



Economic Issues

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New Ideas for Refinancing and Restructuring Mortgage Loans

Estimates from various surveys and agencies offer a stark reality of the current housing situation in the United States: while there is regional variation, there is an excess supply of millions of housing units. Though much of this is caused by lack of consumer confidence, the impact on vacancy rates and homes sales is unmistakable, says Mark Calabria, director of financial regulation studies at the Cato Institute.

Consider:

The number of vacant housing units has increased from 15.6 million in 2005 to a current level of 18.7 million.

Existing home sales in 2010 were only 5 percent below their 2007 levels, while new home sales are almost 60 percent below their 2007 level.

Existing homes and new homes act as substitutes, meaning the differential in sales is likely a function of price. Indeed, the price of existing homes declined by 23 percent (excluding distressed sales), while new homes have experienced a relatively modest decrease of 10 percent. Because the housing market operates on the principles of supply and demand, the solution to a glut of vacant homes with a simultaneous low homeownership rate (65.9 percent which is the lowest since 1997), is to reduce prices to market-clearing levels.

Federal government intervention has helped to prop up these prices artificially, but their harms are twofold.

First, as noted, they are not allowing prices to reach market-clearing levels, thereby keeping households out of homes in which they might otherwise invest.

Second, their policies encourage home building in areas with fewer land restrictions, undermining their goal and also contributing to the excess supply of housing.

Excessive involvement of government-sponsored enterprises such as Fannie Mae and Freddie Mac must be gradually phased out. One way in which this can be accomplished is to implement a step-wise reduction in the maximum conforming loan limit. This will allow private sector market participants to compete, and capital to flow between these risky mortgage lenders and taxpayers.

While there are several means by which this goal can be accomplished, the ultimate objective is clear: mortgage lending needs to become a private-sector dominated industry in order to ensure that the taxpayers are protected and to allow market forces to get people back into homes.

Source: Mark A. Calabria, "New Ideas for Refinancing and Restructuring Mortgage Loans," Cato Institute, September 14, 2011.

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