Conservatives Assail Homeowners: Administration Says "Let Homeowners Go Under"
By David M. Abromowitz | February 28, 2008

Imagine if President Bush, standing in New Orleans a few weeks after hurricane Katrina, had said to the nation: “It’s terrible that a disaster just washed away tens of thousands of homes, but my administration and economic advisers believe in the market and the market alone. Any direct government help is a bailout. Let’s just wait until the invisible hand of the market rebuilds this community.”

Most Americans would have found such rigid ideological indifference appalling in the face of the human tragedy caused by a natural disaster. Yet today—with millions of homes already lost to foreclosure and perhaps 2 million more families possibly being swept out of their homes in 2008—the Bush administration labels efforts to help communities drowning under a sudden deluge of foreclosed and abandoned property a “bailout.”

Treasury Secretary Henry Paulson says he is sticking to a reliance on the marketplace to work itself out, echoing Herbert Hoover. President Bush threatens to veto any legislation that includes much-needed government action to help the housing market regain stability.

The foreclosure epidemic is a man-made disaster. Rapid unprecedented deflation in home prices in hundreds of communities around the country is not a natural result of benign market forces, but rather has it roots in a culture of under - regulation that allowed largely unsupervised subprime mortgage brokers and lenders to take over the home finance market. For a time, this resulted in rising homeownership rates, which grew from 65 percent to 69 percent in the decade up to 2007. But about half of that the growth came from subprime lending, according to a study by the Federal Reserve Bank of Chicago. Bad money chased out good lending from the market.

Pushing homeownership to boost claims of creating an “ownership society,” the Bush administration urged on the Federal Reserve to keep credit cheap well past the point where rampant housing price inflation was signaling warning signs. The Fed and the Bush administration had regulatory tools such as the Home Ownership and Equity Protection Act, other regulatory powers of the Fed and other banking agencies, and consumer protection jurisdiction—any or all of which could have been used to cut back subprime lending abuses and rein in what appear to have been widespread unfair and deceptive loan products.

Yet they did nothing to nip the subprime housing bubble in the bud, and now insist that ideology will continue to trump responsibility to the American people. The President’s 2008 Economic Report intoned earlier this month: "Markets naturally self-correct, rewarding good strategies and punishing bad ones. Any government actions mitigating the outcomes of risky behavior may create perverse incentives for reckless decisions by borrowers and investors who may come to rely on government interventions."

Treasury Secretary Paulson followed up (in an interview in today's Wall Street Journal) with his argument that any effort to help homeowners is only a "bailout for financial institutions and Wall Street." Yet most of the legislation under consideration—and especially proposals put forth by the Center for American Progress—are anything but a bailout for Wall Street. What's more, it is precisely because markets are not functioning normally that action is needed, and quickly.

Neighborhoods like Westview Village in Atlanta, where 22 out of 85 homes are vacant due to foreclosure and abandonment in one several block area, are all too typical across the country. Crimes, blight, and decay set in quickly, hurting dozens of innocent homeowners for every possibly misguided subprime borrower who made a bad deal. These same market forces threaten to engulf otherwise safe home mortgages in other neighborhoods as the effects of the housing crisis and the related credit crisis in financial markets freeze lending.

Fortunately, congressional leaders have refused to blindly accept this laissez-faire vision of the greatest homeownership crisis since the Great Depression. With about 1 in 14 home mortgage borrowers nationally now delinquent or in foreclosure it is clear that defaults have spread well beyond the subprime market as home prices continue to plunge. They fell another 9 percent in the fourth quarter of 2007 compared with the prior year , according to the Case Schiller housing price index.

Legislation now before the House of Representatives and the Senate includes an array of targeted efforts aimed at breaking the freefall in home values. Especially important is the appropriation of a fast infusion of funds to localities facing the greatest foreclosure threats—funds that will enable responsible local organizations to move quickly in neighborhoods drowning in a tidal wave of recent foreclosures. Mirroring the Great American Dream Neighborhood Stabilization Fund, or GARDNS fund proposal of the Center for American Progress, Enterprise Foundation, and other leading housing groups, this money would allow foreclosed and bank-held properties to be bought at a discount, refurbished, and returned to the market at affordable prices for sale or rent. Enacting and funding this legislation would prevent vacancies and arson, and restore stability to hundreds of communities teetering on the brink of blight.

Legislation is also under consideration that mirrors the Center's Saving America's Family Equity, or SAFE program—a proposal that would transfer large numbers of existing loans to new owners to help stabilize the broader housing marketplace. We need a widely accepted process to facilitate the transfer of troubled mortgages from the current holder of the mortgages on behalf of a variety of investors with conflicting interests, to new ownership. The sale price paid, however, must reflect the current value of those mortgages, which often is significantly less than the face value of the mortgages.

This "haircut" will prevent a bailout of the financial institutions and investors who uncritically and irresponsibly created the bubble by lending excessively in the hope that continued house price appreciation would bail them out of poor credit decisions. Our plan also boasts a method to prevent assisted borrowers from getting a windfall. As housing prices stabilize and appreciation resumes, the benefit of that write-off would be shared and some of the forgiven debt repaid at property sale.

This process will help unfreeze the capital market by enabling investors to exchange uncertainty concerning the value of the securities they hold for liquidity, reduced market risk, and some legal certainty. These new and responsible loan products, backed by the federal government, will enable new lenders to make new loans available to many of the affected homeowners, keeping them in their homes. New lenders will only step in if one or more new loan products are available, including expanded flexibility for the Federal Housing Administration.

At a time of such great uncertainty, we are seeing investors naturally reluctant to provide capital to lenders for the new loans, given the potential for further plummeting house prices. This reluctance could lead to further defaults on currently performing loans, which would be a severe deterrent to the market's natural function. Without credit availability, house prices will fall further. It is a sensible role for government to take on some of this catastrophic risk through the SAFE program, to unfreeze the capital markets.

After Katrina devastated New Orleans and the Gulf Coast, President Bush in fact spoke about the need to rebuild New Orleans. He wisely ignored some in his party who would indeed have left it all to market forces, and avoided plunging into issues of blaming some of the homeowners for bringing on their own troubles. He instead spoke these words: “In the task of recovery and rebuilding, some of the hardest work is still ahead, and it will require the creative skill and generosity of a united country.”

Today we face a similar challenge. Our first commitment is to meet the immediate needs of those who already had to leave their homes because of foreclosure, and their neighbors who are clinging to their homes amid economic turmoil and social upheaval. But an equally large task is to restore stability to the overall U.S. housing market by helping the marketplace find its footing. Voluntary measures championed by President Bush and Treasury Secretary Paulson are simply inadequate.