Business Briefs

Taxhavens

Britain Declares Its Offshore Status

Anxious to get a substantial chunk of carbon trading by hedge funds, Britain is advertising its "offshore" status, according to the London *Financial Times.* British Chancellor of the Exchequer Gordon Brown on March 21 gave carbon trading by hedge funds the official British blessing—a Treasury rule exempting them from taxes! Carbon credits held by funds in offshore centers will now be treated as exempt from any tax on profits.

To keep all their "profits" from so-called carbon trading, hedge funds had been having to figure out ways to get around the tax—how very wearying. Now they can legally enjoy the usual UK offshore tax evasion. "It is hugely beneficial because it [no taxes on profits] is going to bring a lot of liquidity," said Ernst and Young Accounting partner Julian Young. "It is clearly a good thing for climate trading and a good thing for fund managers."

Man Group immediately formed a "Green Man Group" announced by outgoing CEO Stanley Fink: "While the science of global warming is quite scary, there are opportunities there." GLG Partners launched another hedge fund "to buy and dispose of carbon credits." How? RAB Capital's Special Situations hedge fund bought 2.25 million acres of Ethiopian forest "on which it hopes to generate carbon credits."

Deregulation

Electricity Free Market Hit as Illegal

Attorneys General from four states argued in court that electricity deregulation is illegal, according to a *Baltimore Sun* article on March 27. Marjorie Kelly and Richard Rosen, both from the Tellus Institute, report on the lawsuit which will be argued in Federal appeals court against the radical dereg Federal Energy Regulatory Commission (FERC), which has been destroying Franklin Roosevelt's Federal Power Act utility regulation, over the past 20 years. The authors point out that this is a "broader stealth attack on the New Deal, and it is part of a larger attempt to have markets take over critical public services, such as water, education, and electricity."

Consumers whose utilities have been deregulated, paid 55% more for electricity than those in regulated states last year, they report. The lawsuits assert that the 1935 Federal Power Act required the government to see that rates are "just and reasonable." FERC has done only the bidding of the Enrons and other power pirates. The states in the suit are Rhode Island, New Mexico, Colorado, and Utah. They could soon be joined by Maryland, Connecticut, and Delaware, where rates will zoom up, as soon as rate caps expire. Former FERC staffer Lynn Hargis, now an energy attorney, remarked: "The last time we relied on the market to set electricity prices, it was the Great Depression."

Economy

U.S. Income Disparity Exceeds 1928 Levels

According to the March 29 *New York Times,* Prof. Emmanuel Saez, UC Berkeley, and Thomas Piketty of the Paris School of Economics, concluded that while total reported income in the U.S.A. increased almost 9% in 2005, the most recent year for which data is available, average incomes for those in the bottom 90% fell by $172, or 0.6%. Yet the incomes of the top 1%, rose to an average of more than $1.1 million each, an increase of more than $139,000, or about 14 %.

The income of the top 300,000 was equal to that of the combined lowest 150 million Americans, and on average 440 times as great per person. The income of the top 10% was 49% of all income in 2005, the greatest since 1928, when it was likewise 49%. The top 1% got 22% of all income in 2005, the highest share since 1928, when they got 24%. The income of the top one-tenth of 1%, and of the top one one-hundredth of 1%, each grew by about 20% over one single year in 2005: up $908,000 to $5.6 million for the first group, and up $4.4 million to $25.7 million for the second group.

The IRS admits that its income data, which were used in the study, markedly understate larger incomes.

Property Speculation

French Housing Bubble Is Set To Burst

Ambrose Evans-Pritchard wrote in the March 28 British *Telegraph* that "French property construction plummeted 15.1% in February and home prices have begun to slip." French house prices had grown 210% since 1995, compared with 190% in the United States. Last year, it slowed to 7.2% and in January became negative: -0.6%. Jean-Paul Six, chief economist for Standard & Poor's, said that this is "the delayed effect of rising interest rates." Spain is also vulnerable, with more than 93% of mortgages on floating rates. "It is worse than in the United States," said Manuel Romera, director of Instituto de la Impresa in Madrid.

France's mortgages are mostly on fixed rates and there is no sub-prime market. However, according to OFCE research institute, house prices are 25% overvalued. In Italy, house prices have increased 92% in ten years, and last February, for the first time, the number of cities with declining prices was more than those with increasing prices, according to *L'Espresso* March 28.

Securities

Sub-Prime Securities Worst in U.S. History

Sub-prime mortgage-backed securities sold in 2006 may be the "worst-performing in recent history," says Standard & Poor's, with delinquencies on the underlying loans "consistently higher" than in the prior five years, according to Bloomberg March 28. Some 13% of sub-prime mortgage loans made in 2006 are delinquent, according to S&P, with 6.65% of the total classified as "seriously delinquent," or more than 90 days late. S&P raised its estimate for losses on bonds backed by the loans to as high as 7.75% from a previous peak assumption of about 6.5%.

S&P said this revision could have a "material" impact on the ratings of collateralized debt obligations (CDOs), or securities consisting of slices of other higher-rated mortgage bonds. Residential mortgage bonds represented a whopping average of 73.8% of CDOs of asset-backed securities collateralized by so-called mezzanine structured finance tranches in 2006, up from 42% in 2003.

Hedge Funds

Does *Financial Times* See Hedge Fund Collapse?

The London Financial Services Agency was expected to open investment in hedge funds to the general public on March 27. In the March 27 *Financial Times* there is a very cautiously worded look at what the opening of the hedge fund market to investors means. The recent IPOs of Fortune and Blackstone should "tell us something," says author Roger Ehrenberg. The IPOs will generate a ton of cash for the funds, but these funds are not like cash-starved tech start-ups of the IT bubble; they are supposedly already swimming in cash.

"This is a classic case of too much liquidity chasing too few opportunities," says Ehrenberg. "When debt investors wake up to the fact that they are systematically underpricing risk, the highly leveraged deal structures simply will not work."

He indicates that KKR, Texas Pacific Group, and Apollo are also considering going public. Why? "They see the private equity bubble and want to extract value before it pops."

Financial Markets

U.S. Housing Collapse Is Contagious

The housing collapse is "a train wreck in slow motion . . . accelerating and turning into a contagion," according to *Barron's Weekly,* March 26, which ran two interviews with insiders, each warning about spreading collapse created by the falling housing market. Robert Shiller, author of *Irrational Exuberance,* published in March 2000 at the beginning of the IT crash, has added new chapters to the latest editions of the book, and is now forecasting a similar fate for the housing market. Shiller has tracked home selling prices over years, and compared them to construction prices, as a baseline. He sees a collapse of prices of 20-30%, spread over the next 10 years. The second interview is not quite as optimistic. According to insider fund manager Sy Jacobs, "the problems in subprime are not self-contained. It is a pinprick to a larger problem. . . . Subprime will bring down mortgage lending, housing and in turn, the economy and the market."

In the meantime, Jacobs, who manages a $45 million fund, has found ways to game the market, not only by short selling subprime lenders, but most recently, short selling credit-ratings agencies, themselves major beneficiaries of the CDO (collateralized debt obligations) market, as well.

Corporate Fraud

U.S. Homebuilder Hit by FBI Probe

Beazer Homes USA, Inc., the sixth-largest U.S. homebuilder, has been hit by an FBI probe. Beazer has been asked by U.S. attorneys for documents on its mortgage business. Beazer, a Fortune 500 company with assets of $4.5 billion and revenues of $5.5 billion in 2006, saw its stock fall 9% on March 28, and another 8% in after-hours trading, according to the *Financial Times* March 28. It had already suffered hefty losses in the fourth quarter of 2006.

Beazer said it believed the U.S. Attorney's request was triggered by articles published in the *Charlotte Observer,* which detailed allegations of questionable loans Beazer arranged for low-income buyers, and unusually high foreclosure rates in Beazer's subdivisions in the area of Charlotte, North Carolina. These foreclosures rates have averaged 13% since 2000.

"The FBI is conducting a potential fraud investigation regarding Beazer," the FBI said in a statement. distributed by its Charlotte, North Carolina, field office March 27. The investigation is being conducted jointly with the Department of Housing and Urban Development and the Internal Revenue Service.

Briefly

FREDDIE MAC reported losses of $480 million in the Fourth Quarter of 2006, as against a profit of $684 million in the same quarter of 2005. The loss was caused by the fall in value of its derivatives amidst a collapsing housing market.

ARE CLIMATE CHANGE derivatives coming next? This is not a joke. Just this month a climate-change risk-assessment service called Climate Appraisal Services was set up to rate the risk of sea level rise caused by climate change to home and business owners. The risk-assessment service will use the Intergovernmental Panel on Climate Change's computer models and data as the basis for the risk assessment.

SUBPRIME AUTO loans begin to go bad. Oregon's CNW Research estimates that issuance of such loans rose from $6 billion in 1999, to $11.6 billion in 2006, and that a total of about $34 billion is now outstanding. As a percentage of all autos made each year, they rose from 9.4% in 1999, to 13% in 2006. Some lenders, like Wells Fargo, are trying to cut back, while others are issuing more such risky auto loans to replace lost business in real-estate mortgages.

THE HEDGE FUND bubble grew, and concentrated, during 2006. A London group, Hedge Fund Intelligence, put out a report March 30 saying that total hedge fund assets grew 30% to $2.08 trillion in 2006. But the increase in the number of hedge funds was 800 (1,500 launched and 700 went under), a growth of less than 10%. Hedge funds are getting much bigger, and the bubble is concentrating; about 350 hedge funds and "funds of hedge funds" control more than 75% of the whole $2-plus trillion market.

"GREENPEACE FOUNDER defends peaceful use of nuclear energy," read a recent story in *Folha de São Paulo,* quoting Patrick Moore. Moore is also quoted in Channel 4's "The Great Global Warning Swindle."