The New York Times
DealBook
Edited by Andrew Ross Sorkin

JUNE 25, 2010, 2:02 AM

Analysts Question a Threat by Fannie

Fannie Mae's decision to begin punishing people who walk away from their unpaid mortgages could prove difficult to sell to the public and might be impossible to execute, housing and lending experts said Thursday.

The big mortgage financing company, which owns or guarantees millions of mortgages, announced on Wednesday that it would sue homeowners who have the capacity to pay but default anyway, David Streitfeld reports in The New York Times. It also said it would prevent these strategic defaulters from getting a new Fannie Mae-backed loan for seven years, which could potentially shut millions of buyers out of the market.

But it was unclear, the experts said, why Fannie Mae was threatening delinquent owners and what it hoped to achieve. The new direction seems to run counter to the Obama administration's efforts to reinvigorate the housing market. And there were basic questions about how Fannie would be able to distinguish between those homeowners who defaulted intentionally and the unfortunate ones who had no choice.

"How are they going to do this, and for what result?" asked Grant Stern, president of the **Morningside Mortgage Corporation** on Bay Harbor Islands, Fla. "So they can find the people who have a little money left after their house crashed and take it away from them?"

A Fannie Mae spokeswoman said that the goal of the new punitive policies was to force defaulting homeowners to work with their servicers to surrender their houses through either a lender-approved short sale or by formally giving up the deed.

"We really want to encourage borrowers to pursue alternatives to foreclosure," said the spokeswoman, Janis Smith.

Fannie's newly aggressive stance comes as the debate is heating up over how much, if at all, borrowers should be held liable for their foreclosures.

Republicans recently added a measure to a Federal Housing Administration financing bill in the House of Representatives that would forbid strategic defaulters from getting an F.H.A.-insured loan.

The California Legislature is debating a proposed law that goes in the other direction, shielding many more delinquent borrowers from debt collectors.

Fannie and its sister company, **Freddie Mac**, control 30 million mortgages, providing liquidity to the housing market. They have been under government conservatorship since September 2008; the ultimate cost of the rescue to taxpayers might hit $400 billion.

Chris Dickerson of the Federal Housing Finance Agency, which regulates Fannie, said, “We support Fannie Mae taking a policy position that discourages borrowers who can afford to pay their mortgage from walking away.”

Fannie Mae will announce the details of its new program next month, when the servicers who collect mortgage payments on Fannie’s loans will get explicit instructions on how to make recommendations for lawsuits.

But for some in the mortgage business, the new direction seemed little more than a cruel joke.

“Fannie wants to lock people up in a jail of negative net worth for much of the rest of their lives,” said Lou Barnes, a Colorado mortgage banker. “They’re bringing back the debtor’s prison.”

The plan poses some political problems as well as practical ones. Fannie Mae might be a ward of the government but its new policy is at distinct odds with the Obama administration, which has been trying to restart the fragile housing market by lowering interest rates, offering tax credits and insuring millions of new loans.

A Treasury Department spokesman said Fannie Mae’s plan did not represent official Obama administration policy. A spokesman for Freddie Mac said it was closely following Fannie’s moves but had not yet adopted them.

Strategic defaults have been a rising concern for years. Lenders first noticed people purposefully ditching their houses early in the financial crisis. In late 2007, Kenneth D. Lewis, then chief executive of **Bank of America**, said people were remaining current on their credit cards but defaulting on their home loans, a phenomenon that he said “astonished” him.

The lenders are less surprised now, but perhaps more worried. Bank of America said recently that it was putting owners in danger of foreclosure into payment plans that were supposed to be affordable — but that a third of the borrowers were failing to pay anyway.

“You could say the customer is choosing not to make those payments,” said Jack Schakett, credit loss mitigation executive for Bank of America Home Loans.

Borrowers who stop paying the mortgage can get a year of free rent, and sometimes two. “There is a huge incentive for customers to walk away,” Mr. Schakett said in a recent media briefing.

Fannie is not saying how many of its borrowers are strategically defaulting. The firm's delinquency rate, traditionally about 0.5 percent of its portfolio, began sharply ascending in mid-2007. At the beginning of this year, it leveled off at 5.5 percent.

About a quarter of homeowners with mortgages, or about 11 million households, owe more than their home is worth, and are potentially vulnerable to a strategic default. A flat or rising real estate market could encourage many of them to hold on; a declining market would suggest it was time to go.

Fannie was established as a federal agency in 1938 but was chartered by Congress as a private company in 1968. For years it prospered by virtue of its special status as a government-sponsored entity charged with increasing the nation's homeownership rate, enriching its shareholders and executives in the process.

During the housing boom Fannie overreached and bought many loans of buyers who were ill-equipped to pay them. Its fate is uncertain; it is not even clear it will be around in seven years to enforce any edicts.

Christopher F. Thornberg, a principal at **Beacon Economics** who correctly forecast that the housing boom would implode, said he understood what Fannie was trying to do, and even sympathized to a degree.

It is rational economics, he said, to assume that someone who walked away from an unpaid mortgage once might do so again. It also made sense, he said, for Fannie to try to limit strategic defaults from becoming an even bigger problem. And the new program also addresses the moral hazard question, Mr. Thornberg said: If borrowers are not punished for their missteps, they might not learn their lesson and might do it again.

And yet, he noted, the banks were bailed out, and their executives walked away rich. "Why should I pay my dues when they did not?" he said. "There is no clean answer on this."

Go to Article from The New York Times »