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Obama policies ended housing free fall



By Mark Zandi, September 28th, 2012

Voters judging President Obama's economic policies this fall have a lot to think about. There is the fiscal stimulus, the auto bailout, saving Wall Street and then reforming it, not to mention health-care reform.

How the administration handled the foreclosure crisis probably won't figure large in the picture. But it should.

Housing was ground zero for the Great Recession. Between early 2006 and Obama's inauguration in 2009, average house prices fell by a third across the country. In certain areas, including cities as diverse as Akron, Orlando and Las Vegas, house prices fell by more than half. Homeowners lost some \$7 trillion in equity, and foreclosures surged. Millions of busted mortgage loans led to hundreds of billions of dollars in losses, sending the U.S. financial system to the brink of collapse.

Housing's problems have remained an economic millstone, slowing the U.S. recovery. Historically, housing rebounds from recessions quickly, propelled by low mortgage rates. Home sales and housing construction have often powered rapid and substantial job creation, but not in the current recovery. While sales and construction have started to rise again, they have yet to add jobs on net.

The Obama administration deserves credit for quickly ending the housing free fall. In particular, Obama empowered the Federal Housing Administration to ensure that households could find mortgages at low interest rates even during the worst phase of the financial panic. When banks were making few loans of any kind, mortgage borrowers could still obtain credit because of the FHA.

The FHA had been virtually dormant during the housing bubble, but it made about one-third of all U.S. mortgage loans in the period after the bust. Without such credit, the housing market would have completely shut down, taking the economy with it. The effort took a toll on the agency's finances, but so far the FHA has avoided turning to taxpayers

for help, making it one of the few housing-related enterprises — public or private — that have not.

Temporary tax credits also enticed home buyers to act sooner rather than later, breaking a self-reinforcing deflationary cycle in the housing market. Prospective buyers had remained on the sidelines, waiting for prices to stop falling, and their reluctance caused prices to drop still more.

The tax credits didn't spark additional home sales so much as pull sales forward from the future; sales weakened sharply as soon as the credits expired. The credits also were expensive, costing the Treasury tens of billions of dollars, and much of the benefit went to home buyers who would have bought homes anyway. But the tax benefit gave buyers a reason to stop waiting, ending the downdraft in prices.

Critics charge that the government's intervention was costly and ineffective, that the administration should have let the housing market sort things out on its own. This would have been a reasonable position if house prices had been too high when Obama's policies kicked in; but they weren't. By the time Obama took office, prices had fallen substantially; with low mortgage rates factored in, homes were as affordable as ever. Investors knew this, and as soon as they saw prices nearing the bottom, they began snapping up distressed properties. These investors weren't house flippers, like those who fueled the housing bubble, but long-term players seeing bargains. Obama's efforts to shore up housing were well timed.

But while Obama's response was on target during the financial crisis, his policies failed to quickly resolve the foreclosure crisis and jump-start a housing revival. Some 7 million homeowners have lost homes in foreclosures or short sales, and there are still 3 million homeowners facing repossession.

The administration's main effort to help these homeowners, the Housing Affordable Modification Program, has fallen well short of its goals. HAMP offers monetary carrots to banks and mortgage investors who work with homeowners, modifying loan terms before a property is foreclosed.

The concept was laudable but better in theory than in practice. HAMP helped — about a million homeowners will ultimately receive modified loans — but that isn't nearly enough. And calibrating incentives to induce banks to modify enough mortgage loans to make a difference has been daunting.

The administration probably should have added a financial stick to HAMP's carrots, to induce banks to participate more aggressively. Banks have recently allowed more short sales, which are better than foreclosures, but the change happened mainly because of the legal settlement between banks and state attorneys general over the robo-signing scandal.

To be fair, the administration has tried to improve HAMP, most recently by increasing the incentives for Fannie Mae and Freddie Mac to reduce homeowners' loan principal.

But Fannie and Freddie's regulator, the Federal Housing Finance Agency, opposes principal reduction, fearing a rash of mortgage defaults by homeowners trying to get their loans modified. The FHFA's fear is misplaced, but the agency has the final say.

The administration has also succeeded in ramping up its Housing Affordable Refinance Program. HARP makes it easier for homeowners with Fannie and Freddie mortgages to refinance their loans even if they are deeply underwater. HARP was stalled until the administration persuaded Fannie Mae and Freddie Mac to make some changes; now, with the help of record-low mortgage rates, HARP has gone into overdrive. Assuming mortgage rates stay low, nearly 3 million homeowners will eventually benefit from the program.

Most importantly, while it is disappointing that Obama's housing policies did not end the foreclosure crisis more quickly, housing is no longer a mortal economic threat. Indeed, the evidence suggests that housing soon will again be a significant source of growth and jobs.

Home sales, construction and house prices are all improving in much of the country. Some argue that this would have happened anyway, without the government's help during and after the Great Recession.

I doubt it.

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