Obama Mortgage Policy Key to Election Narrative

By Shanthi Bharatwa
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NEW YORK (TheStreet) -- Housing has been among the top priorities for the Obama administration heading into the election year, with the government announcing a slew of measures aimed at providing relief to troubled borrowers in the past few months.

Many of the recent proposals are just tweaks to existing programs and the jury is still out on whether they will provide enough relief to borrowers to prevent them from defaulting and losing their home to foreclosure.

But the announcements of such measures play an important part in framing the narrative for the Obama re-election campaign.

"Most of these measures are aimed at the middle class. It is a calculated strategy of appealing to those most likely to vote," said David Johnson, CEO, of political consulting agency Strategic Vision and a senior Republican consultant who worked on Bob Dole's1988 Presidential campaign.

Through these mortgage relief programs, the administration is advancing its claim that it is "fighting for the middle class" and that Republicans, who are against further government intervention in housing, are " out of touch," with the plight of average American, says Johnson.

Housing remains among the few macro-economic indicators that is yet to show any sign of improvement in a slowly recovering economy.

While not as critical an issue as, say, job growth when it comes to determining who wins the election, housing policy has always been a political hot potato and there is nothing quite like stories of people losing homes to stir politicians into "doing something."

""I'm not one of those people who believe that we just sit by and wait for the housing market to hit bottom," Obama said at a news conference, in an obvious shot at Governor Mitt

Romney, who previously suggested that foreclosures be allowed to run their course. "There are real things we can do right now that would make a substantial difference in the lives of innocent, responsible homeowners."

Yet early efforts to bring relief to mortgage borrowers and boost the housing market through programs such as the Home Affordable Refinance Program(HARP) and Home Affordable Modification Program (HAMP) have fallen woefully short of the government's own estimates.

"To the extent you believe the government can stabilize the mortgage market, they have been timid," said Brian Gardner, senior vice president of Washington Research at KBW.

The Obama administration's approach to housing policy has been to "dip its toes in the water, but never fully plunge into the pool," according to Gardner. That has constrained the effectiveness of the programs.

Responding to criticism that such programs are too restrictive in their eligibility criteria, the administration announced changes to the HARP program last fall, removing a cap that prevented "underwater borrowers" who owed more than 125% of their home's value from availing of the refinancing program.

Analysts have noted that the program is starting to see a higher participation from borrowers, with one analyst estimating HARP 2.0- as it is now more commonly known- to provide a $12 billion upside to the mortgage banking industry.

>>Obama's HARP IS Music to Bankers' Ears

Earlier this year, the U.S. Treasury Department announced new guidelines under HAMP, extending the program by another year to the end of 2013 and targeting an increase in principal reductions as a form of mortgage modifications.

The government will now triple the incentives paid to servicers who reduce principal owed by borrowers as opposed to merely reducing interest rates or offering term extensions.

It also for the first time offered incentives to mortgage giants **Fannie Mae**(FNMA) and**Freddie Mac**(FMCC) to reduce principal on loans.

Democrats have been stepping up pressure on the Federal Housing Finance Agency (FHFA), the conservator of the two bailed out mortgage giants, to consider making principal writedowns on underwater mortgages.

Proponents of so-called principal reductions argue that it will prevent borrowers who owe substantially more than their properties are worth from defaulting.

The FHFA acting director Edward DeMarco, who as conservator is mandated to minimize losses to taxpayers, has resisted the idea, saying that preliminary analysis shows principal reductions could cost the taxpayers as much as $100 billion and is unlikely to be more effective than other forms of modifications in preventing default.

He also worries that it will encourage moral hazard- borrowers who are current on their payments may consider defaulting to get a writedown on their debt. It could also provide a backdoor bailout for banks, who hold most of the second liens on mortgages.

But the Treasury is now attempting to sweeten the deal for Fannie and Freddie with incentives under HAMP that would allow them to conduct principal reductions at more attractive terms.

For taxpayers, that might make little difference as they are paying for the subsidy one way or the other.

>>Fannie, Freddie Mortgage Bill Coming Due, but Who Will Pay?

Other relief measures include slashing the fees to refinance loans backed by the Federal Housing Administration (FHA). The FHA will drop upfront insurance premiums that borrowers must pay from 1% of the loan balance to .01%. The FHA will also drop annual premiums from 1.15% of the loan balance to 0.55%.

The $26-billion mortgage settlement between the 49 states and the five largest mortgage servicers including **Bank of America**(BAC),**JPMorgan Chase**(JPM) and **Wells Fargo**(BAC) announced in February was another win for the Administration. The settlement will require banks to adhere to new servicing standards and spend $10 billion in reducing principal, $ 3 billion towards refinancing and $7 billion in pursuing foreclosure alternatives.

Bank of America might end up reducing principal on 200,000 mortgages by as much as $100,000.

Another initiative involves allowing Fannie Mae and Freddie Mac to sell foreclosed homes in bulk toinvestors who will then convert them into rentals.

The boldest move yet is President Obama's announcement during the State of the Union address of a broad refinancing plan that would allow all "responsible" homeowners with a non-GSE loan, who are current on their payments to refinance loans at low interest rates under a new program run by the FHA. The proposal will need to get Congressional approval and many analysts have said it is "dead on arrival" in an election year.

>>Obama Showers Borrowers With Mortgage Relief

But that may still work in favor of Obama campaign, which would argue that the administration has continued to put out proposals that will help borrowers, only to be blocked by Congress.

Analysts remain skeptical that any of the changes will have a lasting impact on housing. "The programs have been small and have misdiagnosed the problem," says Mark Calabria of the Cato Institute, who argues that the fundamental problem in the housing market is excess supply versus demand. Programs targeting refinancing do not really help create demand for housing.

"The administration runs the risk of continuously promising massive fixes that do not solve anything," says Calabria.

Gus Altuzarra, CEO of Vertical Capital Markets, which buys whole mortgage loans agrees. "They are trying to win voters over by putting more things out there. But they don't address the problem. You need to make credit available so that inventory is absorbed, prices go up and then someone will get closer to equity on their home," he said.

He says banks need to be encouraged to make more home loans without fearing regulatory consequences, something that may be more in the domain of the**Federal Reserve** than the government.

He does, however, believe that the administration is right in targeting principal reductions. "In order to fix housing there needs to be an adjustment to the principal balance. If a house is upside down, they have no motivation to pay. The interest rate may go down to 4% from 6% with the help of a refinancing program, but borrowers are still stuck," says Altuzarra.

The recently announced measures could have some political impact in certain crucial states such as Colorado, Nevada, North Carolina, Virginia and Florida, where there are a high number of underwater borrowers, says Strategic Vision's Johnson.

"Those are the states I will be watching for the effectiveness of the programs . If we see unemployment dropping but foreclosures going up, that will be a problem. We need to see both measures go down in those states," he said.

--Written by Shanthi Bharatwaj in New York