



Catch the Interest-Rate Wave at the Summit

By Steven S. Ross ■ *Editor-in-Chief*

Does the real estate crisis have you gloomy? What does it mean for the business cases evolving for bringing fiber to the home, especially to new homes? And will it really continue?

The Short Answers

- Fiber becomes even more important to builders and developers seeking to differentiate their offerings in a weak market. The cost of fiber in new builds is so trivially low compared to the advantage in selling price and time-to-sale that they barely need discussion. More than ever before, the very customers who are most creditworthy (young professionals and young seniors on the verge of retirement) are the most likely to demand broadband access.
- MDUs become more attractive targets for network builders. Single-family developers are stretching out the amount of time they need to sell new subdivisions. This makes it harder for greenfield network builders to subsist while customer bases build. But many MDUs – certainly high-rises – traditionally build out faster. This should continue as retirees boost that segment.
- Network operators need to go way beyond the triple- and quadruple-play. Right now, video can pay the bills. And there's credible evidence (see this month's First Mile) that "TV-style" video has at least a near-term future. But multiple niche products will shore up the business case and help with housing sales in the first place.
- Money to finance network builds becomes harder to get. There's a national credit crunch. But will it continue?

Subprime: The Inside Look

The subprime mortgage mess is causing a great deal of the market stress. It is easy to

dismiss the problem – after all, only about 5 percent of all mortgages issued over the boom were subprime – but there's a domino effect. To understand why, one has to understand what makes a mortgage "subprime," and understand how defaults in that market affect property speculators, even conservative speculators.

Remember What Makes a Mortgage Subprime

1. Low or zero down payment. If you haven't accumulated capital, you are a risk. And if the value of the property declines, you are an even greater risk because you might walk away and because you have no wiggle room – no cushion. Remember, you were broke to begin with.
2. Low payments at the start of the mortgage. Typically these mortgages are interest-only for a few years, and ARM for lowest rates. So value amortization would occur only if prices rise. And higher interest rates can sink you.

But the default rate even on these mortgages is unlikely to climb to more than 10 percent – perhaps a half-percent of all mortgages issued, and certainly less than a half-percent of the *value* of all residential mortgages issued. And what if it grows to 1 or 2 percent? What's the big deal, you might ask?

The press has tagged the banks as villains, but for the most part the banks' models correctly identified the risk in terms of the *borrowers*. They seriously underestimated the risk in terms of number of speculative buyers who never intended to live in a new home, however. And investors in the mortgage-backed bonds that eventually get sold to finance the lending are even more removed from market smarts. Even most banks don't have much experience with new houses, which account for only 2 percent of supply and 10 to 15 percent of sales.

But a buyer moving into a new house triggers an existing-home sale – actually, several. The housing economists *were* saying that between 15 and 20 percent of new home sales were to speculative property-flippers, and if that were actually the case, the models would work. But speculation, fueled by low interest rates and credit to *creditworthy* borrowers, was actually two or three times higher than what the marketplace detected.

Why? In part because most regions had a big backlog in registering mortgages and deeds. The public sector clerks were overwhelmed by the buying boom combined with the mortgage refinancing boom.

Now the long-term conventional mortgages that the speculators took out are in deep water. Speculators – even creditworthy, conservative speculators – have defaulted because their houses have declined in value by more than the amount of their small down payments. Facing a long time to a price turnaround, they are walking away from properties. The more subprime defaults, the longer the downturn – and the more speculators are drawn into the vortex.

So far, the Federal Reserve has been sitting on the fence, but an interest-rate cut is in the cards. There's a risk – less money will come in from overseas – but the move should keep more speculators from defaulting, and should cut the cost of network builds.

That, combined with the advantage of FTTH in a weak market, should give us a big push. Catch the wave in Dallas September 10-12 at our Broadband Summit. **BBP**

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