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Karl Denninger
314 Olde Post Road
Niceville, FL 32578

From the Desk of Karl Denninger

August 24, 2007

The Honorable Chris Dodd
United States Senate
448 Russell Building
Washington DC 20510
FAX: 202-224-1083

Dear Sir :

I have sent you a few faxes over the last couple of weeks regarding the Mortgage Mess, and have committed the sin of opposing proposals without putting forward a concrete, constructive alternative.

This letter is intended to fix that omission, because **I believe there is a reasonable and minimalist proposal to solve the problem for most homeowners, while not letting those who inappropriately took risk off the hook.**

Specifically, I call on you to put forward, promote, and work to pass **one** reform to the Bankruptcy Law, which as you know was recently amended to benefit creditors.

The change, which would serve to fix a huge amount of the mortgage and housing mess, is simple:

1. Mortgage debt acquired as an original, owner-occupied purchase-money mortgage, irrespective of size or type, is 100% dischargeable in a personal bankruptcy petition. This provision would not apply to mortgage debt acquired via a HELOC, Refinance, or for any property that is not owner-occupied. Do whatever is necessary so that the risk of a 1099 for taxes on the deficiency disappears as well.

This would instantly solve the problem for homeowners caught in this mess. It would also allow the housing market to correct back to historical valuation norms, that is, the level of 2.5-3x annual income. Finally, it would allocate the actual losses in this mess, which will be very large **no matter what is or is not done**, to where they belong – *to the speculators, investment banks and other “paper purchasers” (e.g. CDO buyers) who inappropriately took on risk.*

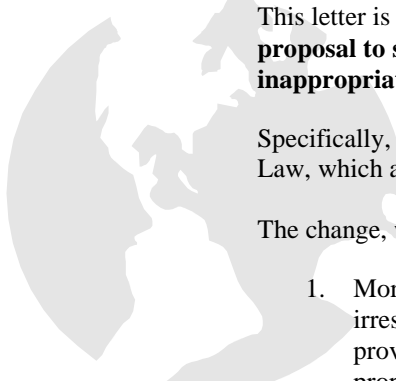
Once home prices correct to 2.5-3x income, those people can buy their homes back at the **appropriate** value with a safe, sound, **affordable** and secure 30 year fixed mortgage.

The **fundamental** problem here Mr. Dodd is not that money has gotten “too hard to get.” It is that **inappropriately priced risk fueled a speculative feeding frenzy which led to home prices rising to totally unaffordable – and unsustainable – levels.**

There is only one fix that does not destroy our economy or serve as a “bailout” for those who took on that risk – home prices must come down.

Given this, the question then becomes “how do we allocate the losses which will **inevitably** result from such a re-pricing of assets?”

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We do not wish to allocate those losses to those who did not deserve it – those who legitimately got trapped in unaffordable mortgages through no fault of their own; those who were pursuing the American Dream of home ownership, not speculating on increases in house prices, just as people speculate on the increase in stock prices.

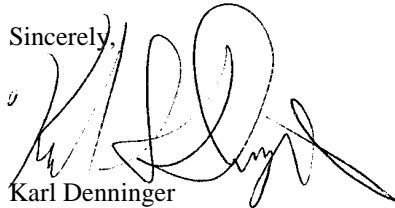
The above change in bankruptcy laws would precisely target the desired goal and allocate the damage to those who attempted to profit by blowing that bubble in the first place.

If Congress attempts to **avoid** the re-pricing of risk and asset values, what is almost certain to happen instead is that we will either enter a deflationary spiral (reference: Japan, who tried to hide this same sort of mess in their real estate market) or worse, a hyperinflationary spiral where debt will essentially be inflated away – but gasoline will be \$10/gallon and milk \$10/gallon as well.

The latter will destroy the middle class in this country, as they simply cannot afford those sorts of inflationary pressures – yet they are **unavoidable** if Congress or the Fed attempts to monetize the debt.

I ask that you give serious consideration to this approach in addressing the housing crisis, as it will provide targeted relief where it belongs – with those who were unreasonably taken advantage of by “Animal Instincts” on Wall Street and in the Mortgage Industry, while leaving exposed those who *should* be exposed to the costs of their own speculative excess.

Sincerely,

A handwritten signature in black ink, appearing to read 'Karl Denninger', with a large, stylized initial 'K' and 'D'.

Karl Denninger