

House of Representatives passes Democratic home mortgage bill backed by the Fed and banking industry

Barry Grey
9 May 2008

The House of Representatives on Thursday passed a bill that provides limited relief to a fraction of the millions of homeowners who are unable to meet their mortgage payments, while enabling mortgage companies and banks to offload failing loans to the federal government.

The bill passed by a vote of 266 to 154, with 39 Republicans joining with all but six House Democrats to support the measure. President Bush on Wednesday announced that, should a similar measure be passed by the Senate, he would veto the bill. The upper legislative chamber is scheduled to consider its version of the bill next week.

The House bill, authored by Massachusetts Representative Barney Frank, the chairman of the House Financial Services Committee, is carefully tailored to marginally reduce the flood of home loan defaults and foreclosures, at a minimal cost to the government, so as to stabilize the housing market and stem the losses suffered by banks and financial institutions from the collapse of subprime mortgage-backed securities.

The main provision of the House bill calls for the Federal Housing Administration (FHA) to guarantee up to \$300 billion in refinanced home loans. Home owners with subprime and adjustable rate mortgages, who demonstrated their ability to pay off a refinanced loan, would have the principle on their loans reduced and the debt converted to a thirty-year, fix-rate mortgage, resulting in lower monthly payments.

Home owners who received refinanced mortgages and subsequently sold their homes would be forced, under the plan, to pay the government a portion of the profit, if any, they made from the sale.

The plan is entirely voluntary, i.e., banks and mortgage lenders would have the option to accept a reduction in the principal on troubled loans in return for a federal guarantee on the refinanced mortgages. Any losses from defaulted FHA-backed loans would be borne by the federal government, not the banks or mortgage lenders.

No bank or mortgage lender would be required to participate in the plan, and the financial firms would decide which, if any, loans they refinanced in return for a government guarantee against losses. As a result, mortgage companies and banks that

decide to participate will “cherry pick” the loans they refinance, choosing from among the loans which qualify under the terms of the bill only those they believe most likely to default.

A major goal of the plan is to reduce the rising number of homes that are “underwater”—worth less on the market than the outstanding debt owed to the mortgage provider. Estimates of the current number of such home-owning families in the US vary between 4 million (roughly one in 12 families with mortgages) and 10 million. With home prices expected to fall another 15 percent over the next two years, Moody’s Economy.com predicts that by early 2009 nearly one in four, or 12 million, homeowners will be underwater.

It is generally believed that the credit squeeze and resulting banking crisis can be overcome only if and when the housing market stabilizes and home prices stop falling.

Congressman Frank had said his bill would provide relief to between 1.5 million and 2 million distressed home owners over the next five years. However, the Congressional Budget Office (CBO) last week released an estimate that concluded the measure would help a maximum of 500,000 home owners. With 1.5 million families already in foreclosure as of January, and another 2.8 million likely to face foreclosure over the next four years, according to the CBO, the House bill stands to help only 8.6 percent of foreclosure victims.

It does nothing to help those who have already had their homes foreclosed, or block banks and mortgage lenders from carrying out new foreclosures. Last week, RealtyTrac, a firm that tracks defaults and foreclosures, reported that foreclosure filings rose by more than 112 percent in the first three months of 2008 over last year. Lenders are currently filing foreclosure proceedings against more than 7,000 home owners a day.

The CBO explained that of the 9 million home owners who hold subprime or other high-interest mortgages, “most would not be refinanced under the proposed program.” Some 40 percent, it noted, have second liens on their homes, and the holders of these loans are unlikely to agree to forgive a portion of the debt. Other borrowers will not be aware of the program, and still others will be unable to afford even a cheaper loan

because of “a significant event, such as job loss, illness, divorce or death.”

Of the approximately 1.4 million remaining subprime borrowers, according to the CBO, less than 40 percent are likely to find their primary lenders willing to participate in the plan.

For these reasons, the CBO estimated that the actual cost of the program—resulting from defaults of FHA-backed refinanced loans—would amount only to \$2.7 billion over the next five years. This is less than the amount spent on the Iraq war every 15 days, and a billion dollars less than the 2007 earnings of the top hedge fund manager in the US.

Congressional Democrats did not dispute the CBO’s findings. Steven Admamske, a spokesman for Rep. Frank, called the CBO estimate “very good news.” During the debate on the House floor Thursday, Frank defended his bill on the basis of the 500,000 figure.

Banking industry associations are generally supporting the bill, because it is entirely voluntary, gives banks the option to offload bad loans to the government, and does not prevent banks from foreclosing on home owners or impose other restrictions.

The bill also includes a provision barring lawsuits against certain mortgage servicers.

In a speech Monday at Columbia University in New York, Federal Reserve Board Chairman Ben Bernanke tacitly endorsed the Democratic measure, saying “the best solution” for home owners whose mortgage debt is greater than the value of their home “may be” a modification of the loan to make it more affordable, “perhaps combined with a refinancing by the Federal Housing Administration or another lender.”

Frank sought to win the support of the Bush administration by including in the bill several measures promoted by the White House, including tighter regulation of the government-chartered mortgage finance companies Fannie Mae and Freddie Mac, an overhaul of the FHA and an expansion of the cap on mortgage revenue bonds issued by states and localities.

However, Treasury Secretary Henry Paulson, after some wavering, said Wednesday he opposed the bill on the grounds that it is “too prescriptive and goes too far in terms of shifting risk from lenders to taxpayers.” He added that the Bush administration did not want to impede a “necessary correction” in house prices.

Bush, after meeting with Republican legislators Wednesday, said he was opposed to the bill because it would “reward speculators and lenders.” He said he would “veto the bill that’s moving through the House today if it makes it to my desk.”

This supposed aversion to “rewarding speculators” comes from an administration that helped broker the rescue of Bear Stearns in March with \$29 billion in guarantees from the Fed and has worked with the Fed to pump close to \$1 trillion into the financial markets and provide backing for a half-a-trillion dollars in mortgage-backed securities held by Wall Street banks

and finance houses whose value has plummeted since the collapse of the housing market.

The administration’s programs to deal with the housing crisis, all based on voluntary agreements with major Wall Street firms and mortgage lenders and servicers, have to date aided a derisory number of homeowners. One program, called FHA Secure, has, according to some estimates, helped a total of 2,000 home owners. Another, called the Hope Now Alliance, has secured loan modifications for 179,500 borrowers.

When the Bush administration speaks of speculators, it includes the millions of home owners who were victimized by predatory lenders, who pushed subprime adjustable rate mortgages on unsophisticated home buyers with the assurance that home prices would continue to rise and the buyers would be able to refinance out of their high-interest rate loans before their mortgages reset to even higher monthly payments.

As the Treasury Department argued in a recent power point presentation, “Home owners who can afford their mortgage but walk away because they are underwater are merely speculators.”

There are indications that, despite Bush’s veto pledge, the administration is looking to negotiate a deal with the Democrats that would provide even more sweeteners for the banks and mortgage companies. Keith Hennessey, director of the White House National Economic Council, said Wednesday that differences between congressional Democrats and the White House were not “insurmountable.” Hennessey, according to the *Wall Street Journal*, “expressed interest in finding a way for the White House to get more involved in negotiations as the debate advances.”

The *Journal* reported that the White House wants “greater flexibility” for the FHA and lenders than that provided in the House bill. Specifically, it wants to give the FHA “the ability to charge higher premiums for higher-risk deals—for instance, those involving home owners with low credit scores.”



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