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Underwater, Out of Mind

GOP presidential candidates are ignoring the economy's No. 1 problem: the housing market.

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It takes poker-champion nerves to ride into the country's foreclosure capital, bask in the bright lights for a day, then skip town without tossing so much as a $5 chip toward the housing crisis that is keeping the economic recovery tied up in the desert. But that's what seven Republican presidential candidates did in a televised debate from Nevada this week, dodging questions about falling home values and repeating long-discredited whoppers about how economic growth alone—or squashing government-backed mortgage lenders—can heal the housing market.

Rep. Michele Bachmann seemed to speak for the group when, asked about helping Nevada residents keep their homes, she wandered through motherhood, foreclosure, and job loss before wrapping up with a vague promise: "I will not fail you on this issue," she said. "I will turn this country around. We will turn the economy around. We will create jobs. That's how you hold on to your house." Others chose to discuss the Troubled Asset Relief Program. No one on stage offered anything better—or more specific.

Reverting to platitudes might seem a gutsy gamble in a state that has led the nation in foreclosures for 56 months, but it's nothing new for a GOP field that has essentially avoided the most pressing economic issue in America today.

More and more research suggests that the U.S. economy won't grow at a good clip until home prices break their free fall and start creeping up again. "The enormous gap between current home prices and those that seemed plausible when mortgage contracts were written is at the root" of the economy's woes, reported economists from Barclays Capital this week. "Until the pipeline of foreclosures and distressed sales is resolved, a protracted period of cyclical weakness is indeed in store." A study published earlier this year by the Federal Reserve Bank of San Francisco found that after the Great Recession, employment growth has returned much more slowly in counties where homeowners piled up debt during the housing bubble, compared with counties where debt levels remained relatively low.

Falling home prices have robbed Americans of huge amounts of presumed wealth and, as a result, drained consumer spending power, investment activity, and borrowing ability for prospective small-business owners. The median home price slumped from its 2006 high of $227,100 to $158,700 in May, a 30 percent drop, according to data from the National Association of Realtors. Homeowners across the country lost $7.4 trillion in equity during the housing price plunge. New home construction, which typically helps lead the way in a recovery, is at its lowest level since

World War II. At least 5 million people have lost their homes to foreclosure, and another 3.5 million are expected to do so in the next one to two years, according to Moody's Analytics chief economist, Mark Zandi. Nearly 15 million borrowers owe more on their mortgages than their properties are worth. One in three homes sold today are short sales or foreclosed properties.

GOP presidential contenders have said hardly anything—or at least, anything constructive—about how to fix those problems. The putative front-runner, former Massachusetts Gov. Mitt Romney, acknowledged the housing pain in the economic plan he released last month. "Millions of homes have been lost to foreclosure," he wrote in the introduction. "I've seen far too much hopelessness and too many dreams shattered. I've met Americans who lost everything that they had saved a lifetime to build." But none of his plan's 59 points tackle housing directly. Asked about the candidate's housing policies this week, a Romney spokeswoman, Andrea Saul, answered simply, "Our housing plan is forthcoming." Romney told a Las Vegas editorial board this week that he wants to let the foreclosure process "run its course and hit the bottom"—a recipe for inaction.

Texas Gov. Rick Perry's housing plan mimics the head-in-the-sand approach employed by the Obama administration for its first two years in office: insisting that a rising tide of economic growth will wash away the home market's problems. "Governor Perry's immediate remedy for housing is to get America working again," said spokesman Mark Miner. "The governor believes turning this economy around and creating jobs will address the housing concerns that are impacting communities throughout America." Perry's housing record as governor is mixed. Texas has not suffered from foreclosures as badly as many other parts of the country, in part because of its stricter lending laws, which Texas Bankers Association President and CEO Eric Sandberg says Perry has supported. But the governor has taken heat for providing tens of millions of dollars in state tax incentives to subprime lenders such as the now-defunct Countrywide Financial and Washington Mutual.

Other GOP contenders—including Bachmann, Herman Cain, Jon Huntsman, and Ron Paul—have centered their housing plans on promises to privatize Fannie Mae and Freddie Mac, the government-sponsored entities that guarantee the vast majority of new home mortgages. That's a huge, and potentially damaging, oversimplification.

Reforming the housing-finance system is a complicated, long-term proposition. Even scholars who call for privatizing Fannie and Freddie, such as the American Enterprise Institute's Peter Wallison, say that privatization should occur gradually to avoid injecting more chaos into the market. Many analysts say that removing a government guarantee would do nothing to stimulate the housing market—and that it could slow the market down as lenders price in higher risk and raise the price of mortgages.

Some conservative economists have urged Republicans to think more boldly. Columbia University's Glenn Hubbard—who chaired the Council of Economic Advisers under President George W. Bush—and Christopher Mayer want to allow Fannie and Freddie to refinance as many as 30 million mortgages into cheaper rates, a strategy that they estimate could save borrowers about $2,000 a year on their loans. (Hubbard is advising Romney.) Harvard University's Martin Feldstein, a CEA chairman under President Reagan, has advocated reducing the mortgage debt of some 11 million underwater borrowers to 110 percent of each home's value. Feldstein says that such action would cost $350 billion and would stop the fall in home prices.

President Obama, meanwhile, has given GOP candidates a huge opening on housing by pursuing a suite of anemic policies since taking office. For his first two years, his administration insisted (like Perry today) that reviving the economy would resuscitate the housing market. This year, the president acknowledged that the market needs more help, but he has not tried aggressively to bolster falling prices. The administration's modest early efforts to modify loans—the Home Affordable Modification Program and the Home Affordable Refinance Program—have each affected fewer than a million borrowers, which is less than a quarter of those initially targeted. Recently discussed efforts to extend HARP are already being panned as unlikely to provide much additional relief. Some Democrats are now trying to distance themselves from Obama because of his poor track record on housing.

Why have Republicans resisted filling such an obvious void? Blame entrenched ideological and financial interests. Intervening in the market to drive down debt levels—as Hubbard and others suggest—would turn off archconservatives; one of the tea party's seminal early moments, after all, was CNBC commentator Rick Santelli's rant against an Obama plan to reduce mortgages for some underwater borrowers. Even disentangling government from the mortgage-guarantee business risks alienating traditionally heavy GOP donors in the real-estate, home-builder, and mortgage-banking industries. On the other hand, primary voters are more than ready to bash the "Ownership Society" initiatives championed by President Bush.

"There are not a lot of political wins" in housing policy during a GOP primary, says Mark Calabria, a director of financial-regulation studies with the Cato Institute and a former aide to the Senate Banking Committee. "The smart thing for the Republicans to do right now is stay out of it. The most effective thing anyone can do is to speed up the foreclosure process, but I have a hard time seeing anybody running for office calling for that. And you are not going to see any Republican roll out any homeowner-bailout program until after the primaries."

Theoretically, that silence could give congressional Republicans space to cut a deal with Democrats that addresses housing and stokes the recovery—without undercutting a major talking point of the GOP's presidential field. One such deal could include major cash assistance to underwater homeowners who didn't borrow at subprime rates, as Feldstein suggests, along with accelerated foreclosure proceedings for distressed borrowers who will never be able to afford the homes they live in.

But in the real world, no one expects Obama and Congress to do anything about housing any time soon, and that inaction only raises the ante for GOP hopefuls. For a Republican candidate trying to break out of the pack—in other words, any of them—an aggressive housing policy could be a good move. The framing is surprisingly simple: "I don't like this any more than you do, but if we don't make homeowners whole again, we're not going to create a lot of jobs for a long time." The candidate could use the housing plan as a model to demonstrate how he or she would transcend rhetoric and bring a fractured country back together.

If nothing else, it could play well in Nevada.