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You think you own your home? Think again...

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Back in 2008, when residential real estate prices had dropped around 35-40% around the world, people were saying that Iceland was going bankrupt because of a housing crisis in southwestern United States. I thought how far-fetched that connection was, and chocked it up to newspaper headlines.

More recently, in listening to some of the senate's inquiries into Goldman Sachs, I had second thoughts about the Iceland connection. I realized I had been thinking parochially, as if houses were all about bricks and mortar, local supply and demand. What got me thinking globally more recently was the way the Goldman people talked about housing as a commodity. They talked on a totally different level, within a totally different context, as if from a different and detached world. Let me explain.

Back in our parents' generation, people bought a house for shelter, when they could afford to. It was not considered an investment, for good reasons as there was little inflation in residential property. My own parents bought a house for $30,000 in the 1950s and sold it 25 years later for $60,000. They were happy they made some money, but it never occurred to them to buy any more of these things.

Things happened over the ensuing years from the 1950s that created distortions in the normal demand and supply equilibrium in housing. First, tax deductions on residential loans against income were expanded in amount, and increased to include second homes and credit card interest. Then, as we all know, interest rates went to record lows and credit was easy to get. People bought more housing, and prices rose because, well because they could. Add on the newly created home equity loans, and people could not only have the American dream, but would also borrow an easy $100,000 on top to buy their dream car, or new kitchen, or whatever. So the house became the proverbial ATM.

Some of the low-cost financing was made available through securitization, that is packaging of loans and subsequent slicing them up into equities for people to buy in the stock market. This moved the loan itself, and some of the responsibility, out of the banks and distributed it over millions of Americans who treated their piece of the loan as stock. It could go up or down; with no guarantees, and lending and loan payback were further separated.

This leads me to the Goldman interrogation. As I listened to them talk about housing, there was a complete disconnect between the house as shelter and the money flows swirling around it. The house was simply another vehicle, another commodity, no different than oil or bananas. Bets were made. Whether the value went up or down, if the bet was right, money would be made. It therefore didn't matter when Goldman or others shorted the market, a bet that values would go down. On the surface, they all concluded that there was nothing wrong in it, since they were only trying to make predictions as everybody else in the financial world did. The Senators asked whether they were simply market makers as they claimed, or market manipulators. Either way, when Goldman acts, others listen, and mortgage markets are affected. The home owner is the last to know.

When people bet wrong on banana prices, the worse that happens is people lose some money on bananas. If you replace bananas with houses that people live in, the ramifications are so obviously different. About 70% of Americans own their own homes, and many millions of them have wrecked lives from the financial engineering that helped fuel the boom.

I am not writing this article to say Goldman did anything wrong; rather, to wonder at the process that we have created over the years. That simple house used for shelter, whose price was basically determined by how many Americans wanted it, and could afford it, has been changed. It was modified by tax strategies, lending policies, manipulated interest rates, equity loans, credit card proliferation, reverse mortgage borrowing, securitization and depersonalization of debt responsibility, and finally the synthetic CDO, which is too difficult to explain and certainly not understood by the homeowner. The homeowner is worlds apart from the real factors that influence his or her ability to buy and live in shelter. The American dream was to own a house, not to own a commodity whose value was determined, created, collapsed, and otherwise controlled by people living worlds away.

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