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The U.S. Foreclosure Crisis

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Without doubt, the U.S. economy is showing signs of significant recovery in many sectors and regions. But while housing, the epicentre of the crisis, is off its bottom, it is still a pall over economic expansion in some parts of the country—most notably the sand states of Arizona, Nevada, Florida and California, as well as the big-auto-loser, Michigan. Part of the problem is the continuing increase in mortgage delinquencies and foreclosures that add to the inventory of unsold homes, depressing prices further.

The foreclosure problem has not been solved by the government's Home Affordable Modification Program, or HAMP. It is a loan modification program that for relatively few delinquent borrowers has reduced monthly payments, but leaves the borrower with negative equity. **More than 11 million homeowners, comprising about a quarter of all homeowners with a mortgage, are underwater,** according to real estate research firm First American CoreLogic. **More than five million households are behind on their mortgage payments and risk foreclosure; that is almost 5% of all households in America.** HAMP does not allow for principal write-downs, so it has helped only a small portion of distressed homeowners by extending terms and reducing mortgage rates. Treasury's argument against principal forgiveness has been the fear of creating moral hazard. They got over that fear with Wall Street bailouts and now Main Street will get the same treatment.

Just recently, with foreclosures mounting—more than 2.8 million homes were lost to foreclosure last year, according to data provider RealtyTrac and the firm expects a record 3 million foreclosures this year—the Obama government has announced a new plan that pays distressed homeowners \$1,500 in resettlement assistance to sell their homes. Taking effect on April 5th, the program could encourage hundreds of thousands of delinquent borrowers who have not been rescued by the loan modification program to sell their houses through a process known as a short sale, in which a property is sold for less than the balance of the mortgage. Lenders will be 'compelled' to accept that arrangement, forgiving the difference between the market price of the property and what they are owed.

One of the other big problems with the loan modification plan was that the mortgages were often owned not by the originator but by investors who held the MBS issued against a pool of loans including this one. The new plan pays the homeowner the resettlement fee, pays the mortgage servicer the same \$1,000 fee in the earlier plan, another \$1,000

can go toward a second loan, if there is one, and the investor has the advantages of liquidity and the prospect of getting more money than in a foreclosure. The borrowers likely will suffer less damage to their credit rating and, as part of the transaction, they will get the lender's assurance that they will not later be sued for an unpaid mortgage balance.

The new plan doesn't keep people in their homes, but it does eliminate the costs of foreclosing properties and the deterioration of value associated with vacancies. Of course, it also puts a lot more houses on the market, increasing the downward pressure on prices. So, for now, the hardest-hit regions will continue to suffer the consequences of the crisis—job losses, reduced consumer spending, business bankruptcies and the ensuing fallout to commercial real estate.

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