OpenMarket.com

Obama Administration Crafting Yet Another Bailout: Speculators and McMansion Owners May Benefit

by Hans Bader on July 26, 2011 · 0 comments

in Bailout Watch, Economy, Legal, Property Rights

As if America didn't already have enough bailouts, the Obama administration is planned yet another — one that could enrich "McMansion homeowners and property speculators."

As Philip van Doorn notes at *The Street*,

A report on Wednesday that the U.S. Treasury is considering "a plan that could help 1 million or more homeowners avoid foreclosure," leaves some very disturbing questions unanswered. First and foremost: Why should taxpayers bailout McMansion homeowners and property speculators? According to *Bloomberg*, the proposal is "aimed at promoting modifications of delinquent or defaulted home loans, including writedowns of principal" for "mortgages that are bundled into mortgage-backed securities not issued by government agencies." . . .According to the report, the plan would address the difficulty in writing down the principal balances of the "nonconforming," privately securitized mortgages because "writedowns can't happen under the covenants governing such securities." Private-label notes represent about 20% "of the $6.8 trillion in mortgage-backed securities outstanding."

Supposedly, the plan

won't cost the Treasury a thing, while obviously forcing investors to take it on the chin. The securitized private-label mortgages didn't conform to Fannie and Freddie guidelines for a variety of reasons. Some are "jumbo loans," with initial balances exceeding the agencies' limit. Others are loans with small initial down payments or other higher-risk "features" that caused the government-sponsored enterprises to stay away. Finally, many of the private-label securitized mortgage loans were collateralized by investment properties or second homes.

If the Treasury indeed announces this plan, while touting its aim of "helping families," it will be very interesting to see if the families being helped include speculators, wealthy borrowers and those who enjoy a vacation homes in the Hamptons. Of course, if the government places, as President Obama put it, "some pressure" on banks to facilitate writedowns on the private-label mortgages, the banks — especially Bank of America (BAC_) — are likely to suffer as well, possibly beyond their current expectations.

Earlier, Associate Attorney General Tom Perrelli and state attorney generals demanded that banks reduce the mortgages of certain favored underwater borrowers (many of whom are underwater because they didn't make a substantial downpayment, the way thrifty people do), using the banks' unrelated foreclosure paperwork violations as a pretext (benefiting lucky borrowers who were never foreclosed upon, much less treated improperly in any way). But as Cato Institute economist Mark Calabria noted, this demand made no sense.

This was reminiscent of 2010, when Obama administration allies proposed a trillion-dollar bailout for those lucky mortgage borrowers whose loans were owned by the government-backed mortgage giants Fannie Mae and Freddie Mac — including wealthy borrowers who have no difficulty paying their mortgage — in order to increase their disposable income and temporarily pump up the economy through the next election.

Behind the administration's flawed mortgage bailout proposals is the false assumption that the economy recovered slowly due "a collapse" in private consumption. But as Calabria noted, it's investment that lagged, not consumption: by the middle of last year, "private personal consumption" had already risen "higher than at any point during the boom, after reaching bottom in the Spring of 2009." As he wrote in August 2010, "unlike consumption, which has largely rebounded, investment today is about 20 percent below its peak." It's investment that needs to increase dramatically, not consumption. The administration's extortionate demands on the nation's banks discourage such investment.

Tagged as: Mark Calabria, Thomas J. Perrelli, Tom Perrelli