Federal Intervention in U.S. Housing Market Continues With Home Affordable Foreclosure Alternatives Program

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The art of economics consists in looking not merely at the immediate but at the longer effects of any act or policy; it consists in tracing the consequences of that policy not merely for one group but for all groups.

-Henry Hazlitt, Economics in One Lesson (1946)

On November 30, 2009, the U.S. Treasury Department issued Supplemental Directive 09-09 outlining the guidelines for the new Home Affordable Foreclosure Alternatives ("HAFA") program.

HAFA is the latest of several efforts of the Federal government to revive the slumping U.S. housing market, a market which has been affected by Federal intervention therein for 70 years for purposes of increasing housing affordability and availability to low-income families. With the collapse of the subprime mortgage market in 2006 and the corresponding economic crisis spurred on by widespread investment in mortgage-backed securities, a revival of the housing market has been the top objective of policymakers in Washington, D.C. Beginning during the waning months of the Bush Administration and passage of the First Time Homebuyer Tax Credit in 2008 and continuing into the Obama Administration with two subsequent modifications and extension of the Credit as well as the establishment of a federal mortgage loan modification program called the Home Affordable Modification Program ("HAMP"), these short-term fixes have met varying degrees of success. However, uncertainty abounds when considering the long-term effects these initiatives will have on the housing market.

Relation of HAFA to HAMP

HAFA is an outgrowth of the HAMP program which offered incentives to mortgage servicers and investors who were able to provide certain qualified borrowers with a modification of a first mortgage loan which was in default or at risk of default with the goal of keeping borrowers in their homes through the difficult economic times.

The Failure of HAMP

The HAMP program, however, has been derided by many economists and commentators as not only failing in its goals, but actually adding to the woes of the U.S. housing market. A January 2, 2010 New York Times article documents the ill effects of the program, including temporary modifications leading ultimately to new defaults and eventual foreclosures, banks using temporary modifications to avoid a proper accounting of the mortgage losses still on their books, and a glut of properties still on tap for foreclosure proceedings that will prolong the current housing slump.

In direct contrast to the HAMP program, the HAFA program does not facilitate borrowers retaining possession of homes that they can no longer afford. Instead, HAFA is designed to facilitate short sales and deed-in-lieu of foreclosure transactions for borrowers who qualify for HAMP but, for whatever reason, cannot complete a HAMP loan modification.

Background on Short Sales and Deeds In Lieu of Foreclosure

A short sale is the sale of a property at a price which is less than the aggregate balance of all liens against the property. The consent of all lenders and/or lienholders is required in order to close the sale, and consent is received only after a detailed analysis of the property's market value and the borrower's financial circumstances, including any hardship issues. A deed in lieu of foreclosure, referred to in short as a "deed-in-lieu,",describes a situation where the borrower transfers the property to the lender via a deed in satisfaction of the loan. In order for a deed-in-lieu to work, the borrower has to be able to deliver clear and marketable title to the lender, and the existence of junior liens will make this transaction unworkable as the senior lienholder, by accepting the deed from the borrower, would thus take title to the property subject to the junior liens.

HAFA's Eligibility Requirements

A loan is eligible for HAFA if its meets the criteria set out in the HAMP guidelines; namely:

- The property is the borrower's principal residence;
- The mortgage loan is a first lien mortgage originated on or before January 1, 2009;
- The mortgage is delinquent or default is reasonably foreseeable;
- The current unpaid principal balance is equal to or less than $729,750; and
- The borrower's total monthly mortgage payment (as defined in Supplemental Directive 09-01) exceeds 31 percent of the borrower's gross income.
- HAFA applies to loans not owned or guaranteed by Fannie Mae or Freddie Mac, which will issue their own versions of HAFA in coming weeks.

HAFA Program Guidelines

HAFA is a complex program, with 43 pages of guidelines and forms, designed to simplify and streamline use of short sales and deeds-in-lieu of foreclosure.

HAFA:

- Attempts to complement HAMP by providing a viable alternative for borrowers (the current homeowners) who are HAMP eligible but nevertheless unable to keep their home.
- Uses borrower financial and hardship information already collected in connection with consideration of a loan modification.

- Allows borrowers to receive pre-approved short sales terms before listing the property (including the minimum acceptable net proceeds).
- Prohibits the servicers from requiring a reduction in the real estate commission agreed upon in the listing agreement (up to 6 percent).
- Requires borrowers to be fully released from future liability for the first mortgage debt (no cash contribution, promissory note, or deficiency judgment is allowed).
- Uses standard processes, documents, and timeframes/deadlines.
- Provides financial incentives: $1,500 for borrower relocation assistance; $1,000 for servicers to cover administrative and processing costs; and up to $1,000 for investors for allowing a total of up to $3,000 in short sale proceeds to be distributed to subordinate lien holders (on a one-for-three matching basis).
- The program does not take effect until April 5, 2010, but servicers may implement it before then if they meet certain requirements. The program sunsets on December 31, 2012.

Analysis

HAFA's goals are laudable. Borrowers seeking a short sale approval or deed-in-lieu acceptance presently face an uphill battle and the great majority of short sale transactions are not consummated. Some of the HAFA guidelines, such as a floor on agent commission reductions, a pre-approval short sale process, and use of standardized documents, are positive developments.

Nonetheless, HAFA is likely doomed to failure for the same reasons that doomed the HAMP process. First, the pool of eligible loans is arbitrarily selected. Investment property loans are ineligible, as are mortgage loans above the $729,750 amount. Second, the incentives for participating servicers and investors - $1,000.00 to servicers and $1,000.00 to investors - do not seem sufficient enough to justify an acceptance of a short sale or deed-in-lieu over a foreclosure proceeding.

Third, and most significantly, is the fact that HAFA, like HAMP, only applies to first mortgage liens, and eligible borrowers are responsible for negotiating releases and/or consents with junior lienholders. Given that many homeowners are at risk of default in their mortgages because of repeated borrowing against their home's equity, many of the targeted borrowers have second and even third mortgage loans. It seems doubtful that a second mortgage holder will accept $3,000.00 in full satisfaction of its loan, meaning that financially-strapped borrowers will have to come up with additional funds out of pocket to obtain the release of these junior lienholders.

What About the Tax Credit?

With HAMP deemed a failure, and HAFA's prospects looking dim, has any recent governmental effort to spur on a housing recovery worked? Much has been written about the "success" of the first time home-buyer tax credit, and its recent extension through April 2010 would suggest that it must be having some sort of positive effect on the market. However, some commentators argue that while the credit has satisfied the objective of stabilizing housing prices, its overall economic effect has been to stabilize prices at artificially high rates. These commentators further argue that a second slump may result when the credit ultimately expires without renewal. Hence, while the home-buyer tax credit has shown better short-term success than HAMP, it remains to be seen whether the housing prices will rebound once the credit is no longer available later this year.

Conclusion

For decades, home ownership has been an integral part of the "American Dream." Unfortunately, decades of Federal intervention in the U.S. housing market designed to further this noble goal ultimately led to an unintended consequence - the creation and rise of the subprime mortgage market and a corresponding overinvestment in securities backed by these risky mortgage loans. When the subprime borrowers defaulted, a domino effect rippled through the housing market and the economy as a whole, and artificially inflated housing prices plummeted. The HAMP program, which attempts to keep borrowers in their homes and thereby prevent foreclosures, has been adjudged a failure by most experts, and the foreclosures have continued. Now comes the HAFA program, designed to streamline the short sale and deed-in-lieu process. While only time will tell as to whether HAFA will face the same fate as HAMP, the fact that HAFA is tied to the same set of limitations as the HAMP program suggests a similar fate.

In the end, the best program to spur on the recovery of the housing market is no program at all. Only when legislatively-imposed barriers to the normal foreclosure process are removed and lenders are allowed to clear out their inventory of foreclosed properties without further delays will housing prices drop to levels at which enough Americans can afford to purchase them.