New FHA Short Refinance Program Nothing More Than Another Bank Bailout Combined With Welfare

March 3, 2011 - Imagine you purchase stock in a company using borrowed money. Now, just imagine that the stock drops significantly in price. You still owe the money that you borrowed. Fortunately, you have enough money coming in to cover your loan payments, but you cringe every time you have to write your monthly repayment check. Now just imagine that the government is willing to step in on your behalf. They tell your lender that if he reduces the amount of money you owe to current value, the government will guarantee repayment on the rest of your loan. And even though you've never missed a loan payment and you are making enough money to repay what you owe, they are giving you a pass on personal responsibility in the name of "fair play". This would be a form of welfare, and most people would probably be very much against it. But this pretty well sums up how the FHA's Short Refinance program works. It is one of the most shameful, waste ridden government programs in history and it is a complete abuse of taxpayer dollars.

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There is absolutely no doubt that some people who are facing foreclosure were sold a complete bill of goods by lenders and loan brokers. The ones that I really feel for are the elderly who had homes that were paid-off. A lot of these people were convinced that simply by taking out a home equity loan, they could lead a much more comfortable life. What they weren't told in many cases was that these loans had adjustable rates, dangerous repayment plans that allowed monthly payments that were less than the accumulated interest on the loans, and that they could eventually lose their homes.

There are also millions of people who, through no fault of their own, have lost their jobs in this depression (and yes, that is precisely what I think we are in) and who find themselves in the unenviable position of not being able to make their mortgage payments. Due to the downturn in housing prices, a majority of these people probably have no real prospect of being able to sell their homes in a regular sale. They are facing the prospect of a short sale, in which they will reap no financial benefit, or a foreclosure. Neither is a very attractive option.

But there are also millions of people who fall into other categories. Some of them purchased homes that they never had any hope of being able to afford. The person who makes $50,000 per year never had any hope of being able to pay for a $1 million house.

And then there are those who are still employed and able to continue making payments on their homes but that had the misfortune of purchasing homes when the market was high. Unfortunately, that's the risk that anybody takes when they purchase any investment; including a house. Many of these people opted for the most risky loans available because they allowed them to make minimal payments. The gamble they took was that the housing market would continue to increase in value and that they would always be able to refinance. It's kind of like purchasing stock using a margin account; something which most investors will tell you can be very risky but which can also be very profitable. In this case, they gambled and lost. Now they want to make that loss the responsibility of the bank. Actually, they want to make it the responsibility of taxpayers.

Banks are worried that many of these homeowners will eventually just walk away from their homes. This is called a "strategic default". It happens when someone who can afford to repay their debt simply decides that it is more cost effective for them to simply walk away from their obligations. If that happens, and their mortgages are uninsured by the government, then the banks will have to eat the entire loss.

Under the FHA program, banks have to agree to write down the principle owed on first mortgages to no more than 97.75% of the value of the property. In return, they get a federal guarantee on the modified mortgage, so if the owner later walks away, taxpayers are on the hook. But at least the homeowner will have some equity in their home so the chances of them walking away will be less, right? Well not quite.

The program is not limited to homeowners who have only one mortgage. They can still have a second mortgage on the house and the lender on that mortgage doesn't have to agree to any reduction in principle. Even worse, the combined first and second mortgage amounts can be as high as 115% of the homes current value at the time the refinancing takes place. That means that the homeowner may very well still be underwater. Maybe I'm crazy but there is no reason that I can see to believe that these people still won't decide to walk away at a later date; leaving taxpayers on the hook. And if housing prices continue to fall - and there are indications that housing prices are not yet at the bottom - those chances will only increase.

Well, at least the government will require that these new loans are given only to people with good credit, right? Well, not exactly. The minimum acceptable credit score to qualify for the program is 500. At ACCESS we've been saying for years that credit scores are meaningless, computer generated garbage, but by any standards even I have to say that 500 is a bad score and shouldn't qualify for a home loan. It is indicative of someone who is not paying their bills on time. The FHA's attitude towards this seems to be, "well, it's only taxpayer money." As a taxpayer, I resent that.

And remember, the program is only available to people who are current on their loans.

Better yet, the banks are the ones that get to choose which loans they place in the program. What do you think the chances are that they will throw this bone to their lowest risk clients? Instead, taxpayers are likely to be left backing the riskiest loans in their portfolio. The FHA seems fine with that because again, "it's only taxpayer money."

In simple terms, the program is a combination of corporate and personal welfare. And it is not cheap. The FHA has set aside $14 Billion for it. Yet, even with that amount of money, the program has resulted in only 245 applications and a total of 44 endorsements for new loans in the past five months. That's a lot of money to set aside for a program with such abysmal results.

There is absolutely no hope of a recovery in housing until we actually hit market bottom. And we can't hit market bottom until the government stops interfering with it. Hitting bottom will be painful but the only thing that this and other government programs are doing it dragging out the misery. And by most analyst accounts, all of the government programs over the past two years to keep homeowners out of foreclosure have been a failure. This one appears to be on par with that track record.

Making taxpayers responsible for even more privately financed debt is immoral and an abuse. It is time for the FHA and the Treasury Department to shut all of these programs down.

byJim Malmberg
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