Thoughtful Refinancing or Lipstick on a Pig?

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A few weeks ago the Congressional Budget Office (CBO) released a white paper entitled "An Evaluation of Large-Scale Mortgage Refinancing Programs," analyzing the potential impact of a so-called stylized refinancing program (more on that in a minute) that would promote widespread mortgage refinancing (or so they say..more on that too).

While the stylized program analyzed by the CBO is not an analysis based on a legislative proposal (and instead is an analysis based on a CBO-developed probabilistic model of borrower behavior, estimated from the historical performance of GSE and FHA mortgage loans), the analysis, nevertheless, serves as a basis to assess whether (any similar) refinancing program would have a significant impact on the U.S. housing market.

The stylized program analyzed by the CBO is aimed at helping those distressed borrowers who do not qualify for the current federal refinancing programs (i.e., HAMP, HARP and the FHA) by loosening eligibility requirements. The thought is—loosen eligibility requirements (e.g., relax LTV tests, waive appraisal requirements, limit borrower income tests, include existing loans guaranteed by the GSEs and FHA, etc.) and more distressed borrowers will be able to refinance their mortgages and avoid default. After all, even those contestants who are *not* smarter than a fifth grader know that avoiding default is beneficial to both the distressed borrowers and the economy at large.

Under these loosened eligibility requirements, the CBO estimates that the program would cause $2.9 million mortgages to be refinanced, resulting in 111,000 fewer defaults on loans and an estimated savings for the GSEs and FHA of $3.9 billion on their guarantee exposure, and from the borrowers' perspective, the estimate savings within the first year is estimated to be $7.4 billion. Wow—you say…things are looking good. But (and wait for it because it is a BIG BUT), the CBO estimates that federal investors in MBSs, including the Federal Reserve, GSEs and Treasury would experience an estimated loss of $4.5 billion. And, now for the BIG BUT, non-federal investors (i.e., everyone else involved) would experience an estimated loss of $13-15 billion.

All of this loss for what (here is where we feel a sense of déjà vu):

- a program that doesn't help delinquent borrowers (i.e., borrowers most likely to default)—actually, the program specifically excludes delinquent borrowers and borrowers that have been late for 30 days within the past year—and sounds a lot like the existing federal programs HARP and HAMP, which have been criticized for not helping enough borrowers;

- a program that will have a net benefit on the economy of about 0, as the losses to investors will negate the gains to borrowers;

- a program, that in the end, probably won't reach too many distressed borrowers, because many borrowers that wanted to refinance and could, one way or another, have already done so (remember, mortgage rates *have* been historically low for a few years now);

- a program that may end up increasing the GSEs and FHA guarantee exposure, as lenders will likely not agree to refinance unless the "put back" options and standard reps and warrants about the loans themselves are eliminated; and

- a program that does nothing for borrowers with significant negative equity to reduce the incentive for "strategic" default or the susceptibility to delinquency caused by life or other economic realities (think unemployment rate 9.1%).

We want to see an end to borrower delinquency and foreclosure as much as the next guy, but creating another program that has about as much chance of success as the *Cubs* winning the World Series is not the direction in which our hopes should be pitched.