Housing: Washington Only Delaying Inevitable

Friday's announcement of more intervention in the housing mortgage market will result in a deeper, longer, and more painful delay in the inevitable decline in housing prices that are necessary to clear the market. According to the Obama administration, the "broad new initiatives" will help troubled homeowners to refinance their existing mortgages with more favorable affordable ones provided directly by the government. Part of the new program is "meant to temporarily reduce the payments of [those] borrowers who are unemployed [but are] seeking a job." In addition, the enhancements include inducements to "encourage lenders to write down the value of loans [already] held by borrowers in modification programs."

In simple English, HAMP (the Home Affordable Modification Program), announced with great fanfare and high expectations early on in the Obama administration, isn't working, and so more of the same is required. The original intent of HAMP was to "better assist responsible homeowners who have been [negatively] affected by the economic crisis through no fault of their own … and to help more people who owe more on their mortgage than their home is worth."

Despite claims from the Treasury Department that "more than four million homeowners have refinanced their mortgages to more affordable levels…[and] more than one million are saving … over $500 per month through the … program," the program "continue[s] to see challenges." And so, the new program enhancements "will provide more opportunities for lenders to restructure loans for some families."

So far, HAMP's list of attempts to prop up the mortgage market include:

• support for Fannie Mae and Freddie Mac so they can continue to offer below market interest rate loans;

• support for the mortgage market by buying more than $1.4 Trillion in existing toxic mortgages;

• providing additional federal funds for mortgages that the private lenders aren't willing to provide because of excessive risk;

• pressuring lenders a "modification initiative" to reduce payments from borrowers to "affordable levels" so that they don't walk away;

• expanding the guarantees on home loans from $625,000 per loan to $729,750 per loan;

• pressuring lenders to provide "expanded refinancing flexibilities," particularly "for borrowers with negative equity";

• another "initiative" to state and local housing finance agencies to "provide sustainable homeownership and rental resources for American families";

• the First Time Homebuyer Tax Credit;

• providing $5 Billion "in support of affordable rental housing; and

• creating the Hardest Hit Fund for housing finance agencies to support homeowners in "neighborhoods hardest hit by concentrated foreclosures."

So far, fewer than 200,000 people have been able to get permanent new loans out of the approximately seven million borrowers who are in trouble and behind on their payments. In the fourth quarter of 2009, the number of households at least 90 days past due on their mortgages grew by 270,000, and the number of foreclosures in the fourth quarter rose by 9 percent. And that number didn't count nearly 40,000 owners who did a short sale on their home (where the lender agreed to accept less than what it was owed on the original mortgage).

The latest survey by Campbell/Inside Mortgage Finance showed that nearly half of all home purchases in February were "distressed properties" (involving homes that were acquired as part of either a foreclosure or a pre-foreclosure sale), an increase from 37 percent in November. That report stated,

> Increased government efforts, including temporary foreclosure moratoriums and a push to qualify more financially troubled homeowners for mortgage modifications, temporarily reduced the number of distressed properties coming on the housing market in the fall and much of this past winter. But now a growing number of distressed properties appear to be hitting the housing market.
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> As more distressed properties have come onto the market, home prices are again showing signs of weakness. Average home prices for all four categories of properties–damaged REO, move-in ready REO, short sales, and non-distressed–declined from January to February in the latest survey.

All that HAMP did was to delay these foreclosures from coming onto the market in a timely manner until now. And with the expiration of the First Time Homebuyer Tax Credit of $8,000 at the end of April, that temporary acceleration of future sales into the present will cease.

In addition, more homeowners are opting for "strategic defaults." The *Los Angeles Times* tells the story of Wynn Block. A 66-year-old retired psychologist, she purchased a two-bedroom home in 2006 for $385,000. The market value of her home today is "in the low-$200,000s." She said, "There was not a chance that house was ever going to be worth anywhere near what my mortgage was, " so she elected to walk away."

Credit bureau Experian and a consulting firm, Oliver Wyman, estimated in a study that nearly one out of every five homeowners who were seriously delinquent on the mortgages in the last quarter of 2008 walked away. Luigi Zingales at the University of Chicago estimated that 35 percent of defaults last December were "strategic defaults." He added, "The fact that people are strategically defaulting…the risk that the number of people doing this might explode is significant."

Gary North makes the excellent point that when someone walks away from a mortgage and the house is ultimately sold, the market price drags down the prices of the other homes in the neighborhood, thereby increasing the chances of other walkaways as well.

Finally, there is the "overhang" of potential resets of Alt-A and Option ARM mortgages in 2011 and 2012, which will add additional pressure on prices.

Mark Calabria, director of financial regulation at the Cato Institute, says "it was government, mostly Washington, which got us into this mess in the first place. Decades of subsidies for the housing industry have resulted in … leaving the nation with a massive inventory of vacant homes." He points out that, "In a nation of 130 million homes, we have almost 19 million that are vacant." And nearly seven million of those aren't even on the market, waiting for the "market to turn" before being listed for sale. In any event, Calabria says, "Our housing markets are facing a problem of way too much [emphasis added] housing." But Washington's attempts to support the housing market is based on the belief "that getting construction going will reduce unemployment."

Ultimately, home sales and consequently home construction will not be determined by expensive, wasteful, and interventionist policies, but "by family incomes and basic demographics." Efforts such as HAMP and additional enhancements announced on Friday are simply "government pretending these fundamentals don't matter." He concludes that "when you're in a hole, [the best thing to do is to] stop digging. In the case of housing, as a country, we built too much. The cure is to build less." The only way for markets to clear, he says, is to allow supply and demand to even out, and for that to happen, prices must fall further.

All of these federal interventions are foolishness and expensive failed experiments based on false economic theories that will do nothing but extend the time, and the pain, until market prices fall enough to bring buyers back into the market. Politicians' continued denial of reality through intervention will only delay the inevitable.