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The Refi Delusion

Instead of refinancing mortgages, the government should speed up foreclosures.

Providing fresh evidence that it is intellectually exhausted, the Obama administration is flirting with revisiting the mortgage-refinancing market. And like the semi-criminal scam that was the Home Affordable Mortgage Program, this new push is not really about helping out innocent bystanders crushed by the housing crash, but about the hundreds of thousands of market-massacring new foreclosures that are coming down the pipe — foreclosures that may be delayed, even if they are not prevented. The Committee to Reinflate the Bubble is in session.

Banks are reasonably eager to refinance certain kinds of mortgages — what they lose in interest, they make up in fees and other compensation. But the banks are not keen on refinancing a lot of the mortgages that the government would like to see refinanced: those for “underwater” borrowers, who owe more on their houses than their houses are worth.

Think of it from the lender’s point of view: A loan on a house that exceeds the value of the house is an inherently risky loan. In effect, the banks already have made a bad bet: They’ve got (for example) $250,000 hanging out there for $200,000 in post-crash house. Banks aren’t going to be inclined to reduce the risk premium on upside-down mortgages. But even with that risk, the bank would rather have a performing $250,000 mortgage on its books than a $200,000 house that it might have a hard time selling if it is foreclosed on, which has to be maintained and insured, and which generates no income between the foreclosure and the sale. So the risk of default ought to encourage many banks to refinance borderline cases: A $250,000 mortgage at 4.5 percent is not as valuable an asset as a $250,000 mortgage at 6 percent, but it’s still a more valuable asset than that $200,000 house. But most banks have fairly low foreclosure risks: Those mortgages are mostly insured, often by the government, and those insurance premiums already have gone out the door. Most people don’t want to default, even though it is easy to do so, so the lenders have a pretty good reason to think they’ll win if it comes to a game of mortgage chicken with people who are current on their payments.