Resolution Trust Corp. followed an entirely different course more than 20 years ago during the savings and loan crisis. The RTC closed insolvent banks, fired management, wiped out shareholders, seized bank assets, put crooks in jail and sold the assets to minimize taxpayer costs. Only federally insured depositors were "bailed out."

An alternative method of dealing with banks would be to follow the RTC model by seizing the bank and wiping out management and shareholders. Next, instead of paying off depositors and liquidating the bank, maintain deposits and careful lending. Seize the "toxic" assets and replace them with government capital. Then sell the bank to private investors in a public offering. Advocates of this approach call it "creating a bridge bank." As a scare tactic, opponents misname it "nationalization." In fact, propping up banks at the expense of the public should be called "nationalization."

With the government's new public-private "toxic asset" sales plan, I now believe that the need to use bridge banks may be greatly reduced. Making loans on the assumption that both residential and commercial assets would continue to increase forever was a key to the current crisis. Indeed, property values soared until the bubble burst in 2007. Beginning with the subprime crisis, an increasing number of borrowers failed to make their loan payments. Foreclosures ensued. Property values fell. Bank capital shrank, and lending virtually ceased. Lack of credit stalled the global economy, and we entered a recession. There was no market demand for the bank's distressed properties.

The government could not purchase the assets because there was no market to establish a price. If the government paid too little, the banks' condition would worsen. If it paid too much, taxpayers would be nailed. Paralysis ensued. The government took emergency steps to keep some critical capital flowing.

Last week, an ingenious proposal emerged from the Obama administration: If private investors pay 7 percent of the price of distressed bank assets, the federal government will match the 7 percent and the FDIC will insure a private loan for the 86 percent balance. Assets will be sold by auction - a sales process at which the FDIC excels - and which we found at the RTC Oversight Board to produce the best price in a fair and transparent manner. The FDIC will approve the companies that will manage and sell the assets - further protecting the taxpayers - and a new market will be born. The price will be market-driven as banks and investors (with government alongside the investors) compete. The lack of credit which drives down prices will be mooted when FDIC guarantees the debt. The guarantee will make credit available and also cheaper - which will in turn bring in better prices for the banks.

As a probable investor in the proposed government program, I can assure you that many other investors are looking seriously at participating - competition will not be wanting.

In similar fashion, a market for mortgage-backed securities will be created. While difficult to achieve, an active marketplace for these securities has the potential to resolve complexities that have been a root cause of the problems at AIG and financial institutions worldwide.

These two programs, known as the "Public-Private Investment Programs," could not come at a better time. The country faces a tsunami of commercial mortgages coming due that cannot be refinanced under current circumstances. Over half a trillion dollars of these mortgages are coming due in the banks - plus hundreds of billions of mortgages in mortgage-backed securities whose structures make it difficult to modify mortgages.

More than \$250 billion of commercial mortgages have loan-to-value ratios of 90 percent or more. Our lending system won't finance more than 65 percent of value. Where will the other 25 percent cash come from? The Public-Private Investment Programs may answer the call and remove one of the most serious obstacles to resolving the world's economic crisis.

Peter Monroe, who lives in the Safety Harbor, was president of the RTC Oversight Board from 1990 to 1993 and, before that, chief operating officer of the FHA. He is a lawyer, real estate broker and CEO of National Real Estate Ventures, a nationwide buyer and seller of distressed residential and commercial properties and mortgages. While a Republican until the 2008 election, Monroe backed President Barack Obama as the best candidate to deal with the economic crisis and reorder national priorities.

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