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Bailout for Underwater Mortgage Borrowers Is Illegal and Economically Illogical

Hans Bader on October 26, 2011

Economist Mark Calabria says Obama's new \$7.4 billion plan to let underwater mortgage borrowers refinance at investors' expense is [illegal and won't help the economy](#). He also says that the Federal Housing Finance Authority (which was created by a law that Calabria helped draft) should have refused to go along with it, rather than succumbing to pressure from the Administration.

Bad as the plan is, at least it isn't aimed at deadbeats, like many other mortgage bailouts that have done so much recently to promote increased delinquency rates and make cynical people who can afford to pay their mortgage simply stop doing so (although the plan does effectively [reward some people](#) for buying larger homes than they could really afford, with little down payment).

I recently spoke to a midwestern lawyer whose law firm handles foreclosures for banks, who described a chaotic, *de facto* moratorium on foreclosures in much of the country that could threaten the long-run stability of the nation's financial system, and cost taxpayers hundreds of billions of dollars. It has gotten so impossible to foreclose on anyone in his state due to new rules that this lawyer's own paralegals, who are aware of this fact, have stopped paying their mortgages, even though they have the money to pay their mortgage (and are not massively underwater), because they realize it will be years before a bank can foreclose on them in the current political climate.

The big banks have totally suspended foreclosure activity in his state because of the robo-signing allegations, even though all the people foreclosed upon were in fact massively behind on their mortgage payments, and any robo-signing that occurred did not change that at all. Small banks are still seeking foreclosure, but will have to wait years to get it due to new red tape. His state's legislature passed a law requiring mediation prior to foreclosure. That mediation, even if entirely fruitless and pointless, is treated as an appearance in any subsequent foreclosure action even if the borrower has no defense whatsoever on the merits, defeating any prompt foreclosure based on failure to appear. The net result is that even borrowers who have no argument to make and no alleged excuse for not making their mortgage payment can't ever be foreclosed upon in less than a year.

Government-controlled mortgage giant [Fannie Mae](#), which helped [spawn the mortgage crisis](#), doesn't even want its defaulted mortgages foreclosed upon any more, and engages in veiled harassment of law firms that have the temerity to actually move forward with foreclosures, by repeatedly auditing them. (The most charitable possible explanation for Fannie Mae's curious hostility to enforcement of its own contractual rights is that it may be afraid that large-scale foreclosures will lead to many empty houses, unguarded houses

in which fixtures and metals like copper can be stripped from the premises by criminals who now specialize in looting empty houses. But such robbery remains rare in many states, and if Fannie continues its *de facto* moratorium on foreclosures, lots of people who are perfectly able to pay their mortgages will simply stop doing so, imposing billions of dollars in losses on the taxpayers, who have already spent more than \$100 billion bailing out Fannie Mae, and may end up incurring hundreds of billions more in losses. It may also set off a wave of copycat defaults by other mortgage holders whose mortgages are held by FDIC-insured banks, some of which may go under and have to be bailed out by taxpayers. Fannie Mae's policy may instead reflect a desire by Obama Administration officials to temporarily suspend all foreclosures until after the 2012 election, even if that results in countless billions in losses to taxpayers, banks, and investors — and even if it sets a dangerous precedent that could result in reduced availability of mortgage loans and increased mortgage interest rates in the long run.)

The Obama Justice Department is also pressuring banks to make risky loans to people just because of their race, potentially planting the seeds of a future housing crisis.

Left-leaning journalists who don't understand economics are pushing for much bigger mortgage bailouts that could cost taxpayers countless billions. The Obama Justice Department and some state attorneys general want to extract more than \$20 billion from banks to use for bailouts for certain favored mortgage borrowers. Progressive intellectuals have pushed for a trillion-dollar bailout at taxpayer expense for people whose mortgages are held by two government-controlled mortgage giants, regardless of whether they can afford to pay their mortgage.