

A MARSHALL PLAN FOR AMERICA'S HOUSING WOES

Foreclosures are rising. Lawsuits are flying. Banks are beleaguered. There has to be a better way. Fortunately, there is.



BY MATTHEW GOLDSTEIN
NEW YORK, OCT 29

What will it take for the U.S. housing market to shake off the gloom?

Even before some of the nation's biggest mortgage lenders were forced to suspend foreclosure proceedings because of faulty paperwork, it was becoming clear that the Obama administration's year-old effort

to pump life into the housing market was falling short.

The federal government just reported that 4.2 million homeowners are "seriously delinquent" on their mortgages and some 10.9 million borrowers are underwater, meaning their loans exceed the value of their homes.

To make matter worse, there is the threat of protracted litigation between banks and

borrowers because lenders might not have followed the letter of law in processing foreclosure paperwork.

An even bigger source of worry is the \$426 billion in so-called second liens -- home equity loans, second mortgages and other loans "junior" to the primary mortgage -- that sit on the balance sheets of Bank of America, JPMorgan Chase, Wells Fargo and Citigroup.



LOCKED UP: A vacant building for lease is pictured in upper Manhattan, New York, October 26, 2010. REUTERS/MIKE SEGAR

“WE WANT TO KEEP AS MANY PEOPLE IN THEIR HOMES AS POSSIBLE, BUT THERE ISN’T A FREE LUNCH.”

The nation’s four biggest banks report that less than 4.5 percent of these loans are delinquent, according to Weiss Ratings. But some mortgage finance analysts like Joshua Rosner of Graham Fisher & Co remain skeptical. “Are the second liens properly reserved for? The banks say they are but that’s debatable,” said Rosner.

Add it all up and there’s the potential for the U.S. housing market to languish in a stupor for years to come.

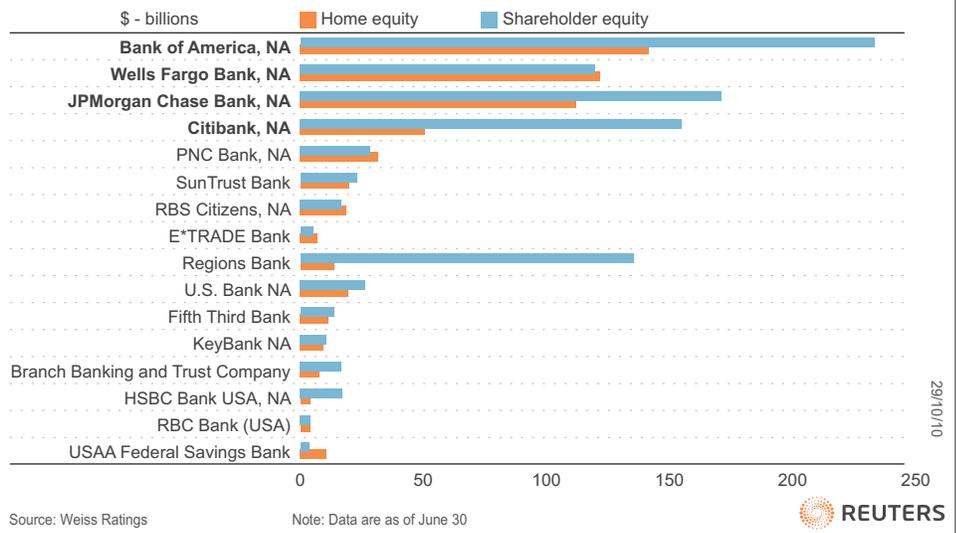
As bleak as all that might sound, there could be a way out -- one that doesn’t involve another government bailout.

Reuters found that after talking to nearly two-dozen housing experts, mortgage traders, lawyers, securities experts and others, there is broad agreement about what a solution to the mortgage crisis might look like. They say a fix must allow many borrowers to stay in their homes, compensate disgruntled mortgage investors and allow banks to take write down loans without causing a repeat of the financial crisis of 2008.

“In the end, everyone has got to give a little and that includes investors, banks, homeowners and regulators,” said Barbara Novick, vice chairman at BlackRock Inc, the world’s largest money management firm. “We want to keep as many people in their

The Second Lien Monster

The biggest U.S. banks have significant exposure to home equity mortgages—big enough to theoretically wipe out most of their net worth as companies. But so far, most banks report that less than 5 percent of their second lien home loans are delinquent.



homes as possible, but there isn’t a free lunch. We want to keep losses manageable for the banks, but enforce principles of contract law as well.”

GRAND COMPROMISE

As always, the devil is in the details. And while everyone may talk about the need for all sides to cooperate, there is still wide disagreement about a solution.

The standoff between banks, borrowers and bond investors benefits few. The only ones who stand to gain from such recalcitrance are the bloggers, pundits and polemicists who throw around catcalls like “banksters” to describe Wall Street bankers and “freeloaders” to describe borrowers who

have stopped making mortgage payments. So a grand compromise would seem to make sense.

BlackRock, for instance, is a proponent of giving federal bankruptcy judges the power to take a holistic approach to a borrower’s debt that doesn’t just focus on a homeowner’s mortgage debt as part of a loan modification. So far, the money manager’s so-called mortgage cramdown proposal has not garnered much support on Capitol Hill.

BlackRock, which manages funds that have invested heavily in mortgage-backed securities, maintains that banks should take bigger writedowns on home equity loans, especially if bond investors must assume

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any losses from a principal writedown on the underlying mortgage.

It's a position that other bond investors endorse. They say one reason the market for mortgage-backed securities has been slow to recover is the federal government's decision to let banks modify mortgages without taking a corresponding hit on home equity loans.

Rosner said the banks are acting as if their big portfolios of home equity loans are performing well, but that may not be the case, especially if the first mortgages fail to perform.

Given that many borrowers are underwater on their mortgages, he said, and "if the possibility of a broad program of principal writedowns occurs, the big four banks could, through the cycle, lose 40 to 60 cents on the dollar on their second lien exposures."

Others say that the only reason the delinquency rate on home equity loans has remained low is that banks often permit borrowers to make minimal monthly payments on that debt, much like a credit card.

The critics contend that in the worst case scenario, the big four banks could suffer losses on home equity loans of up to \$200 billion. To put that in perspective, JPMorgan's total shareholder equity as of June 30 was about \$171 billion.

For the last few quarters, the biggest banks have been reducing the reserves set aside for delinquent loans, and they are fairly uniform in rejecting the doomsday scenarios about the mountain of home equity loans sitting on balance sheet.

Bank of America, with \$141.7 billion in second-lien exposure -- the most of any U.S. bank -- said its hefty book of home equity loans is in good shape because 90 percent "are stands-alone originations" not tied to troubled mortgages.

"It's not fair to do a broad industrywide analysis on home equity loans and assume they are all the same," said Bank spokesman Jerome Dubrowski.

JPMorgan, with \$112 billion in second liens, has charged off about \$2.6 billion in home equity loans this year, not including impaired loans it absorbed from Washington Mutual.

SPREADING OUT THE LOSSES

Still, housing and banking experts say it's the potential for large losses on home equity loans that has rendered the mortgage crisis so intractable. After being propped up by U.S. taxpayers and then spending the past year building up capital, banks are hardly pinning to take another round of writedowns and charges.

"To ultimately resolve this, you are going

to have to come up with some solution for the second liens the banks own," said Bill Frey of Greenwich Financial Services, a firm that specializes in mortgage investing and which has been at the forefront of fighting for the rights of institutional investors. "No one wants the banks to fail, but the banks are going to have to write down second liens."

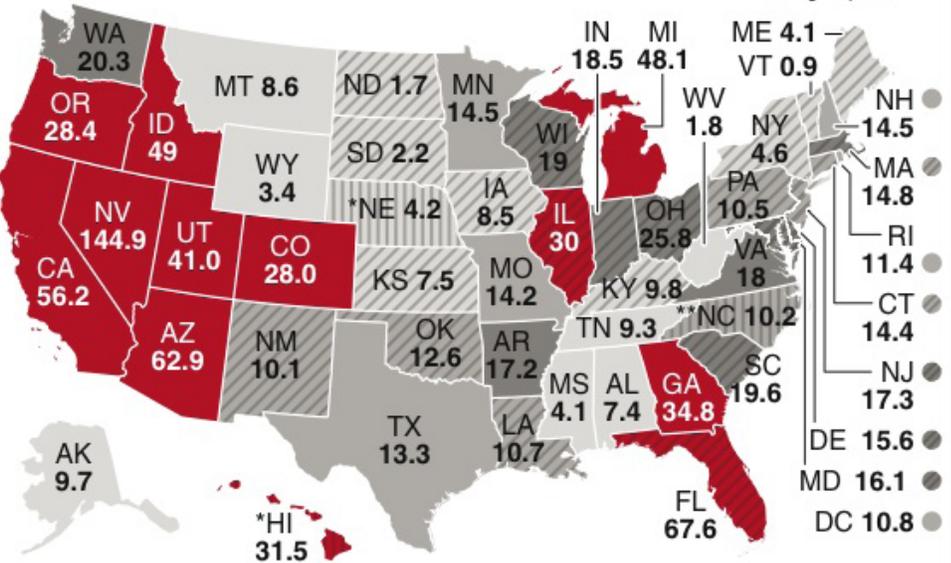
One solution for dealing with the home equity loan issue would be for the regulators

U.S. FORECLOSURES

There were 347,420 total foreclosure filings in September, 3 percent higher than August and 1 percent higher than a year earlier

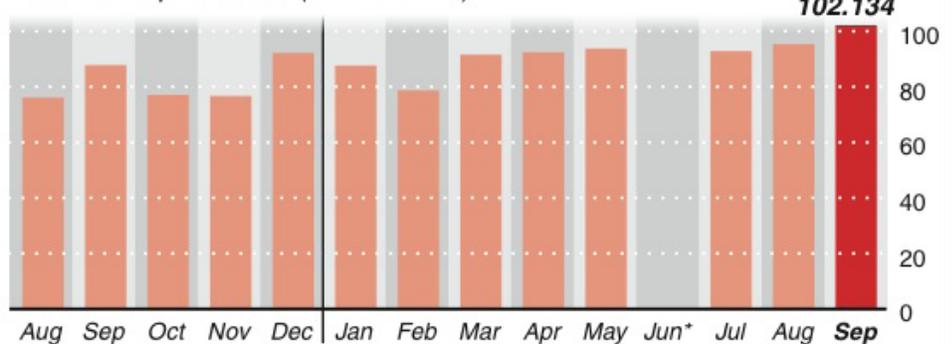
FORECLOSURE FILINGS

Per 10,000 residential units in September



MONTHLY BANK FORECLOSURES

Total from top 10 states (in thousands)



Sources: News reports, RealtyTrac, Atom PR

* Data unavailable



BLOG

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<http://link.reuters.com/heq72q>



OUT ON THE STREETS: A pile of clothes and a sofa sit outside a foreclosed home in Los Angeles, October 25, 2010. (Left) REUTERS/LUCY NICHOLSON Women pass a foreclosed home in Chicago June 29, 2010. (Right) REUTERS/JOHN GRESS



to allow banks to spread out the writedowns over many years, said some of the people Reuters spoke to. Another fix would be to force the banks to take the hit at all once, but have the government provide a loan that is paid down each quarter from the bank's reserves.

But the experts Reuters talked to said once banks are forced to deal honestly with their home equity liability, it makes it easier for other parties to take their lumps as well and come up with creative solutions to the mortgage mess.

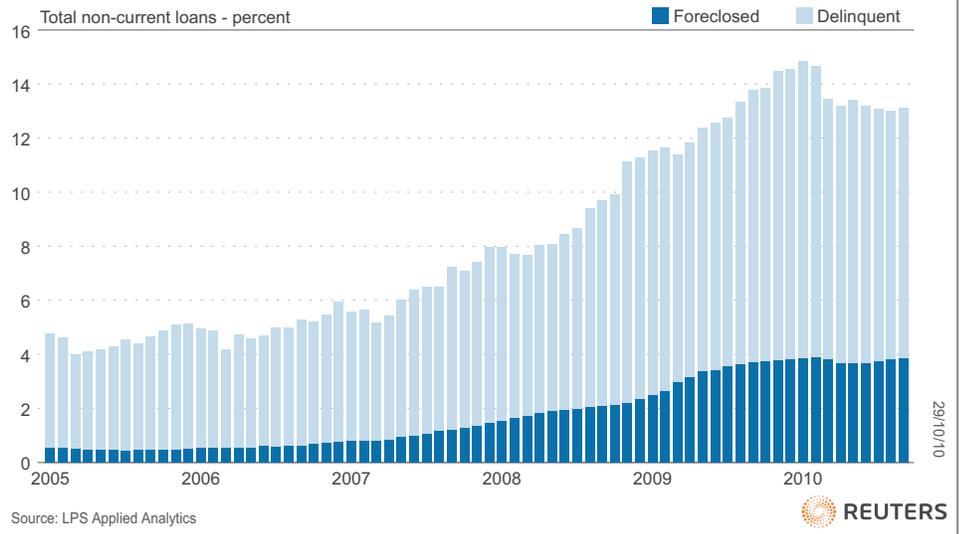
Investors in mortgage-backed bonds would then be less likely to balk at principal reductions on primary mortgages held by borrowers without much cash. A willingness by banks to take a hit on second liens would make it easier to devise a rescue plan that folds the mortgage and home equity loan into a single low-interest rate loan with a reduced principal obligation.

Also, bond investors might become more flexible on negotiating a resolution with banks on claims that lenders are obligated to buy back home loans that were flawed from the start -- either because of defective paperwork or faulty underwriting standards. They're threatening to sue the banks over their alleged failure to live-up to the "representations and warranties" they made about the loans they stuck into mortgage-backed bonds.

Frey suggested that instead of some cash settlement with the banks, mortgage

Mortgage woes persist

The number of U.S. homeowners either behind on their mortgage or facing foreclosure has soared during the financial crisis and is easing far too slowly.



Reuters graphic/Van Tsui

investors might be receptive to receiving preferred stock in a bank.

"No one wants to put the banks in an untenable situation," said Vincent Fiorillo, a mortgage-backed security trader and portfolio manager with Los Angeles-based DoubleLine Capital. "If the choice is between getting something, I think that as a fiduciary getting something would be my first choice."

Fiorillo said it may ultimately take some third party to bring all the sides together and hammer out a "Marshall Plan for the mortgage business."

Any willingness by the banks to take losses on second liens could be just the cure to lure

mortgage investors back to the securitization market -- the very thing that caused the debacle in the first place.

REMEMBER SUBPRIME

In the aftermath of the worst financial crisis since the Great Depression, the business of packaging loans into asset-backed bonds has gotten a bad reputation. Collateralized debt obligations cobbled together from bonds backed by subprime mortgages may go down as one of the worst forms of financial engineering ever.

But not all securitization is bad. It allows banks to free up capital to provide additional lending. One reason securitization remains

in a slump is because private bond investors remain wary after getting burnt on CDOs and because of the dispute with banks over allegedly faulty underwriting standards during the mortgage boom.

"There are two sides to this, which is first untangling the mess and then the question of how do we restart securitization and move forward," said Chris Katopis, executive director of the Association of Mortgage Investors, a bond investor lobby whose members include Fortress Investment Group and DoubleLine Capital. "There are common themes to dealing with both these issues in terms of transparency and better representations and warranties by banks on mortgages."

Meanwhile, for homeowners burdened with so much debt that a reduced mortgage won't make much of a difference, some say it may require the government or banks to provide rent subsidies and possibly relocation money until those borrowers can get back on their feet.

"We're years late in dealing with this and that has made the problem much worse," said Janet Tavakoli, a Chicago-based derivatives consultant who has been a long-time critic of the way banks packaged and sold mortgage bonds during the housing boom. "Entire neighborhoods are devastated and many innocent homeowners with sound

mortgages are underwater."

Tavakoli said a fund to subsidize rents for foreclosed borrowers could be financed "with fines, penalties and judgments" stemming from a resolution of litigation over faulty loan documentation. Law professor Michael Madison, who is teaching this year at

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Columbia Law School and specializes in real estate transactions, said he sees the need for the government to step in and help out some borrowers.

"This talk about a foreclosure moratorium is just going to make the housing crisis worse because it disables the banks in retrieving properties and selling them," said Madison. "But in some cases, this isn't going to get solved unless the federal government comes in and subsidizes the borrowers."

Of course, anything that smells like a bailout may be a tough, if not impossible thing to sell in this political environment. But if all parties to the mortgage mess give a little, it might require U.S. taxpayers to chip in again.

The alternative of doing nothing and waiting for the economy to bail out the housing market seems dim.

"This high unemployment equilibrium could last for years," said Robert Shiller, Yale University economics professor and co-creator of the S&P Case Shiller Index, which monitors the nation's housing market.

"If you are going to deal with this in the short run, you are going to have to violate contracts," he added. "What is more worrisome than the recession itself is that the government doesn't seem to represent the people anymore."

(Additional reporting by Alina Selyukh; Editing by Jim Impoco and Robert MacMillan)



EVICTED: Protesters hold signs outside a foreclosed apartment building, which four families were being evicted from, in Los Angeles, June 11, 2009. REUTERS/LUCY NICHOLSON

AS HAMP GOES UP IN SMOKE, U.S. NEEDS A NEW HOUSING PLAN -- JUST DON'T SAY "BAIL-OUT"

BY ALINA SELYUKH
NEW YORK, OCT 29

The U.S. government's main anti-foreclosure program isn't winning many friends these days because of its poor track record in getting banks to modify mortgages for cash-strapped borrowers.

Of the roughly 1.4 million borrowers who entered the loan modification program, about half were kicked out and did not get the amount of money owed on their mortgage reduced.

Critics of the government's Home Affordable Modification Program, or HAMP, say it's now time to give a fresh look at other ideas to stem the wave of foreclosures. Below are three proposals that are generating the most interest.

GOVT-BACKED REFINANCING

As far back as 2008, Glenn Hubbard, an economic adviser to former President George W. Bush and now a professor at Columbia Business School, has been pitching a plan for a government-backed refinancing program.

Hubbard and his Columbia colleague Christopher Mayer want to use Fannie Mae and Freddie Mac to prod mortgage servicing firms to refinance loans for some 30 million borrowers with high-interest rate mortgages. The Columbia professors, who contend their plan would cost nothing to U.S. taxpayers, propose the new mortgages would be folded into a new round of mortgage-backed securities issued by the government-sponsored finance firms.

The program would target cash-strapped borrowers who are current on their payments but face a risk of declining income and slumping home value.

But to some critics this smacks too much of another housing bailout and to date the measure has drawn little enthusiasm from U.S. lawmakers.

RIGHT-TO-RENT

Some say it's time for the American Dream

to include renting a house as well as owning one. And supporters of this move away from home ownership are the biggest proponents of a so-called right-to-rent program.

One version of the plan, which was proposed by Westwood Capital managing partner Dan Alpert in 2008, would offer delinquent borrowers an option of renting their foreclosed homes at a market rate for five years. The homeowners-turned-renters then would have a chance to buy the house at market value down the road.

The plan would require legislation but it is attractive to some because it forces both borrower and lender to compromise. The borrower gets to stay in the house as renter, but loses the deed to the home. The lender, on the flip side, gets forced to accept a lower-than-original payment.

"It does create losses for the banks, but it avoids the sort of fire-sale environment," Alpert said.

"CRAMDOWN"

The so-called "cramdown" proposal takes the mortgage dispute to court, allowing struggling homeowners to plead to a federal judge for lengthened loan terms, interest rate cuts or reductions in mortgage balances by filing for bankruptcy.

Not surprisingly, the word "bankruptcy," attached to the idea of delinquent borrowers, has run into a lot of resistance on Capitol Hill.

But cramdown supporters, including many bond investors, like the idea because it deals with a major flaw with HAMP, which is a failure to address second liens and home equity loans tied to a property.

Barbara Novick, vice chairman of BlackRock Inc, said a special bankruptcy chapter could be created just for mortgage cramdowns to allow a judge to consider all of a borrower's debts and craft a solution that would force interested parties to compromise.

Not surprisingly, the idea of giving bankruptcy judges added power does not sit well with many banks.



REUTERS/JASON REED

"IT DOES CREATE LOSSES FOR THE BANKS, BUT IT AVOIDS THE SORT OF FIRE-SALE ENVIRONMENT"

Then again, no program for fixing the nation's housing woes is going to make everyone happy. And no plan completely will lift the system from the epidemic of foreclosures. But a consensus is growing that it is time to try something new given HAMP's poor track record.

As Columbia's Mayer said: "What we need are permanent solutions."

(Reporting by Alina Selyukh; Editing by Matthew Goldstein and Claudia Parsons)



PRICKLY PROBLEM: A sign on a foreclosed home is seen in Los Angeles, California, October 25, 2010. **REUTERS/LUCY NICHOLSON**

SIX STEP PROGRAM FOR HOUSING HANGOVER

REUTERS RECENTLY TALKED to nearly two dozen experts about ways to repair the U.S. housing market and while there was much disagreement, the making of a consensus did seem to emerge. Below are suggested paths to finding a way out of the mortgage

- A Camp David summit -- The White House needs to gather together representatives of the banks, borrowers, bond investors and regulators for a summit to discuss an all-encompassing settlement.
- Second lien writedowns -- Any grand deal must entail banks agreeing to take writedowns on their hefty exposure to home equity loans.
- Regulatory easing -- In return for taking writedowns on second liens, regulators must craft a solution for banks to absorb losses over many quarters, or even years, to prevent lenders from depleting precious capital.
- Big Refi -- For eligible borrowers, primary mortgages and home equity loans are rolled into a new mortgage with a reduced principal and ultra-low interest rate.
- Bond investors deal -- In combination with second lien writedowns, bond investors support meaningful principal reductions on primary mortgages and negotiate with banks on how to resolve claims over alleged faulty bonds.
- Borrowers compromise -- Homeowners who can't manage even a reduced loan agree to give up title to a home and relinquish legal claims over potentially faulty documents in return for rent subsidies and relocation expenses.

COVER PHOTO: Vicente Oliveros holds up his eviction notice in Los Angeles, June 11, 2009. **REUTERS/LUCY NICHOLSON**

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