

It's All About Main Street!

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For most of this past year, economists and politicians have been quibbling over the definition of recession while our consumer-based economy has been brought to its knees by the convergence of job loss, rising energy costs, falling commodity prices and the crises in the financial and housing sectors – the perfect storm. Comparisons have been made to the Great Depression; however, I believe the Great Depression began as a cyclical downturn exacerbated by bad economic policy and a “hands off” policy by the Fed. The advice of Andrew Mellon, Treasury Secretary to Presidents Harding, Coolidge and Hoover, which led to the Great Depression – “a high cost of living will eliminate high living forcing people to work harder and live a moral life; values will be adjusted and enterprising people will pick up the wrecks ...” – seems almost quaint by today’s standards. Mellon’s advice seems sound as values will adjust, questionable assets will change hands and falling prices will, eventually, stimulate buyers’ interests. Today, unlike the “hands off” approach of the 1930’s, the Fed and the Treasury are going to great lengths to bolster the banking system.

However, from the view of Main Street, it is extremely difficult to justify the bail out of the institutions that initiated and distributed the factors of the current crisis. Even more galling is the knowledge that some individuals accumulated excessive wealth in the process.

From the banking system bail-out, came TARP (the Troubled Asset Relief Program), viewed and promoted as the plan to assist Main Street rather than Wall Street. The goal of TARP is to create liquidity and promote price discovery. Some of the funds from TARP have been distributed to local governments for direct investment into neighborhoods with high foreclosure rates – in order to purchase homes, satisfy liens, make repairs and offer the property for sale to the market. However, these funds came without regulation, oversight or mandated accountability. In the typical fashion, money is thrown at a problem without a yardstick by which to measure success—or failure. The success of any incentive under TARP will be directly dependent upon how well the purchasing process creates the asset price absent the “panic” factor; this panic factor will stem from the distrust of the asset values reflected on institutional balance sheets which, ironically, leads us back to Wall Street. Should incentives under the TARP plan work, the adjustment period to recovery, as recognized by Mellon, would be shortened and buyer interest and motivation to invest would occur sooner. Without TARP, however, the best case scenario will be a multi-year period on constrained credit availability; the worst case would be persistent capital shortages with less lending and lower prices.

In my view, the government should take an additional approach to boost the confidence of Main Street and come to the direct aid of working families. I believe attention should be given to the bankruptcy code. Presently, there is a provision in the code that prevents the bankruptcy court from adjusting mortgage payments. I recently posed this idea to an economist of a national bank whose response was “the last thing the economy needs is a bankruptcy court telling a man weighing 285 pounds that he now only weighs 185.” Paradoxically, it was the market that told the 185 pounds man that he weighed 285 and extended credit accordingly—a fundamental factor of this crisis. If individuals could regain access to bankruptcy protection, as companies can for reorganization, this would lead to sustainability and control the decrease in property values if families are kept in their homes and are, by extension, incentivized to continue to pay on the paper. Confidence would be restored more quickly. What better way to eliminate the panic factor and to realize a sustainable asset price? In this crisis, values will decrease; however, the focus needs to be on controlling the rate and extent of the decrease.

All of this will take time and, in my view, at least another year before a turn is realized. Restructuring of the financial system and new regulations will not happen until this crisis is quieted. Now that the miracle of reinventing debts into assets has imploded, the economy it once supported must change; hopefully, to a place of sustainability based upon the fundamentals we were taught.

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