How to Boost the Economy by Helping Homeowners

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The disappointing May jobs report raises the question: what's slamming the brakes on economic recovery? For one answer, look to the sector where the economic crisis started in the first place – housing. U.S. housing markets are still broken, and we can't expect a full recovery until they are fixed.

That's why Congress and the administration should act promptly to pass a major home refinancing initiative. Taking advantage of historically low interest rates, it would reduce mortgage payments and give millions of middle class families more money to spend. The idea is to stimulate economic demand while helping responsible homeowners hold onto their homes.

With 33 percent of homeowners still underwater[1] (meaning they owe more than their house is worth), a massive wave of refinancing would allow borrowers who are current on their mortgages to lower their mortgage rate. Cutting their payments by thousands of dollars a year would help them pay down debt and put money back into the economy. The good news is that the benefits far outweigh any small costs the programs would incur. A bill that would allow 12 million borrowers with GSE loans to refinance would provide $2,600 in annual savings to these households. Approximately $1.83 ***trillion*** in refinanced mortgages would lower American mortgage payments by $31 billion a year. The GSEs would even see between $11 to $18 billion in new revenues from upfront costs.[2]

Congress has been offered a raft of proposals that would streamline the process of refinancing home loans for a number of borrowers. These bills are aimed at loans backed by government guarantees from Fannie Mae and Freddie Mac, the mortgage giants currently in conservatorship by the Federal Government. By virtue of having bailed Fannie and Freddie out, taxpayers already "own" the risk of default on these loans. Why not allow refinancing that would reduce the number of home foreclosures?

Negative equity isn't the only problem. Many borrowers are making less than they were in the boom years or have sustained damage to their credit, making refinancing in a very tight credit market impossible.

Critics of government-backed refinancing, such as The Cato Institute, claim that lower payments will delay paying back mortgage investors and banks, making them poorer with less to spend. They also contend that many bondholders, whose investors include pensions and 401(k)s as well as wealthy investors, will take a hit because their bonds will be repaid faster than expected.[3]

In a well-functioning market, low interest rates like we have been seeing would normally induce massive refinancing, and investors would have already seen their pre-pay speeds at significantly higher rates, so they are in effect, "playing with house money."

Even Mitt Romney, the GOP Presidential nominee, endorsed refinancing saying "I think the idea of helping people refinance homes to stay in them is one that's worth further consideration." (After he infamously told the Las Vegas Journal Review last October that the government should not try and prevent foreclosures and "Let it run its course and hit bottom.")[4]

A proposal cosponsored by Sens. Robert Menendez (D-NJ) and Barbara Boxer (D-Calif.) would expand on the current HARP program to allow more GSE guaranteed loans the right to streamline refinancing. Sen. Jeff Merkley (D-Ore.) has offered a bill that requires GSEs to pay closing costs if borrowers take on a 20-year or less mortgage, allowing borrowers to pay down their mortgage and build equity more quickly. Another bill by Sen. Dianne Feinstein (D-Calif.) would allow non-GSE borrowers to refinance into FHA loans.

Several bills on the Senate floor offer straightforward and reasonable ways to get a more solid floor under home prices, which will begin to mitigate further defaults and boost economic confidence among millions of middle class households. These bills complement each other nicely, and Sens. Menendez and Boxer would do well to embrace Sen. Merkley's idea as a friendly amendment to their bill.

Refinancing would likely be a political winner as well. Consider the potential impact in the 16 battleground states comprising PPI's "Battleground Home Values Index" of loans that would qualify for refinancing under the Boxer-Menendez bill.

The following chart, based off work done by Alan Boyce, R. Glenn Hubbard, Christopher Mayer, and James Witkin shows the number of mortgages that might be eligible in each battleground state for a bill such as Menendez-Boxer.[5] The chart also takes into account the average savings per potential eligible household and totals the dollar impact annually to each state. Not coincidentally, some of the most coveted electoral votes in November's presidential election will come from states that would gain the most from significant refinancing efforts. Florida, Pennsylvania, Virginia, and Ohio come in first, second, third and sixth, respectively.

Mortgages Eligible For Government Refinancing in 2012 Battleground States

State	Annual Interest Savings (Millions of Dollars)	Number of Eligible Mortgages	Average Savings per Refi
Arizona	$937.23	318,378	$2,944
Colorado	$851.65	253,639	$3,358
Florida	$2,975.08	980,316	$3,035
Indiana	$582.25	253,294	$2,299
Iowa	$235.96	100,805	$2,341
Michigan	$1,165.95	458,550	$2,543
Minnesota	$884.17	277,725	$3,184
Missouri	$630.18	247,220	$2,549
Nevada	$378.08	119,284	$3,170
New Hampshire	$231.20	67,227	$3,439
New Mexico	$240.84	83,128	$2,897
North Carolina	$1,070.07	368,962	$2,900
Ohio	$1,027.48	427,650	$2,403
Pennsylvania	$1,365.09	469,712	$2,906
Virginia	$1,265.88	346,507	$3,653
Wisconsin	$504.45	171,875	$2,935
Total	**$14,345.56**	**4,372,255**	

Source: Alan Boyce, Glenn Hubbard, Chris Mayer and James Witkin, "Estimated Benefits From Refinancing by State and Congressional Districts," Columbia Business School.

With fixed rates at generational lows (under 4 percent), Congress has a huge opportunity to throw a lifeline to responsible homeowners who have kept paying their mortgage. In fact, there isn't one member of Congress who doesn't have thousands of constituents who stand to benefit from this approach. The housing crisis spills across America's blue-red political map, sparing no region or state. It's a national problem that demands national responses, including a refinancing initiative. Nonetheless, the problem is especially acute in many of the swing states that many analysts believe will decide the 2012 election.

In the chart below, look at the 10 congressional districts with the most mortgages eligible for refinancing in 2012 battleground states.

Congressional Districts With Largest Number of Mortgages Eligible for Government Refinancing

Congressional District	Representative Name	Party	Annual Interest Savings (Millions of Dollars)	Number of Eligible Mortgages	Average Savings Per Refi
FL-14	Mack, Connie	R	$172.84	54,347	$3,251
AZ-2	Franks, Trent	R	$142.80	54,304	$2,756
FL-15	Posey, Bill	R	$148.38	51,986	$2,977
AZ-8	Vacant?	D	$147.57	50,981	$2,892
FL- 24	Adams, Sandy	R	$146.49	48,795	$3,148
FL- 7	Mica, John	R	$149.07	48,720	$3,174
MN-2	Kline, John	R	$170.94	47,094	$3,419
MI- 10	Miller, Candice	R	$131.80	46,972	$2,891
NV- 3	Heck, Joe	R	$151.75	46,969	$3,390
NC- 9	Myrick, Sue	R	$147.01	45,729	$3,082
			$1,508.65	495,897	

Source: Alan Boyce, Glenn Hubbard, Chris Mayer and James Witkin, "Estimated Benefits From Refinancing by State and Congressional Districts," Columbia Business School.

Interestingly enough, most of these seats are represented by Republicans. These legislators have a choice: either take an ideological hard line against government “bailouts” for homeowners, or work with Democrats to make housing relief a rare bipartisan success story in this election year.

Endnotes

1 James Bianco "Underwater Homes," , The Big Picture, entry posted May 30, 2012, http://www.ritholtz.com/blog/2012/05/underwater-homes (accessed June 12, 2012).

2 Alan Boyce, Glenn Hubbard, Chris Mayer, and James Witkin, "Streamlined Refinancing for Up To 12 Million Borrowers", Columbia Business School, http://www4.gsb.columbia.edu/null/?&exclusive=filemgr.download&file_id=7220514.

3 Mark A. Calabria, "Taxpayers Shouldn't Have to Pay for Underwater Mortgages," The Cato Institute, entry posted February 6, 2012, http://www.cato.org/publications/commentary/taxpayers-shouldnt-have-pay-underwater-mortgages (accessed June 12, 2012).

4 Jon Ralston, "Housing may be pyramid scheme that gets Heck." The Las Vegas Sun, http://www.lasvegassun.com/news/2012/feb/24/housing-may-be-pyramid-scheme-gets-heck, February 24, 2012.

5 Boyce, Hubbard, Mayer, and Witkin, "Streamlined Refinancings for up to 12 Million Borrowers."

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