The Oil Drum: Canada
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

The Round-Up: April 10th 2007

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Mortgage woes could be 'tip of the iceberg'

> For some, the lesson learned is: "buyer beware." But a series of interviews with subprime borrowers, mortgage lenders, appraisers, current and former regulators, and the inspector general of the Department of Housing and Urban Development paints a different picture - of a widespread pattern of questionable lending practices and outright fraud that has already sparked a wave of criminal and civil actions against various players in the $10 trillion market for residential mortgages.
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> Questionable mortgage practices can take on many forms, but the fall into two broad categories:
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> - Predatory lending. In this case, complex mortgage terms and interest rate risks were not fully explained as required by federal law. The borrower is usually the victim.
> - Mortgage fraud. In these cases, often carried out by sophisticated swindlers, the lender is typically the victim.

Fresh concerns over US subprime sector

> Investors on Monday expressed renewed concern about trouble in the US subprime home mortgage market spreading to higher quality loans following a stark profit warning from American Home Mortgage Investment.
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> The warning from American Home, which focuses on prime- and near-prime loans, served as a reminder that mortgage delinquencies are continuing to pile up and could be spreading among less risky buyers.
>
> The absence of negative mortgage-related news has helped shares rebound from the sharp sell-off in February. But the return of troubling news on delinquencies helped damp overall investor enthusiasm for strong employment numbers released on Friday and sent mortgage-related shares lower across the board yesterday.
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> American Home cut its first-quarter profit forecast to 40 to 60 cents per share and cut its quarterly dividend from $1.12 to 70 cents. Analysts expected the company to earn $1.06 per share. The company said its results would be hurt by a lack of buyers for home loans that it pools into securities and sells to investors. American Home shares were down nearly 17 per cent to $21.51 in midday trade.

> American Home also said it was experiencing a high number of mortgage delinquencies, forcing it to increase reserves. It said a "disproportionate share" of bad loans were "Alternate A" mortgages, or those that are made under looser standards but not considered subprime, the highest risk category.

[Are property taxes in subprime soup?]

> Chriss Street thinks if you've got a mortgage from a subprime lender in deep financial trouble, and that's a good-sized bunch, you may want to gulp.
>
> The county's tax collector is concerned that some ailing lenders may be unable to get borrowers' payments to their rightful place, such as prepaid property tax payments. "This is a very serious issue," says Street, who adds the unsettling notion that property owners are still liable for a tax bill even it goes unpaid due to a lender's failure to forward your cash to the tax collector.

[The Subprime Meltdown and the Ownership Society]

> A huge percentage of the easy-money mortgages issued to low- and moderate-income families in the past few years are going bad. This has led to bankruptcies for the big lenders in this market and millions of dollars in losses. The chain of defaults has also raised concerns about the mortgage and housing market more generally, and a growing number of economists view a recession induced by a housing crash as a distinct possibility.
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> The full effects of the collapse of the subprime market remain to be seen, but it is not too early to talk about the policies that got us here. In particular, the government policy of promoting homeownership should be examined.
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> Proselytizers of homeownership can be found in both political parties. Democrats have long argued for lending policies that allow easier mortgage credit to low-income families to help remove an important obstacle to achieving financial security. Republicans tend to frame their support for homeownership as part of their drive to create an "ownership society" in which everyone owns a piece of the country and can share in its prosperity.
>
> The result has been a range of policies that promote homeownership while generally neglecting renters.
>
> While homeownership is often desirable as a means for accumulating wealth and obtaining secure housing, it will not always be a good mechanism for either.

[Defaults Rise in Next Level of Mortgages]

> Reports that Wall Street, which made millions of dollars securitizing mortgages in recent years, is becoming more wary of Alt-A by putting loans back to lenders or by bidding less for them could be an indication that default rates will worsen before they improve.
>
> The problems in subprime mortgages started late last year when big investment banks

started returning delinquent loans to lenders. Many of those lenders have since filed for bankruptcy protection.

"The credit markets were showering the mortgage market with capital, and now that's just evaporating," said Mark Zandi, chief economist at Moody's Economy.com. "The capital markets are going to exacerbate the problem, seemingly."

Until recently, mortgage companies had been able to sell loans to Wall Street banks and other investors for a premium that was big enough to cover their costs of making the loans and to make a tidy profit. The banks would then package the loans into pools to be sold as bonds to hedge funds, insurance companies and other investors.

"Now you are selling at par or lower in some instances," said Thomas M. McCarthy, a managing director at Carlton Group, a real estate investment firm that brokers the sale of mortgages. "It really throws the business upside down."

Something ugly this way comes

The US economy is in deep trouble. The US Federal Reserve is caught in a box. Bankers are one step from being snared in a quagmire, with vivid memories of the insolvent bank system endured by Japan for over a full decade. The US bank problems seem worse by comparison, when factoring in mortgages, huge spread trades sure to go bad, a mountain of credit derivatives growing at 80% annually in size, and a raft of collateralized debt obligations sitting like an ominous cloud.

Asset Inflation Nation

We're an asset inflation dependent nation that has been brought here on the horse called leverage. And over the recent past, leveraging household real estate assets has been the ticket to continued net worth acceleration and GDP growth dependent household consumption patterns. So far, its been delightful. So far, its been delovely. But up to now, let's face it, it has really been driven primarily by deleverage. So as we look ahead, it's the character of the macro credit cycle that we believe is THE most important area to monitor. If households balk at further levering their own balance sheets ahead, what happens to real estate prices? What happens to consumption? Although these sound clich at this point, with the change now occurring in the US mortgage credit markets, we believe it's of central focus. Willingness to lever has been a key aspect of the household asset inflation phenomenon for decades now, and the ripple effects of this phenomenon in terms of shaping and driving the broad US consumption based economy have been more than quite meaningful. No arguments. But the important corollary to this willingness has been the availability of credit at ever lower prices for really over two decades now. We humbly suggest that anything acting to upset this symbiotic willingness and availability relationship changes the game. And although it's more than obvious at the moment, a credit contraction in the land of widespread mortgage credit availability would do the trick in about five seconds in terms of being a marker of important change.

Here Come the Bears

"I'm very pessimistic and very convinced that there will be very hard times equal to the 1930s", said David W. Tice, perhaps the most prominent bear fund manager. This has been an incredibly long bull market, he said, one fueled by a credit-induced boom.

He describes the current problems in the subprime mortgage market as the first chink in the armor and foresees a long bear market ahead.

[Irrational Housing: Insiders out Early and The Duesenberry effect]

Markets operate under the assumption that key players act rationally in most circumstances. Their premise is such that market stability is based on people acting to a set of according rules. Much has been debated about this because economics as a science is cold and aloof; it is a matter of simply stating the facts. Yet we have learned in the recent housing mania that market psychology and behavioral economics play a large role in how people interpret risk and what constitutes an investment. As most bubbles in the past, such as John Laws Banque Gnrale and the South Sea Bubble, many bubbles burst and leap into another bubble. Why is this? The argument goes that in a bubble profit is a major driving force distorting stable growth for radical cancerous increases that are only supportable for a short time. After the glut of speculation is complete, those with a profit that cashed out on time feel the hunger for continued gains. This desire precipitates another bubble in whatever form it may be; technology stocks, real estate, commodities, or foreign investment. Either way, the pattern is such were a few successful insiders gut the system, leave burns on the psyche of a general public only to save up long enough to let the emotional scars to heal. Then they jump into the fire again with their resources ready to be distributed to those at the top again.

It is a disturbing gamblers rush to the top because those that enter a Ponzi game late will have a fate that is predestined. Those that enter the game early will have great success at the expense of those that enter late; after all what you earn is predicated on an infinite number of entrants and as a society we have finite resources and participants. Once this is realized the game is over and those left with no chair realize the music has stopped playing.

[Foreclosure's shadow falls across diverse set of US homeowners]

The explanation lies partly in the housing boom itself. As land values pushed toward record highs, many borrowers stretched against their credit limits to afford a home. Lenders, often charging lucrative fees, stood ready to help them.

By the time the housing boom peaked in 2005, fully 20 percent of new mortgage loans were subprime, four times the share a decade earlier.

[Housing Slump Pinches States in Pocketbook]

State tax revenues around the country are growing far more slowly this year and in some cases falling below projections, a result of the housing market slowdown that has curbed voracious spending on real estate, building materials, furniture and other items.

Nowhere is the downturn more apparent than in Florida, where tax revenue is projected to drop this year for the first time since the energy crisis of the 1970s.

But other states, especially those where housing prices soared in recent years, are also seeing their collections slow, especially in the sales and real estate transfer tax categories.

Market Woes Move to Alt-A

American Home Mortgage Investment Corp. (NYSE: AHM), a large Alt-A mortgage lender, said Friday afternoon that it expects lower income in the first quarter and full year 2007 than previously forecasted, due to conditions in the secondary mortgage and mortgage-backed securities markets. The announcement comes ahead of the company's first quarter results, which are set to be released April 30.

"During March, conditions in the secondary mortgage and mortgage securities markets changed sharply," said Michael Strauss, American Home's chairman and CEO.

"In particular, these markets were characterized by far few buyers offering materially lower prices, both for loan pools and for "AA", "A", "BBB" and residual mortgage securities. These changes had a significant, adverse impact on our company's first quarter results, reducing our gain on sale revenue and causing mark-to-market losses in our portfolio."

Pink slips litter loan industry

Right now, a lot of people are losing. The tumult in the sub-prime mortgage sector has hit some of the industry's employees as hard as its borrowers.

Nationwide, job losses in the category that includes mortgage lending, real estate and construction climbed 346% in the first quarter, to 21,245 from 4,764 in the same period last year, according to outplacement firm Challenger, Gray & Christmas Inc.

"It's a whole sector of the economy that's leaking," Chief Executive John A. Challenger said.

In California, the 3,679 mortgage industry jobs lost in the quarter pales compared with the 70,000 construction jobs that economists figure could disappear over the next two years. When considered individually, though, the loss of a higher-paying white-collar position can be more significant for the economy.

California foreclosure sales near $2 Billion in March

"Foreclosures sold at auction now account for 15 percent of all home sales in California and continue to rise," says Sean O'Toole, CEO and founder of Foreclosure Radar. "This isn't just a story about failing subprime lenders and their customers. At the current pace, foreclosures will be a significant part of the real estate economy. A fact which bears close scrutiny even in areas that are not yet affected."

Sub-prime crisis sours US dream

> Mike Calhoon, of the Center for Responsible Lending, says: "Almost half of all African-American family mortgages are sub-prime mortgages.
>
> "Anywhere from one in five to one in three will lose their homes. This stands to likely be the largest loss of African-American wealth that we have ever seen, wiping out a generation of home wealth building."

Are Loss Reserves Adequate in Light of Rising Delinquencies?

> While the banking industrys absolute capital levels are high, and improvements have been seen in credit card portfolios and fixed rate mortgages, these positive developments have been more than offset by sharply declining quality in adjustable-rate mortgages and other real estate loan classes, such as commercial real estate. The low delinquency and charge-off rates of the past several years may have encouraged the assumption of additional risks without additional loss provisions. Of note, loan loss reserves are down to levels not seen since 1985, while past dues are ticking upward. The historical context of past downturns in the economic cycle, as well as the forward looking credit quality indicator of 30- to 89-day past due loans for the industry, provide an interesting perspective on the adequacy of current reserve levels.

Overselling capitalism

> The crisis in subprime mortgages betrays a deeper predicament facing consumer capitalism triumphant: The "Protestant ethos" of hard work and deferred gratification has been replaced by an infantilist ethos of easy credit and impulsive consumption that puts democracy and the market system at risk.
>
> Capitalism's core virtue is that it marries altruism and self-interest. In producing goods and services that answer real consumer needs, it secures a profit for producers. Doing good for others turns out to entail doing well for yourself.
>
> Capitalism's success, however, has meant that core wants in the developed world are now mostly met and that too many goods are now chasing too few needs. Yet capitalism requires us to "need" all that it produces in order to survive. So it busies itself manufacturing needs for the wealthy while ignoring the wants of the truly needy. Global inequality means that while the wealthy have too few needs, the needy have too little wealth.
>
> Capitalism is stymied, courting long-term disaster. We still work hard, but only so that we can pay and play. In order to turn reluctant consumers with few unsatisfied core needs into permanent shoppers, producers must dumb down consumers, shape their wants, take over their life worlds, encourage impulse buying, cultivate shopoholism and invent new needs. At the same time, they empower kids as shoppers by legitimizing their unformed tastes and mercurial wants and detaching them from their gatekeeper mothers and fathers and teachers and pastors. The kids include toddlers who recognize brand logos before they can talk and commodity-minded baby Einsteins who learn to

shop before they can walk.

Consumerism needs this infantilist ethos because it favors laxity and leisure over discipline and denial, values childish impetuosity and juvenile narcissism over adult order and enlightened self-interest, and prefers consumption-directed play to spontaneous recreation. The ethos feeds a private-market logic ("What I want is what society needs!") and combats the public logic fashioned by democracy ("What society needs is what I want to want!").

Canada restakes claim to Far North with historic trek

In Canada's Far North, as melting ice has increasingly opened this frozen region to the world, the military has used these expensive public displays of ownership on a regular basis since 2002. The sovereignty operations are also used to give soldiers experience in operating in Canada's High Arctic.

Canadian Ranger spokesman Sergeant Peter Moon said that Major Bergeron's team planted a metal flag and pole on Ward Hunt Island during their gruelling trek to Alert. The island is a favoured starting point for adventurers travelling to the North Pole.

"It was put up to remind everybody travelling to the Pole that they are still in Canadian territory," he said.

Mackenzie Valley gas pipeline hits new snag

The last aboriginal holdout to the Mackenzie Valley natural gas pipeline is putting up another hurdle to its development, calling on the federal government yesterday to protect vast swaths of northern wilderness before the project can proceed.

Deh Cho First Nation Chief Herb Norwegian said Ottawa should approve the band's land use plan, which would set aside 60 per cent of its lands in the Northwest Territories as conservation areas, including national parks and wildlife areas, and open the rest for development.

"If there's no plan, there will be no pipeline," Norwegian said at a news conference with environmental leaders. "They've been dragging their heels, they just haven't moved on any issues."

Batter up! Legislators must get ready to take a swing for Alaskans

In January 2006, ConocoPhillips' chairman states to Wall Street heavy-hitters in a conference call about the company's quarterly earnings: "We want to make sure that [the Canadian MacKenzie Delta] pipeline goes before the Alaska gas pipeline. And our company, along with [ExxonMobil], are doing everything we can to make this happen."

In other words, Exxon's strategy is not just some speculative, academic exercise. ConocoPhillips and Exxon are actively implementing their strategy: trying to slow down or kill rival Alaska gas line projects by withholding Alaska North Slope gas.

Canada one of the fortunate countries, according to damning climate change report

> Burton, scientist emeritus with Environment Canada one of the lead authors of the report, is one of many looking for "enlightened" leadership and action from Ottawa.
>
> "Let's not just talk about it, let's put a game plan in place," said Duane Smith, Canadian president of the Inuit Circumpolar Conference, which represents 150,000 Inuit in the Arctic. He said he welcomes today's report that will highlight the Arctic as one of fastest warming and changing regions on the planet.

Will snow cover become a thing of Canada's past?

> By 2050, snowmobiling could be history in Eastern Canada, a quaint winter pastime from the days of yore. It will be just too warm to have reliable snow.
>
> People who like skiing in Banff on real snow better get on the slopes now and enjoy it while they can. The ski season could become truncated, perhaps by as much as 14 weeks a year at higher elevations.
>
> And consumers with a soft spot for California wine would also be advised to sip favourites now: the state could become too hot to support current crop yields.
>
> Those are just a few of the many forecasts contained in the latest report on the impacts of global warming from the Intergovernmental Panel on Climate Change (IPCC), a UN-sponsored body that set more than 1,000 of the world's top scientists to work on what will happen as the planet warms.

Alien Invasion: The Fungus That Came to Canada

> All would become pieces of a medical mystery centered on a tropical disease apparently brought to North America by a warming climate. An alien fungus took root on Vancouver Island eight years ago and has since killed eight people and infected at least 163 others, as well as many animals.
>
> Similar cases have been found elsewhere in British Columbia and in Washington state and Oregon. Scientists say the fungus may be thriving because of a string of unusually warm summers here. They say it is a sign of things to come.
>
> "As climate change happens, new ecological niches will become available to organisms, and we will see this kind of thing happen again," said Karen Bartlett, a scientist at the University of British Columbia who played a central role in the search for the disease's cause.
>
> Her investigation eventually would focus on a fungus, a member of the yeast family called Cryptococcus gattii. The microscopic fungus is normally found in the bark of eucalyptus trees in Australia and other tropical zones.

Dire warming report too soft, scientists say

> Despite its harsh vision, the report was quickly criticized by some scientists who said its findings were watered down at the last minute by governments seeking to deflect calls for action.
>
> "The science got hijacked by the political bureaucrats at the late stage of the game," said John Walsh, a climate expert at the University of Alaska Fairbanks who helped write a chapter on the polar regions.
>
> Even in its softened form, the report outlined devastating effects that will strike all regions of the world and all levels of society. Those without resources to adapt to the changes will suffer the most, according to the study from the U.N.'s Intergovernmental Panel on Climate Change.
>
> "It's the poorest of the poor in the world, and this includes poor people even in prosperous societies, who are going to be the worst hit," said Rajendra Pachauri, chairman of the IPCC, which released the report in Brussels.

Welcome to Mediterranean Scotland in 5 years' time?

> While the international community readies itself for gradual global warming over the next century, a growing number of scientists are beginning to worry that climate change might come much sooner - and be much more catastrophic - than previously thought.
>
> They point out that, in the past, climate change has not been gradual. Europe's climate has switched from arctic to tropical in three to five years and, they warn, it can happen again.
>
> Fred Pearce, of the New Scientist, has spent the past two years speaking to climate experts who are studying the possibility of "type 2" climate change - abrupt, catastrophic and irreversible. He will present his findings as part of the Edinburgh International Science Festival today.
>
> The scientists of the Intergovernmental Panel on Climate Change (IPCC), which will present a long-awaited report into the slow but serious effects of global warming tomorrow, have focused on "type 1" predictions based on already observable warming patterns.
>
> But many climate experts say this method of modelling ignores the possibility of "tipping points" at which the climate suddenly spirals out of control.
>
> "The IPCC is a very conservative body. It assumes that global warming will follow an already observable pattern - that it will be a straight line on a graph," Mr Pearce said. "But there are many scientists who are increasingly worried about a sudden and catastrophic acceleration that could happen at any time."
>
> Sudden "type 2" climate change will happen through a series of "positive feedback" cycles, in which each stage of warming sets off another, like cascading dominoes.

Turning Farming on its Ear

> The ethanol boom is Iowa is akin to the oil boom in Alberta, and is dramatically altering the farm economy of the Midwest. To a lesser extent, the boom is also being felt in Canada, where corn farmers in Ontario and Quebec see a new and growing market for their products.
>
> In Iowa, plants are sprouting up like corn stalks in a hot summer. Mr. Williams has two ethanol plants within 50 kilometres of his farm, with two more under construction. If all the ethanol plants planned for Iowa are built, they would consume the equivalent of last year's entire corn crop in the state.
>
> Like Albertans who see an overheating economy with their oil boom, Iowans worry about the huge increase of trucks on their roads, about the refineries' voracious appetite for water leading to the depletion of ground water, about an influx of out-of-state workers, and about the overall upheaval in their traditional farm economies.
>
> Mr. Williams has spent his career selling to the local elevators, which have marketed the corn to poultry farms in Arkansas and pig farms in Oklahoma. With four ethanol plants nearby, he expects he'll sell his crop directly to the fuel producers, as will many of his neighbours.
>
> "We're starting to hear some genuine distress from poultry and swine producers," he said. Some are actually cutting back production because feed costs are so high.
>
> "This whole ethanol boom has just turned everything on its ear in agriculture," said Mike Duffy, an agricultural economist at Iowa State University. He said the state's agricultural economy is essentially being transformed into an industrial one. "What I liken it to is a giant gong and somebody has whacked the gong with a giant hammer, and it's reverberating and where it's going to end up, we don't know."

Whatever happened to oil sands takeovers?

> According to industry observers, the low level of activity is because oil sands resources are too expensive, forcing foreign operators to invest elsewhere.
>
> "There's a huge markup for what people want for their [oil sands] assets," said Glenn MacNeill, vice-president of investments for Toronto-based Sentry Select Capital Corp. "Some deals proposed to the marketplace haven't been very well received as they're far too expensive. There's been no value in them."

Shell's presence in Canada a shadow of former self

> When Shell Canada Ltd. leaves the public realm later this year, it will mark the end of a long history in Canada.
>
> With all but one per cent of Shell's shares now in the hands of its Anglo-Dutch parent Royal Dutch Shell, transition plans are already underway.

Broken budget promises could hurt Tories: Calvert

Newfoundland Premier Danny Williams has taken out national newspaper ads slamming the government and has criticizing the budget in numerous interviews, calling on Newfoundlanders to vote against the Tories in the next election.

During an appearance on CTV's Question Period on Sunday, Calvert said he's equally angry, claiming Prime Minister Stephen Harper simply didn't keep his promise to fully exclude non-renewable natural resources from the formula used to calculate equalization payments to the provinces.

Harper's promise, made during the last election, would have meant hundreds of millions more in funding for the Saskatchewan.

Instead, the Conservatives' allowed for the option of removing resource revenues, but capped the amount of money paid out to provinces under the equalization program.

The Rock's latest firebrand

In the past year, Danny Williams has managed to aggravate forestry firms, infuriate energy companies eager to sink billions into drilling off Newfoundland's coast, tick off the province's hospitality industry and openly call for the defeat of the federal government. And Newfoundlanders adore him for it.

To many Canadians outside of Newfoundland, the province's Premier, with his blustery, combative style, comes off as a five-foot-nine scrapper with six-foot chip on his shoulder -- especially given his no-holds-barred attack on Prime Minister Stephen Harper over the federal budget, which the Premier has said "shafted" the province of billions in handouts. The Progressive Conservative Premier has urged Newfoundlanders to eject the Tories in the next federal election. "The quicker this government could be out of office would make me very happy," he said on Tuesday.

The comment surprised pundits for its bald-faced effrontery. But to those inside the province, Mr. Williams is the latest and greatest inheritor of a long tradition of leaders with a reputation for recalcitrance.

Auditor blasts costly Ontario nuclear deal

Electricity generated by refurbished reactors at a privately operated nuclear station will cost hydro consumers in Ontario 44 per cent more than the going market rate as a result of the government's failure to drive the best deal possible, the province's auditor says.

Auditor-General Jim McCarter said in a report released yesterday he recognizes that the province was not in a strong bargaining position when it cut the 2005 deal with Bruce Power, the privately owned consortium that operates the nuclear station on Lake Huron.

As a result, his report suggests, the government made too many financial concessions at the expense of electricity consumers.

> The government will pay Bruce Power 7.1 cents a kilowatt hour for electricity produced from reactors the company plans to refurbish. This is significantly higher than the average market price of 4.9 cents consumers have paid over the past five years and experts' projections of future prices, the report says.