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Loan modifications: Why it's in the TARP

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There are many people out there who say that we need to solve our problems in the residential marketplace before we can hope for improvement in the banking and credit crisis, and subsequent economic problems. Specifically, they are referring to the increasing defaults on sub-prime and adjustable rate mortgages (ARM), many of which are moving towards foreclosure.

Previously in this Journal, I wrote about residential declines in Las Vegas and Arizona causing the financial collapse of Iceland. I thought the article was somewhat tongue in cheek, but there was more than a thread of truth. Problematic residential mortgages have led to real worldwide banking problems, uncertainty, and a lack of transparency, which have led to the reluctance to lend, and a broadening economic recession. Ironically, what started out as a real estate related banking crisis has now spread to the general economy further exacerbating the downward banking spiral.

Statistics vary, somewhat dramatically, but I have been able to glean the following facts to help put the problem in context. No one knows for sure, but the total of amount of USA residential mortgages is estimated to be well above $10 trillion. About $1.9 trillion of this pool was written as "sub prime" mortgages during the period 2004 to 2007. In the same time frame, about $750 billion of adjustable rate mortgages were issued. There are certainly more ARMS written prior to 2004, but many have been re-written into these statistics. Therefore, around 25 to 30% of all mortgages appear to be vulnerable.

Of these vulnerable mortgages, and again the statistics vary, about 50% of the sub prime mortgages are delinquent or in foreclosure as of this date. Similarly, about 25% of the ARMs are delinquent or in foreclosure. Thus, about $1.14 trillion or 11% of the mortgage pool is moving toward or in foreclosure.

It certainly is a significant economic problem as it filters through our banking system, and equally important, it is a significant social problem as people lose their homes. However, there does appear to be help on the way. Over the last several months, there have been significant discussions about pressuring lenders to re-work mortgages, extend terms, lower rates, and even reduce principal. The first $350 billion of TARP was given to banks in part to start this process, and some banks have appropriately responded. Some have not. The most recent proposal for part of the next $350 billion of TARP money is to provide a loan guarantee program in addition. Therefore, if a person qualifies, they can have their loan restructured, principal reduced, and FDIC guarantee of the principal. Surely that will allow even the most nervous of banks to forebear on foreclosure.

Personally, and politically, I have problems with some of this effort if the money makes its way to speculators, property "flippers" and others who simply do not deserve these benefits. Further, the other $9 trillion dollars of "good" loans will not be guaranteed by the government, or reduced, and there will thus be many homeowners who feel that their responsible financial planning goes unrewarded. While there undoubtedly will be these inequities, there also will be a dramatic social correction for those who were aggressively manipulated to over-extend themselves, or who are victims of extreme economic problems unforeseen by everyone.

On a purely economic basis, these actions will also have a beneficial impact. I doubt that they will stop this recession prematurely, but it will take a lot of uncertainty out of the equation, and bring lending practice back to a stable and more conservative position and have a positive impact on our economy ..... a win-win for all of us.

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