REMAPPING DEBATE
Asking "Why" and "Why Not"

Economists, real estate agents divided over impact of foreclosure delays

Story Repair | By Diana Jean Schemo | Banking, Economy, Housing, Wall Street Journal

From the Editor:

In this feature, we select a story that appeared in a major news outlet and take it in for repairs. The stories we choose are not necessarily "fatally" flawed; on the contrary, in many cases, they'll bring genuinely newsworthy information to light. But our goal is to show how, with a similar investment of time, a different set of interviews or line of questioning could have produced a different — and, we hope, more illuminating — article.

The source material this week: "Delays Could Stall Recovery, Analysts Say" (The Wall Street Journal, October 9, 2010).

October 19, 2010 — With greater scrutiny of bank conduct slowing the foreclosure process, economists and real estate agents divided sharply over the impact of those delays on the housing recovery.

They also were split over the economic consequences for the real estate market if banks were to make greater use of loan modification programs, as the Federal Deposit Insurance Corporation and some economists have proposed. Under those programs, banks lower payments for homeowners in distress, by some combination of lowering their interest rates, recalculating monthly payments as a percentage of income, or writing down the principal in connection with homes that are now worth less than the value of their mortgages.

The number of foreclosures has hit record levels this year, threatening one in every 139 dwellings in the third quarter. During that same period, banks filed foreclosure documents on nearly one million homes, according to RealtyTrac, a real estate firm that specializes in foreclosure sales and monitors filings. The firm counted a record 372,445 dwellings scheduled for bank auction during the quarter.

As their numbers have grown, so have the questions surrounding the banks' handling of loans in foreclosure. The problems range from inadequate review of cases before moving to foreclosure, to the use of "robo-signers" to sign off on stacks of documents they had not read, to doubts about the true ownership of properties whose loans had been bundled with other properties and sold to investors more than once.

Banking officials and some economists have warned that a national moratorium on foreclosures — an option favored by some in Congress, but which the White House rejects — could cripple a fragile real estate recovery. They warn that allowing the backlog of foreclosed homes to grow, rather than moving them to a quick sale, would introduce additional uncertainty into the market.

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"The housing recovery is about as strong as a half-dead firefly," said Anthony Sanders, director of the Center for Real Estate Entrepreneurship at George Mason University. "The last thing we need is further interruptions." Moratoriums, he contended, worsen consumer confidence by raising the possibility that prices will sink when these properties eventually do come to market. And they slow down that reckoning, he contended.

"There are lots of homeowners who would like to get back in there, if prices get to more affordable ranges," Sanders said.

Simon Johnson, an economics professor at M.I.T. and former chief economist at the International Monetary Fund, disagreed. He believes that the slowdown in foreclosures would not lead to a standstill in the real estate market, as some have predicted. "That's an exaggeration," Johnson said in an interview. "The main problem for the housing market is that the job market stinks. And house prices are not going to come back until there's growth in jobs."

A number of realtors also said they did not expect the slowdown on foreclosures to severely dampen business overall, because foreclosures were a small share of their business.

"I don't expect a big drop in my company sales," said Craig Beggins, of Beggins-Century 21 Realty in Tampa, Florida. Beggins said he handles 130 closings a month, about ten percent of them bank foreclosures. He dismissed the possibility of nervousness around foreclosures metastasizing to halt the entire real estate market as "totally implausible."

"I really think we're looking at a 60 to 90 day problem," he said.

Jim Duncan, a partner at Nest Realty in Charlottesville, Virginia, was not so sanguine. Delaying foreclosure heightens uncertainty in an already jittery environment, he maintained. "The sellers don't know how to best price their home, and the buyers are expecting further price instability," Duncan said. Investors intent on a steal would likely take to the sidelines.

The delays and attendant legal morass surrounding foreclosures could change the calculations of lenders, who until now have resisted calls to modify loans in great numbers. Adam J. Levitin, a professor of law at Georgetown University who has written widely on the housing bubble, said that untangling the legal uncertainties associated with packaging home loans like securities could ultimately require a change in law. Loan modifications, he suggested, could be the price Congress exacts for helping the banking industry.

There has already been a rising chorus calling for banks to make greater use of loan modifications. Over the last few months, the National Association of Realtors had been meeting with banks to urge them to avoid foreclosures wherever possible, by allowing residents to short sell their homes, and by modifying loan terms to keep families in their homes. “We think it’s better for neighborhoods to keep people in their homes,” said Stephanie Singer, a spokeswoman for the organization.

Adam J. Levitin, a professor at Georgetown Law, has argued that broadly administered loan modifications were market neutral. Levitin said that such an option offered the “best solution” to the crisis in home foreclosures.

An estimated 23 percent of mortgages are “under water,” meaning their market value is lower than the amount due on their mortgages, raising the risk that homeowners might walk away from the homes, despite the certain damage to their ability to obtain credit in the future.

William Wheaton, an economist at the Wharton School of Business, has proposed a program whereby banks would lower the principal due on underwater loans to the amount of their current market value, in exchange for a share of the proceeds when an owner later sells in a possibly appreciated market. The FDIC has also proposed various loan modification schemes, which have so far drawn a lukewarm response from banks.

In a 2009 article in the Wisconsin Law Review, Levitin argued that broadly administered loan modifications were market neutral, because it costs more for a lender to foreclose on a home than to modify the mortgage. Levitin said that such an option offered the “best solution” to the crisis in home foreclosures.

“Unlike any other proposed response, bankruptcy modification offers immediate relief, solves the market problems created by securitization, addresses both problems of payment reset shock and negative equity, screens out speculators, spreads burdens between borrowers and lenders, and avoids both the costs and moral hazard of government bailout,” Levitin wrote.

A switch to loan modification, Sanders of George Mason acknowledged, might remove some of those foreclosures from the market permanently, and so actually eliminate the uncertainty represented by a backlog of low priced homes suddenly glutting the market and driving down prices. Sanders said he had proposed a version of loan modification as a policy option a few years ago. But he predicted the respite would be temporary, and would carry the risk that homeowners fall back into default.

“It will slow down the housing market even more,” Sanders said. “All we’ve done is written down the house, which means the market doesn’t move toward recovery.”

And Daren Blomquist, a spokesman for RealtyTrac, warned of a “moral hazard”: the risk that a flood of borrowers with underwater homes would stop paying their mortgages, to take advantage of the opportunity to write off debt.

Jeanne Livingston, a veteran Long and Foster realtor in Washington, D.C., thought keeping people in their homes by rewriting their mortgages would help — not hurt — the housing recovery. “Once we cut down on the inventory, that makes absolute sense in terms of stabilizing the market place…There’s so much supply [now], the confidence level is eroded.”

This content originally appeared at www.remappingdebate.org/article/economists-real-estate-agents-divided-over-impact-foreclosure-delays