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THE OUTLOOK

States Aim to Stem Tide of Home Foreclosures With Funds for Refinancing

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HOPING TO SLOW the quickening pace of home foreclosures, about a half-dozen states are setting up funds to help homeowners with high-risk subprime mortgages refinance to more-affordable loans.

The states -- which include Maryland, Massachusetts, New Jersey, New York, Ohio and Pennsylvania -- are expected to invest a total of more than \$500 million in the effort. That isn't much, given the size of the problem, but state officials hope it will be enough to keep some vulnerable low- and moderate-income neighborhoods from sliding into decline.

Some of the programs will be similar to existing government-lending programs, in which the state extends mortgages to homeowners and then sells those home loans, in some cases to companies such as government-sponsored mortgage-finance giants Fannie Mae and Freddie Mac. The state then recycles the proceeds from the sales to make additional loans.

Earlier this month, Massachusetts officials said the state's housing agency would team up with Fannie Mae to provide \$250 million for a program that could keep about 1,000 delinquent borrowers from losing their homes. The Massachusetts Housing Finance Agency will sell bonds to cover \$60 million of the funding, with Fannie Mae providing the remaining \$190 million.

New York Mortgage Agency officials say they expect to announce a \$100 million program in the next several weeks that would help an estimated 500 homeowners.

More than one million American homes are expected to enter foreclosure this year; the total represents about 2.3% of the nation's 44 million home loans, according to Freddie Mac, which bases its estimate on data provided by Mortgage Bankers Association, a Washington-based trade group. Freddie Mac says about 60% of those homes carry subprime mortgages. Subprime mortgages are home loans made to borrowers with shaky credit records.

The projected foreclosure rate -- higher than during the oil bust of 1987 but not as high as in the 2002 recession -- poses a significant threat to the housing sector, and possibly to the nation's economy if it spurs consumers to maintain a tight grip on their wallets. "Falling home prices hurt consumer spending," says Patrick Newport, an economist at consulting firm Global Insight.

The problem can be traced in large part to consumers who took out adjustable-rate mortgages that had low initial rates but which adjusted higher after two years to a rate that was significantly higher than they expected or could afford. Many of those consumers weren't aware that initial mortgage rates on such loans often are tied to long-term interest rates, which haven't changed much in the past several years. But adjustments are tied to changes in short-term rates, which the Federal Reserve has boosted 17 times since 2004.

For example, a borrower who took out a \$300,000 ARM at 7.32% in mid-2005 would have had an initial monthly payment of \$2,060.79. A typical adjustment would have pushed that payment to \$2,692.63 this year, says Keith Gumbinger, vice president of HSH Associates, a New Jersey publisher of mortgage-rate data. Unable to cover the higher payments, a number of homeowners have fallen behind.

The trend can put neighborhoods at risk. Houses left vacant as the result of foreclosures tend to push property values down and cause neighbors that can afford to do so to sell out and move away, creating a snowball effect.

Foreclosures have been most common in low- and moderate-income neighborhoods, especially in states like Ohio, Michigan and Indiana, whose economies have been hurt by job losses. In Ohio's Cuyahoga

County, which includes Cleveland and 48 suburbs, foreclosure filings rose 95.6% to 13,610 last year from 6,959 in 2001, according to the research group Policy Matters Ohio.

Congress is considering legislation that would allow the Federal Housing Administration to help low- and moderate-income buyers by, among other things, offering overstretched homeowners 40-year loans that would lower monthly payments. But much of the effort to remedy the situation is playing out at the state level.

"You've got local politicians responding to local problems and because the problems are bad enough, they are not going to wait for the federal government to provide the solution," says Kurt Pfothenauer, senior vice president for government affairs and public policy at the Mortgage Bankers Association.

Even so, the state response has been somewhat limited in scope. In most cases, those who are more than 60 days delinquent won't qualify. As for those who do qualify, some are likely to be people who could refinance through private-sector lenders.

"No one is saying this will solve the problem," says Nicolas Retsinas, director of the Joint Center for Housing Studies at Harvard University. "But it could make a difference."

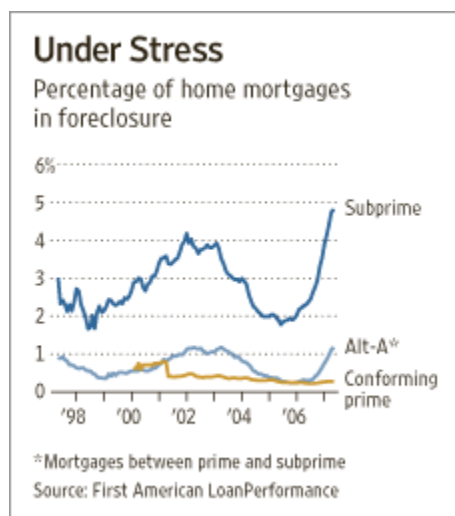
The recent flurry of plans is likely to make less of a difference in regions such as the Midwest, where workers may be unemployed and thus unable to qualify for loans. A potentially more troubling issue is whether taxpayers could be left to pick up any costs, a prospect that led California lawmakers to abandon a similar effort earlier this year. "This only works if you're helping people who pay back what they borrow," says Mr. Retsinas.

For its part, the Massachusetts program sets aside a risk-capital pool to cover 25% of losses from the program, something of an insurance policy. Borrowers must be no more than 60 days behind on their monthly payments in order to refinance into 30-year loans at fixed rates of about 7.75%. As in other states, eligibility is restricted to borrowers with a household income that doesn't exceed certain thresholds -- 135% of the median income in the Boston area.

In places like Boston, where home prices soared, only to fall in recent years, the refinancing plans' success will likely hinge on mortgage lenders' willingness to take a loss. Officials in some states say lenders will do so because in most cases they don't want to risk foreclosure, which can be more costly and time consuming.

But lenders say they are likely to resist any pressure from the state to take a loss on their loans, or even to waive certain prepayment penalties. "Nobody wins in foreclosure," said Kevin Cuff, executive director of the Massachusetts Mortgage Bankers Association. "But it's doubtful mortgage lenders are going to agree to both take a hit and lose a consumer."

(See related letter: "Letters to the Editor: The Government Should Bail on Borrower Handout" -- WSJ August 1, 2007)



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