

BUSINESS 03/18/2010 05:12 am ET | Updated May 25, 2011

The Economist The Obama Administration Should Have Listened To

By Shahien Nasiripour

Eight months ago, the Obama administration [launched a plan](#) to help troubled homeowners avoid foreclosure by providing \$75 billion in taxpayer funds to banks and mortgage servicers. The money was intended to help three to four million homeowners by lowering their monthly payments, largely by cutting their interest rates.

The [next day](#), a Yale economist and a colleague penned a New York Times op-ed arguing for a different approach.

Rather than cut interest rates, John D. Geanakoplos and Susan P. Koniak wrote, the government should reduce the overall amount owed on the mortgage — the principal.

“The plan announced by the White House will not stop foreclosures because it concentrates on reducing interest payments, not reducing principal for those who owe more than their homes are worth. The plan wastes taxpayer money and won’t fix the problem,” they wrote.

The facts seem to be bearing this theory out. As many as [3.4 million homes](#) are expected to enter foreclosure by year’s end, with some experts estimating that next year will be even worse. As of Sept. 1, less than [two percent of homeowners](#) who received a temporary modification under Obama’s plan ended up with a permanent fix. And so far, the plan has already cost taxpayers about [\\$27 billion](#).

Only five of the 1,711 permanent modifications as of Sept. 1 involved a principal reduction — in fact, most homeowners with a permanent fix ended up owing even more on their mortgage than they did before the modification.

For those who were already “underwater” on their mortgages, meaning they owed more on their mortgage than the house is worth, the move pushed them even further below the surface.

A [recent Fed study](#) confirmed that the Obama administration’s plan could actually make matters worse for taxpayers when it comes to helping those homeowners underwater.

And a New York Times editorial [Thursday morning](#) concludes: “What is evident, now, is that at the current pace of modifications, and with the housing market coming under renewed pressure, the plan has little chance of making a meaningful dent in the crisis.”

What to do? The Times says: “To help people with negative equity, the subsidies in the Obama plan should be redeployed so that they are used to modify loans by reducing the principal balance.”

"I think the Obama administration has made a big mistake. The administration's plan went about as badly as I foresaw, possibly even worse," he says. "Things have been awful. They've barely modified any loans, and those they have haven't done any good."

"I don't fathom the logic of their plan," Geanakoplos says, looking back. "I can't figure out who it's going to help."

In that March op-ed, Geanakoplos and Koniak (a law professor at Boston University) proposed the following: a government-formed, taxpayer-funded plan that would focus on reducing principal for credit-impaired homeowners who were underwater in their mortgages. Total cost to the taxpayer: About 3 to 5 billion dollars over three years.

Here's how it would work:

The program would be limited at first to subprime and other nonprime borrowers who were current on their mortgages because a) you don't want to reward homeowners who have fallen behind on their payments, thus risking a situation where homeowners are incented to fall behind and b) homeowners with good credit typically value their high credit scores, thus are more likely to make regular payments and not become delinquent.

The plan would be administered by a staff of community bankers, who would be hired from the private sector. That's where the cost comes into play. These folks, who would be experienced in dealing with home mortgages and loan modifications, would be the ones looking at individual mortgages and trying to determine the best course of action. Under the administration's plan, mortgage servicers do the modifications. The results haven't been stellar.

A key to the plan was that the reduced principal would be less than the value of the house - so the homeowners would have equity again - but still greater than the note-holder could get simply by foreclosing. For example, suppose a couple took out a \$280,000 mortgage when they bought their home, but the home's value dropped to \$200,000. "Bondholders today anticipate making as little as \$70,000 on a foreclosed home like that in our example," Geanakoplos and Koniak wrote, because foreclosed homes typically sell for a steep discount relative to other for-sale homes. So the principal would be reduced to somewhere between \$200,000 and \$70,000.

The net result would be that the homeowners, with newfound equity, would have increased motivation to stay in their homes, and the bondholders would be satisfied because they would maintain their income stream and wouldn't lose as much money as they would through foreclosure. Communities also would benefit, because there would be fewer foreclosures in the area, which means less blight, less houses for sale on the market, and less downward pressure on housing prices.

In referencing the provision in Obama's plan that pays mortgage servicers and bondholders for each successfully modified loan, Geanakoplos and Koniak wrote: "The taxpayers need not and should not be responsible for making up the difference between the payments due bondholders before a loan is modified, and those due after modification. Why? Because the bondholders and the banks, the ultimate beneficiaries of homeowner payments, will be better off if mortgages are modified correctly and foreclosures stopped. The government 'owes' them nothing more than that."

And Geanakoplos says the bondholders have already largely discounted the value of their subprime mortgage holdings. He should know; in addition to being an economist, he's a partner in a hedge fund that trades in mortgage-backed securities.

"Bondholders who actually have to mark their positions properly have them marked way down, anticipating that these borrowers will eventually default," he told the Huffington Post in an interview Wednesday. "So you wouldn't be costing

“That’s the whole point. That’s the beauty of the plan,” Geanakoplos says. “You’d be making the people absorb the loss who have already taken the loss.”

Shahien Nasiripour 

Chief Financial and Regulatory Correspondent

[Suggest a correction](#)

MORE:

- Financial Crisis
- Loan Modification
- Subprime Mbs
- Making Home Affordable
- Geanakoplos

You May Like

Sponsored Links by Taboola

New Haven: This Meal Service is Cheaper Than Your Local Store

Home Chef

Just Type in Your Name, Wait 10 Seconds, Then Brace Yourself

Truthfinder People Search Subscription

Getting Older? It’s Time You Learned About NAD+ and Sirtuins

MIT Technology Review | Elysium Health

The Most Addicting Shopping Site For Women

Tophatter

American Giant just created the first real leggings designed to replace your Jeans

WhoWhatWear | American Giant

There Is a No Cost Solar Program in Connecticut? (This is Crazy)

Free solar Energy

FROM OUR PARTNERS

Presented by LendingTree

Transfer your debt to a card with 0% APR for up to 21 months

Rates dip to 3.2% APR (15 yr). See if you're eligible

An astonishing 21-month 0% APR credit card

Getting Approved for 1 of These Cards Means You Have Excellent Credit

These refi rates drop jaws, proving to be the best

These 4 balance transfer credit cards could help you save big

SUGGESTED FOR YOU

12 Super Cute Love Notes That Beat A Text Message Any Day

Photos From Within Trump's White House Are Why Photography Was Invented

15 Things That Lasted Longer Than Michael Flynn As National Security Adviser

Ivanka Trump Tweeted About Religious Tolerance. It Didn't Go Down Well.

'Unbreakable Kimmy Schmidt' Season 3 Teaser Is A Love Letter To Beyoncé

WHAT'S HOT

What's Behind Trump's War With The Press?

'Flip Or Flop's' Christina El Moussa Reveals What Led To Split From Tarek

White Nationalist Richard Spencer Booted Out Of CPAC

Trump's Former Aide Concedes There Was No Voter Fraud In New Hampshire

Public School Fires Back After Betsy DeVos Criticizes Its Teachers

Donald Trump Names H.R. McMaster As National Security Adviser

'The Walking Dead' Fans Think They Spotted An Unforgivable Error

Seth Meyers Thinks Donald Trump's Presidency Is About 1 Thing

[Advertise](#) [RSS](#) [Careers](#) [FAQ](#)

[User Agreement](#) [Privacy](#) [Comment Policy](#) [About Us](#) [About Our Ads](#) [Contact Us](#) [Archive](#)

Copyright © 2017 TheHuffingtonPost.com, Inc. "The Huffington Post" is a registered trademark of TheHuffingtonPost.com, Inc. All rights reserved.

Part of HuffPost Impact

