Underwater Mortgages Causing Downward Economic Spiral

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Abstract

Underwater mortgages are depressing housing demand by creating blockages in the mortgage finance system. Families in trouble because of a loss of income can't make their monthly payments, refinance, or sell their homes. By coupling effective counseling with robust solutions for troubled homeowners—such as loan modifications, refinancing, and rental housing options—we can get on the road to economic recovery much faster, writes Peter Tatian in a commentary for U.S. News & World Report’s Debate Club.

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Restoring the housing market is key to the economic recovery. Housing construction creates jobs—well-paying American jobs—that feed back into our economy. Every new construction job produces two more jobs in the local economy (and, conversely, every construction job lost results in two additional jobs being eliminated). But housing demand remains tepid and, as a result, the construction industry has stagnated.

What's the problem? Underwater mortgages are depressing housing demand by creating blockages in the mortgage finance system. Interest rates are at all-time lows, but underwater homeowners can't take advantage of them because they can't make up for lost equity. Families who find themselves in trouble because of a loss of income or other financial shock can't make their monthly payments, refinance, or sell their homes. Foreclosures result, which drag down the prices of nearby homes, increasing the likelihood that other homeowners will fall underwater and perpetuate the downward spiral. Lenders become increasingly wary of making new mortgages, afraid of the risk of losses from bad loans.

The failure of the market to correct these problems is exactly why public policy needs to intervene. With proper help and incentives, many (but not all) underwater mortgages can be turned into performing loans. Underwater homeowners who might otherwise need to walk away from their homes would be more willing to stay in them if refinancing were available. This would mean fewer foreclosures, which benefits homeowners, lenders, neighbors, and the housing market. Plus, with lower monthly payments, homeowners would have more disposable income to prime the economic pump, such as by investing in home repairs or improvements.

The trick is identifying which homeowners can benefit from refinancing. Housing counseling can play a key role here. Urban Institute research has shown that housing counselors can help homeowners and lenders restructure loans and increase the likelihood that those loans will remain current, or identify other options for people who cannot afford to remain in their homes. By coupling effective counseling with robust solutions for troubled homeowners—such as loan modifications, refinancing, and rental housing options—we can get on the road to economic recovery much faster.

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Other Publications by the Authors

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Economists and government officials say the country’s economic woes can’t be fixed until the downward spiral of foreclosures and falling home prices come to an end. Devising a plan that helps without rewarding banks for making bad loans or costing too much has proven hard for both the Bush and Obama Treasury Department. One contender would reduce Americans’ home-mortgage payments, people familiar with the discussions said, possibly through a cut in the interest rate, the costs of which would be shared by the government and mortgage servicers. As part of a new national standard for modifying lo This entire spiral in economic activity. A thousand rupees come to one person, and suddenly everyone is better off by some amount. Now, what if the reverse happens? You’ve been robbed off by ₹ 1000. Forget wine and dine; you would cut down your expense that you were certain you would do. Now, this is where the downward spiral of the economy begins, also popularly referred, ‘The Slowdown.’ Here it is how we are here. The Demonetization. Sometimes mortgage rates went down and homeowners could exchange their mortgage for a cheaper one, giving them a few extra dollars to spend with the kids on the weekend. The system is huge. Total assets of federally supported housing finance entities Fannie Mae ($3.5tn), Freddie Mac ($2.2tn) and Ginnie Mae ($2tn) are close to the total government debt of France, Germany and Italy. They believe there could be a downward spiral of mortgage failures, screwed up documentation, delayed payments and another procyclical acceleration into the hole of depression. Before the pause driven by the coronavirus and the relief efforts, Mr Calabria and Mr Mnuchin had been vigorously pushing a plan to take Fannie Mae and Freddie Mac out of the government’s protection.