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THE HOUSING MARKET CRASH OF 2007 AND WHAT CAUSED THE CRASH

Posted on [December 18, 2011](#) by [Thomas DeGrace](#)



The **Housing Market Crash of 2007** was the worst housing crash in U.S. history. The Housing Market Crash of 2007 was the cause of the financial crisis. This nearly caused the U.S. to experience another depression like the Great Depression. There are a number of things we can look at to determine how the housing bubble occurred and what happened to cause the bubble to collapse.

The Housing Bubble

The housing market experienced modest but steady growth from the period of 1995 to 1999. When the stock market crashed in 2000, there was a shift in dollars going away from the stock market into housing. To further fuel the housing bubble there was plenty of cheap money available for new loans in the wake of the economic recession. The federal reserve and banks praised the housing market for helping to create wealth and provide a secured asset that people could borrow money to help the economy grow. There was a lot of financial innovation at the time which included all sorts of new lending types such as interest adjustable loans, interest only loans and zero down loans. As people saw housing prices going up, they were stepping over each other to buy to get in on the action. Some were flipping homes in an effort to take advantage of market conditions. If you understand fractional banking, you would know that with a 10% reserve requirement, in theory it would mean that 10 times that money can be created for each dollar. With 0% down needed to buy new homes, an unlimited supply of money could be created. With each loan, banks would quickly securitize the loan and pass the risk off to someone else. Ratings agencies put AAA ratings on these loans that made them highly desirable to foreign investors and pension funds. The total amount of derivatives held by the financial institutions exploded and the total % cash reserves grew smaller and smaller. In large areas of CA and FL there were multiple years of prices going up 20% per year. Some markets like Las Vegas saw the housing market climb up 40% in just one year. In California, over ½ of the new loans were interest only or negative-amortization. From 2003 to 2007 the amount of subprime loans had increased a whopping 292% from 332 billion to 1.3 trillion.

The Beginning of the Crash

The housing market peaked somewhere in 2006. We were beginning to see some of the early signs of trouble when some types of subprime loans started to go into default. There wasn't worry at that time since never in history have prices for housing market gone down nationally. Once the credit markets froze in the summer 2007, things began to deteriorate rapidly. Subprime credit stopped completely and interest rates for credit for other types of borrowing including corporate loans as well as consumer loans rose dramatically.

Timeline of Events for 2007

February: Freddie Mac announced that they were no longer buying the most risky subprime.

April: Subprime lender New Century Financial Corporation files for bankruptcy.

June: Bear Stearns announced a loan of 3.2 billion dollars to help bailout one of its funds that invested in collateralized debt obligations (CDOs).

July: The stock market hit a new all-high over 14,000. On July 31, Bear Stearns liquidates two of its mortgage-back security hedge funds

August: A worldwide credit crunch had begun and there were no subprime loans available. Subprime lender American Home Mortgage files for bankruptcy. This marked the start of the **housing market crash**

September: The Libor rate rises to its highest level since December of 1998, at 6.8%.

December: The stock market finishes the year at 13,264.

Timeline of Events for 2008

January 11: Bank of America acquired Countrywide financial for 4.1 billion dollars. Countrywide had a total of 1.5 trillion dollars worth of loans.

March 16: Bear Stearns on the verge of bankruptcy signs a merger agreement with J.P. Morgan to sell itself for \$2 a share which was fraction of the current trading price.

May 19: The markets had its final day above 13,000 closing at 13028.

September 6: The treasury announced a takeover of both Fannie Mae and Freddie Mac that had over 5 trillion dollars in mortgages.

September 14: Bank of America signs a deal to acquire Merrill Lynch.

September 15: Lehman Brothers files for bankruptcy. The Dow drops 400 points closing at 10,917

September 17: The federal reserves lends \$85 billion dollars to American International Group (AIG).

September 18: Fed Chairman Ben Bernanke and Treasury Secretary meet with congress to propose a \$700 billion dollar bailout. Bernanke tells congress "If we don't do this, we may not have an economy on Monday."

September 26: Federal regulators seize Washington Mutual and then strike a deal to sell most of to J.P. Morgan for 1.9 billion dollars. This represents the largest bank failure in U.S. history.

September 29: Congress votes down the \$700 billion bailout plan. That same day Citigroup acquires Wachovia.

October 1: The Senate passes the \$700 billion bailout bill.

October 3: The house passes the \$700 billion bailout plan and the president signs it into law.

October 6: The fed announces that it will provide \$900 billion in short-term loans to banks. The Dow closes below 10,000.

October 7: The fed announced that it will lend around 1.3 trillion dollars directly to companies outside the banking sector.

October 10: The Dow closes at 8451, the stock market has had its worst week ever losing 22% over the past 8 trading days or 8.4 trillion dollars from the market highs in 2007.

October 14: The Treasury taps \$250 billion of the bailout fund and uses the money to shore up the nations top banks.

December 31: There were over 3 million foreclosures by this year. Florida, Arizona and California had rates of 4% with Nevada at 7.3%

The aftermath

Even though the financial crisis was resolved by start of 2009 the housing market continued to decline throughout 2009. There were over 3 million foreclosure filings for 2009. Unemployment rose to over 10% and the housing market crash created the worst recession since the early 1980's. By the 4th quarter of 2009 the U.S. has experienced significant GDP growth and corporate earnings had increased by over 100%. The Unemployment Rate had stabilized towards the end of 2009. By 2010 housing prices still haven't gone up and we are still working through a surplus of housing inventory.

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calvin says:

September 8, 2012 at 2:56 pm

Greed and only greed caused the crashes. Investing is the attempt to make a financial killing, in other words, bigger profits and less work. Why else would anyone with their head on straight want to make a profit on the backs of