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Dust-Up

Obama's mortgage plan: What should taxpayers think?

Why should they shoulder some of the losses generated by bad loans? Richard K. Green and Christopher Thornberg debate.

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Today's topic: In President Obama's plan, taxpayers would pay loan-serving companies, lenders and troubled homeowners billions of dollars to keep those homeowners out of foreclosure. Why should taxpayers -- particularly those from parts of the country that aren't inundated with defaulting mortgages -- shoulder some of the losses generated by bad loans? Richard K. Green and Christopher Thornberg debate the president's foreclosure- prevention plan.

Time to hold our noses and help troubled borrowers

Point: Richard K. Green

It is easy to understand why many taxpayers -- especially those who have always made their mortgage payments or have remained renters -- would resent subsidizing the bad behavior of lenders and some borrowers. Indeed, as recently as a year ago I would have opposed government-subsidized loan modification.

That said, the world has changed since then. First, many borrowers who were responsible now find themselves in trouble because rapidly falling home prices in some areas have left them with mortgage balances that exceed their house value, because they have lost their job in the midst of a rapidly deteriorating employment market, or both. The idea of allowing people to refinance into new loans backed by Fannie Mae and Freddie Mac at the current low interest rates -- even if the borrowers now have little or no equity -- makes a lot of sense to me.

Second, the costs of having even irresponsible borrowers default are large. Recent work by a number of scholars has convinced me that foreclosed houses, once they reach some critical mass within a neighborhood, do substantial damage to the value of nearby houses. Foreclosed houses, moreover, are not well maintained and therefore harm neighborhood aesthetics. I think we must hold are noses and pursue policies that reduce foreclosures, which I believe the Obama plan will do.

That said, I would like to see an additional feature in the Obama plan: a claw-back provision for those who get a direct mortgage subsidy from the government and then later sell at a profit. If we taxpayers are going to help people remain in their houses, we should get the equivalent of partial-ownership interests in the houses we subsidize.

I hope one of the lessons we have learned is that if families want to really be homeowners, they have to make a financial commitment to their houses in the form of down payments. We have actually known for a long time that very low or zero down-payment loans do not perform well. We also find that people who use other people's money for down payments often are less likely to pay their mortgages back than those who use their own money. But in the current environment, more families who did make large down payments and who paid their monthly mortgage installments on time are in trouble. I think we need to help them.

Richard Green is director of the Lusk Center for Real Estate at USC, where he is also a professor in the School of Policy, Planning and Development and the Marshall School of Business.

What taxpayers should and shouldn't be angry about

Counterpoint: Christopher Thornberg

Taxpayers should resent the idea that their hard-earned money is going to bail out those who took on loans they clearly couldn't afford. They should also resent taxpayer money going to banks whose egomaniacal CEOs take on excessive risk to drive up their annual bonuses to absurdly high levels even as they buy $1,000 garbage pails and walk away rich from the ruin they leave behind.

But there is a large difference between the two situations from a public policy perspective. When banks fail, the potential impact on the credit markets and money supply is enormous. This is a lesson well learned after centuries of banking crises. It is the reason we have a Federal Reserve bank system.

But we don't have a Federal Reserve-style housing system. Why? Because the evidence that blight is caused by foreclosures is scanty at best, and blight is not a massive public issue that can cause economic depressions. Some studies of California housing markets in the early 1990s do seem to show a link between blight and foreclosures, but we have to remember that the greater cause of the blight was the fact that there were no buyers of the foreclosed units. This was because of the loss of population thanks to the horrid downturn in the Southern California economy, which was driven by the rapid loss of many defense and aerospace industry jobs.

In short, if we are going to spend taxpayer money, I would suggest that we use it not to help people who spent beyond their means to keep homes they don't deserve, but to help those prudent families take advantage of falling prices by buying empty units. This prevents blight and rewards good behavior, not bad.

And if we really wish to not harm those who may have made a bad choice, how about another basic change: If they allow themselves to be foreclosed on quickly and efficiently, let's not allow any black marks on their credit records. Then they can start fresh and perhaps go buy one of those foreclosed units themselves.

In any case, policy debate aside, taxpayers have little to fear. Most folks out there that used subprime or Alt-A mortgages bought so far outside their means and are so far underwater that there is little that can be done for them within the limited means provided under Obama's bailout plan. They don't qualify for Freddie or Fannie refinancing, and there is simply no way their loans can be modified to keep them in their houses. As such, I expect that little taxpayer money will actually be spent on the worst of the borrowers.

Christopher Thornberg is a founding partner with Beacon Economics.