Insight

Administration Misfires Cost Taxpayers, Failed to Fix Housing

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More than five years after the recession ended, housing markets across the country remain stubbornly feeble. Despite this reality, recently characterized by Federal Reserve Vice Chairman Stanley Fischer as the “unusual weakness of the housing sector during the recovery period,” administration officials continue to rely on their patchwork of inefficient initiatives to singularly address that weakness and assist struggling borrowers. Yet from staggering burdens imposed on financial institutions by the Dodd-Frank Act to redefaults in the Home Affordable Modification Program (HAMP), government policies intended to help housing recover have too often insidiously held it back and cost taxpayers billions.

Take the Home Affordable Refinance Program (HARP) for example. Federal Housing Finance Agency (FHFA) Director Mel Watt traveled to Atlanta last week to encourage local residents to take advantage of HARP, following his most recent outreach effort in Chicago. By FHFA’s estimate, these metros include many of the 810,069 borrowers across the country still eligible to participate. With the jump in interest rates last year and expectation of further increases coming, the window of opportunity to refinance and reap the most significant savings possible has likely closed for most already. Ongoing outreach appears to be a last-ditch effort for a program that has been plagued by endless repetition of trial and error, not unlike others under the umbrella of the Making Home Affordable (MHA) initiative.

Yet HARP (or whichever version of HARP is currently operating) has performed far better than HAMP, which received yet another extension in June. The program will now operate through 2016, a full 10 years after the housing bubble burst, despite new HAMP modification trials falling in the second quarter of 2014 to their lowest level since the program began in 2009. Originally slated to end last year, HAMP makes generous incentive payments (partly funded by taxpayers through TARP with the rest covered by Fannie Mae and Freddie Mac) to encourage the renegotiation of residential mortgages with terms that bring payments to a more affordable level for struggling borrowers. The program has fallen far short of helping the 3-4 million borrowers projected, while costing taxpayers billions.

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In its most recent report to Congress, the Special Inspector General of TARP (SIGTARP) noted that 1.3 million HAMP trial modifications were converted to permanent modifications after meeting program requirements. Of those 1.3 million modifications, 392,501 borrowers subsequently fell behind on payments and redefaulted out of the program (See Figure 1). 217,098 of those redefaulted modifications had been funded through TARP, directly costing taxpayers $1.3 billion or almost $6,000 per modification on average. Another 90,687 borrowers of the remaining 903,231 active permanent modifications have missed one or two months of payments and are considered at risk of redefaulting, potentially costing taxpayers another $543 million if further redefaults cost similarly.

And that’s not all. The way HAMP was designed, rates and monthly payments were lowered for a period of five years but scheduled to rise slowly for three years thereafter. As such, payment increases begin this year for the first HAMP modifications in 2009. Overall, 88 percent of all borrowers receiving a HAMP modification will ultimately be subject to increased payments over the coming years, which may cause a spike in redefault rates. In fact, the likelihood of redefault already increases with time; the oldest HAMP modifications currently have a redefault rate of 51.7 percent.

Foreclosure mitigation programs, like HAMP, are only successful insofar as they allow borrowers to afford their mortgage payments sustainably over the long term. HAMP perfectly illustrates how even well intentioned initiatives can backfire. With a significant portion of the program participants redefaulting and possibly entering foreclosure, some local communities have been prevented from rebounding more quickly. Furthermore, HAMP modifications and subsequent redefaults are concentrated in states that were already hardest hit by the foreclosure crisis, including Florida, California, and Illinois which alone are responsible for one-third of HAMP redefaults.

In his speech, Vice Chair Fischer identified two headwinds to the rebound of housing: the large inventory of distressed properties and tight credit conditions for construction loans and mortgages. On both counts, this administration shot itself in the foot. Unsuccessful programs like HAMP have likely prevented some markets from recovering more quickly by extending the time it has taken to clear distressed properties from the market. Similarly, states with judicial foreclosures have had slower recoveries for that very reason. On the second count, it is only recently that the administration has expressed a more serious interest in bringing back private-label securitization. The Dodd-Frank Act and the failure to tackle housing finance reform or make it a priority have increased uncertainty in the market and directly contributed to the climate of tight credit.

Instead of adopting pro-growth policies like tax simplification or immigration reform that could have uniformly lifted housing markets through stronger job and wage growth, the administration’s legacy on the housing recovery is defined by its focus on proposing, altering, and re-proposing a variety of housing market fixes that have ultimately fallen short. A winning agenda moving forward would include a more forceful push to build a safer housing finance system with clear rules and policies dedicated to stronger job and wage growth, which would more uniformly help borrowers still struggling and give families the incomes needed to buy homes.