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Viewpoint

Credit crisis' far reach hits Florida's state-run funds

FLORIDA'S LOCAL GOVERNMENT Investment Pool owns more than \$2B in debt tainted by subprimes



RACHEL BECK

IF YOU THINK the credit crisis is someone else's problem, just look at what is going on in Florida—where plenty of people seemingly far removed from the financial turmoil have been hard hit by its impact.

Nothing illustrates that more than the decision by officials in Jefferson County, a mostly rural slice of the state's northern panhandle, to not pay electric, food and gas bills so that its teachers wouldn't have to miss a paycheck.

That \$500,000 in bill juggling was needed because the supposedly conservative state-run investment pool that minded the district's money temporarily shut off access to the funds after it made some extremely bad bets on its mortgage-related investment choices.

This mess in Florida may only be the tip of the iceberg, and could rob Christmas for many unknowing Americans.

"Contagion affects the innocent," notes David Kotok, chief investment officer at the portfolio management firm Cumberland Advisors in Vineland, N.J. "What is happening here is the outcome of dysfunctional credit markets."

For the first half of this year, there was some hope that the mortgage meltdown would be contained to a limited number of defaults on home loans and a temporary pullback in new home construction.

Then this summer, lending standards for mortgages to corporate borrowing began to tighten, and trading in the riskiest corners of the credit markets became paralyzed. That sent stocks plunging from record highs as worries mounted over the extent of this

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ZACHARY D. PORTER/DAILY REPORT

Economist Donald Ratajczak said he was aware of subprime loans but didn't understand the severity of losses.

Economist: Keep expectations low over the next six months

DONALD RATAJCZAK says a recession isn't on the horizon, but 'it will be very close.' Home construction slowdown in Atlanta will help.

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ECONOMIST DONALD RATAJCZAK said Monday that Americans should expect another six months of economic problems before improvement.

"I don't think we are going to have a recession, but it will be very close," said Ratajczak, the former longtime head of Georgia State University's Economic Forecasting Center and a consulting economist for Morgan Keegan.

Ratajczak's gave his economic outlook before a few hundred developers and real estate experts during The Council for Quality Growth Annual Meeting at the Atlanta Marriott in Duluth.

Ratajczak blamed the mortgage crisis for the economy's shape, comparing the housing market and real estate in general to the technology boom and bust of the late 1990s.

"Housing is still going to be a [burden] on this economy," said Ratajczak, who also spoke about the state's water crisis, oil, employment and interest rate cuts.

Abuse of mortgage underwriting that took place in 2005, 2006 and early 2007 and overbuilt supply contributed to the current plight, he said. For example, he said 96 percent of all mortgages given out in California in early 2006 didn't have proper documentation.

"We put people in homes that they didn't have a right to be in," Ratajczak said.

Ratajczak said economists knew something was wrong at the beginning of 2006 when they saw the figures for 2005, which showed that about 2.1 million homes were built versus the expected 1.7 million to 1.8 million. He said the extra 300,000 to 400,000 homes were built on a speculative basis.

The rate at which home values accelerated past the inflation rate also signaled disaster was on the horizon. Over a 100-year period, inflation and home valuation were about even, he said. But over the past three years, home valuation accelerated three times the rate of inflation. Nationwide, the median home price in 2005 rose 13.8 percent, compared to 7.8 percent in Atlanta, he said.

Ratajczak acknowledged that he had not expected as big an adjustment in housing.

"I didn't understand all of the severity of all the losses in the syndicated loans," Ratajczak said. He added that he knew about the subprime loans but didn't know about the contamination of AA loans, or high quality credit loans. He said half of the \$300 billion to \$400 billion in subprime loan losses will be from investors outside the United States.

"We sold it really well," Ratajczak joked.

A recent slowdown in residential development will help address the oversupply issue, he said, noting that building permit applications in metro Atlanta were 48 percent lower than they were a year ago. He said he expected the decrease to continue.

Ratajczak also expressed little faith in the forecast the National Association of Realtors released Monday that stated home sales would be up in 2007 and 2008.

"They are sellers. . . . That's not going to happen. Why? They have to climb a big hole to get to this year's average," Ratajczak said.

Although his speech was primarily a tongue lashing to the mortgage lenders and developers, he said real estate still is a relatively good investment.

"Housing is a good advantage, but it's because of the tax advantage of the home," said Ratajczak. He warned that anyone whose home value grows faster than inflation should worry about a correction.

Ratajczak predicted the Federal Reserve would lower interest rates a quarter of 1 percent today and could say that if turmoil persists, it would be ready to do more, signaling another quarter percent drop at the end of January.

Ratajczak said he didn't have a solution to the water crisis but urged Georgians, Floridians and Alabamans to take it seriously.

"I want South Alabama to stop watering their lawns. Everybody in the Chattahoochee has to abide by the same rules," said Ratajczak, who also suggested adopting alternative water sources such as digging wells and piping water in from other water sources. "I want these

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60 seconds

UBS writes down \$10B from subprime losses

Swiss banking giant UBS AG said Monday it will write off a further \$10 billion on losses in the U.S. subprime lending market and will raise capital by selling substantial stakes to Singapore and an unnamed investor in the Middle East.

UBS will now record a loss for the fourth quarter and said "it is now possible that UBS will record a net loss attributable to shareholders for the full year 2007."

UBS said that the government of Singapore Investment Corp., or GIC, is investing 11 billion francs (\$9.75 billion), while an undisclosed strategic investor in the Middle East is contributing the other 2 billion francs (\$1.77 billion).

As recently as the middle of November, UBS had predicted a profit for the fourth quarter despite ongoing speculation about its subprime holdings.

"Conditions in the U.S. mortgage and housing markets have continued to deteriorate, and we have updated our loss assumptions to the levels implied by the current distressed market for mortgage securities," the company's chief executive, Marcel Rohner, said in a statement.

"In our judgment these write-downs will create maximum clarity on this issue and will have the effect of substantially eliminating speculation," he added.

"UBS revises its outlook for its fourth quarter 2007 from an overall Group profit, as anticipated in its announcement of 30 October 2007, to a loss. It is now possible that UBS will record a net loss attributable to shareholders for the full year 2007."

In October the bank downgraded the value of some assets by over 4 billion francs (\$3.4 billion) because of losses linked to the U.S. mortgage crisis.

The writedown meant UBS posted a net loss of 830 million francs (\$712 million) in the period ending Sept. 30, the first quarter in nine years in which it suffered an operating loss.

Tony Tan, deputy chairman of GIC, said the 9 percent stake does not mean Singapore is seeking control of the Swiss bank.

"GIC is now the single largest investor in UBS and this is the largest investment GIC has made in any company," Tan said during news conference in Singapore. "We did not make it a condition that our investment should have a representation (on UBS's board.) We have no desire to control the business of the bank."

—The Associated Press

Credit crisis' far reach hits Florida's state-run funds

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credit-market turmoil.

Those most affected by all this have seemed to be the financial institutions that had packaged the subprime loans into complex securities. The value of such debt suddenly plunged, leaving them with big losses on their books.

Many of these so-called safe investment funds were chasing higher yields, and were willing to ignore the risks to get them. Now it looks like many of us may get stuck with the bill.

This mess is getting bigger and broader, however. The subprime woes are fanning out to people and places that never saw them coming.

Enter Florida. A state-run cash-management fund, which held public money from school districts and local governments, was thought to be highly liquid and safe—as recently as mid-November, when its admin-

istrators said that there was minimum risk due to the credit-market turmoil.

Things didn't stay rosy for long. It turns out that Florida's Local Government Investment Pool owns more than \$2 billion in downgraded and defaulted debt tainted by the subprime mortgage collapse.

Its asset-backed commercial paper holdings, which carried top ratings from Standard & Poor's, Moody's Investors Service and Fitch Ratings as recently as August, was downgraded after there were declines in the value of its collateral.

Word of such illiquid investments spooked the funds' investors in recent weeks, setting off a multibillion dollar run that depleted the pool's assets from \$27 billion to \$14 billion in no time. To control the chaos, state officials suspended withdrawals, leaving many locales scrambling to pay their bills.

Hal Wilson, chief financial officer of the Jefferson County school district, said that with its \$4.1 million in the fund frozen, he had to decide whether to pay 220 teachers or to put off many of the district's vendors, who he noted "have families they have to feed, too."

Those in Florida got a bit of relief when top state officials allowed local governments to make limited withdrawals starting Thursday. More than \$1.1 billion was retrieved from the fund.

Florida officials also decided this week to quarantine the worrisome investments in

Economist: Keep expectations low over the next six months

Ratajczak, from page 6
people to worry about water."

Throughout his presentation, Ratajczak reiterated that the first half of 2008 will be a testing time when the economy is going to grow slowly and employers will either wait it out or start to dump people onto the unemployment lines.

Around the country, a few industries such as transportation, manufacturing, bank-

a separate fund and the head of the agency responsible for the fund stepped down, too.

Wilson still has worries, though. On Thursday, he withdrew the \$2 million maximum that can be taken out of the fund without penalty to cover the immediate needs for his district, but remains concerned about being able to pay the schools' bills. Due on Dec. 20 is a 5 percent pay raise for teachers, retroactive to July, that his district had negotiated earlier this year.

Florida isn't alone. In Montana, Connecticut and Maine, there are concerns over the debt exposure of state-run funds. And across the world in Norway, four remote towns lost millions of dollars due to their complex debt investments.

Standard & Poor's maintains ratings on 75 local government investment pools in 26 states, not including Florida. Of that total, 17 have investments in asset-backed commercial paper and nine have exposure to structured investment vehicles—two areas that have been badly battered by the subprime meltdown.

Many of these so-called safe investment funds were chasing higher yields, and were willing to ignore the risks to get them. Now it looks like many of us may get stuck with the bill. ☞

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ing and homebuilding already are seeing job cuts. Other industries that are more hopeful are legal, accounting, consultant, leisure, health, export manufacturing, some retailing and some wholesale, he said. Metro Atlanta's employment outlook has the same pattern, but slightly better, he added. ☞

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