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Obama's Christmas in August? Really?



James Pethokoukis [writes on Reuters today](#) (h/t: [Instapundit](#)) that the Obama Administration may be planning to eliminate many/most/all underwater mortgages in a single swoop:

Rumors are running wild from Washington to Wall Street that the **Obama administration is about to order government-controlled lenders Fannie Mae and Freddie Mac to forgive a portion of the mortgage debt of millions of Americans who owe more than what their homes are worth.** An estimated 15 million U.S. mortgages – one in five – are underwater with negative equity of some \$800 billion. (Emphasis mine)

If this does come to pass, the mind simply boggles at the thought.

The underwater mortgages would become Federal government debt practically overnight. It might be time to think about not paying your mortgage....

How Would This Even Work?

Presumably, the way it would work is for Fannie & Freddie to do a one-time reset of all of the mortgages in their portfolios to some sort of “appraised value” based on homeowner request, which would include some sort of appraisal conducted at the homeowner’s request. If Fannie/Freddie then approves the “reset”, there would be some sort of a purchase of the full mortgage contract from the bank who “owns” the mortgage, then a write-down by Fannie/Freddie of the value. The Fed would supply Fannie/Freddie with the money to stay solvent while taking these massive write-downs.

So let’s say you’ve got a \$500K mortgage on a house whose value has dropped to \$350K. The bank who wrote the mortgage may have packaged it into some MBS with various streams of payments due the bondholders. You now make an application to have your mortgage reduced; you get an appraiser to come in, look at the house, and issue an appraisal of \$350K. If approved, then presumably, Fannie would reduce the stream of payments it was due from the bank to the \$350K principal level, and write down the resulting loss on its books.

Then again, if there are multiple different bondholders... Fannie might have to pay those people off to buy their payment streams in discounted present value basis.

Maybe if the loan is still on the bank’s books, Fannie would simply purchase it for the face amount, then take the loss directly, and send it to whichever servicing company Fannie uses to handle collections and payment processing.

The whole thing would take some time, I think, but all underwater mortgages would become “overwater” mortgages overnight. At the cost of some \$800 billion, of course.

Plus, there are a host of unanswered questions — which is inevitable given that we’re talking about a rumor here. But I wonder.... If after a homeowner receives this “mortgage reset”, house prices rise, and he ends up selling for a profit... would he have to pay that back to the Fed, or is that his to keep? Would only primary houses be eligible, or investment property as well? Would the loan have to be delinquent to be considered, or would there be relief for homeowners who have kept current, despite being underwater? Would second or third mortgages or even refis be eligible, or only the primary mortgage?

Argh, so many questions without answers....

Is This Good or Bad for Real Estate?

Many taxpayers would be understandably irate if such a thing were to come to pass. As Pethokoukis notes:

The political calculation is that the number of grateful Americans would be greater than those offended that they — and their children and their grandchildren — would be paying for someone else’s mortgage woes.

But leave the political realities for other blogs to cover in greater depth. What about for the real estate industry? Would such a “loan forgiveness” program be good or bad for real estate?

Presumably, short sales would disappear, since no house would actually be underwater anymore. Foreclosures are likely to come to a halt or a near-halt; why foreclose, when you the bank might recover the full value of the mortgage from the Feds? Would prices recover? Since the principal reduction would have to go hand-in-hand with a new appraised value of some sort, if anything, wouldn't that create a "new normal" for the pricing for housing in a given area?

Would banks relax their lending standards, knowing that Fed would bail them out if the loan goes underwater? Even if this "reset" is sold as a once-in-a-lifetime thing, wouldn't bankers be justified in believing that a precedent has been set? Units might go up if true, but that almost suggests that we'll have another bubble in real estate in a few year's time, no? Or have things changed sufficiently now?

Boy... I really haven't a clue as to whether this sort of a bailout-for-homeowners would be a good thing or a bad thing.

As Pethkoukis says, August 17th is a key date, as that is when the Treasury will hold a hearing on the future of Fannie and Freddie. Keep an eye on Washington; these be interesting times we live in.

Your thoughts on either the mechanics of how such a thing might work, or the desirability/undesirability of the "bailout"?

-rsh