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Paulson Considers New Plan to Resuscitate U.S. Housing Market

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By Robert Schmidt and Dawn Kopecki



Dec. 4 (Bloomberg) -- Treasury Secretary **Henry Paulson** is considering a new plan to reduce mortgage rates in another bid to revive the U.S. housing market, a government official said.

The Treasury, which already has a program to buy mortgage-backed securities issued by **Fannie Mae** and **Freddie Mac**, could step up those purchases to drive down interest rates on some loans to 4.5 percent, the official said on condition of anonymity. The plan is preliminary and could change.

The deliberations come as President-elect **Barack Obama** pledges fresh action to help American homeowners, and follow a \$600 billion initiative announced by the Federal Reserve last week to buy mortgage debt. Mortgage applications surged by a **record** last week and the **average rate** on a 30-year fixed-rate loan dropped to 5.47 percent, the lowest level since June 2005, the Mortgage Bankers Association said yesterday.

"Lower mortgage rates will allow households to fortify their balance sheets, and we will likely see consumer spending come back a little quicker than it would otherwise," said **Mark Vitner**, a senior economist at Wachovia Corp. in Charlotte, North Carolina. At the same time, "it's not going to be an instant panacea for what ails the economy," he said.

While lowering mortgage rates to 4.5 percent would allow most homeowners to refinance into a cheaper loan, far fewer will actually qualify, said **Rajiv Setia** and **Nicholas Strand** at Barclays Capital in New York.

Can't Force Banks

"Over 90 percent of the mortgage universe out there would be refinancable, but you can't force banks to lend to people," said Setia, a fixed-income strategist for Barclays.

The Bush administration has been faulted by Democrats and consumer advocates for failing to take sufficient steps to stem record home-loan foreclosures this year. Federal Housing Finance Agency Director **James Lockhart** has been prodding private mortgage servicers and bond investors to cooperate with government efforts to modify or refinance loans for troubled borrowers.

Treasury "keeps nipping at the edges to come up with a wholesale response, but always ends up with a partial response," said **John Taylor**, president and chief executive officer of the National Community Reinvestment Coalition in Washington. "Regardless of whatever rhetoric Paulson keeps throwing around, foreclosures continue to go up."

Brookly McLaughlin, a Treasury spokeswoman in Washington, declined to comment.

Paulson's Deals

Paulson last December brokered a deal with banks and mortgage servicers to fix interest rates on some

subprime loans for five years. He put together an industry-led coalition called "Hope Now" to help Americans at risk of losing their homes. He first resisted, then accepted, foreclosure relief as part of the \$168 billion economic-stimulus package passed in February.

House prices in 20 U.S. cities declined in September at the fastest pace on record. The S&P/Case-Shiller home-price index dropped 17.4 percent from a year earlier. Foreclosure filings in October were up 25 percent from a year ago, according to RealtyTrac Inc., a seller of default data.

Washington-based Fannie and McLean, Virginia-based Freddie, seized by FHFA on Sept. 6 after examiners found the companies' capital to be too low or of poor quality, own or guarantee about \$5.2 trillion of the \$12 trillion U.S. home-loan market.

Only Helps Agencies

Strand, Barclay's head of agency mortgage bond strategy, said between 20 percent and 25 percent of U.S. loans originated in 2006 and 2007 are currently under water and wouldn't qualify for refinancing through Fannie and Freddie, which require borrowers to maintain at least 3 percent equity in their homes.

"So this would help, but it only helps agency borrowers," Strand said. "I don't see how this would help other non-agency borrowers who essentially can't even get a mortgage at this point."

Agency mortgage securities are guaranteed by federally chartered Fannie or Freddie, or by government agency Ginnie Mae.

Yields over benchmarks on agency mortgage bonds have widened as mortgage rates tumbled. The **difference between yields** on Washington-based Fannie's current-coupon 30-year fixed-rate mortgage bonds and 10-year Treasuries widened to as high as 208 basis points yesterday, the closing level the day before the Fed's announcement. A basis point is 0.01 percentage point.

Bloomberg current-coupon indexes represent the average of yields for the two groups of mortgage bonds with prices just above and below face value, the ones lenders typically package new loans into. The spread helps determine the rates offered to homeowners on new prime mortgages of \$417,000 or less in most areas, and up to \$625,500 in high-cost locations.

Increasing Portfolios

When taking over Fannie and Freddie, the largest U.S. mortgage-finance companies, Paulson said that he would direct the firms to increase their \$1.5 trillion mortgage-asset portfolios and have his department start buying their home-loan bonds to help lower the cost of home financing.

Last week, the Fed announced plans to buy as much as \$500 billion of agency mortgage securities, as well as \$100 billion of Fannie, Freddie and Federal Home Loan Bank corporate debt.

Amid Congressional criticism of "Hope Now," Paulson asked lawmakers in July to authorize him to purchase equity stakes in Fannie Mae and Freddie Mac as a way of boosting confidence in the mortgage lenders and expanding credit. At the time, he told Congress he wouldn't need to use the authority because simply having it would be enough -- less than two months later he was forced to take the two over.

Paulson then pushed Congress to pass a \$700 billion plan to buy toxic mortgage investments from banks, recognition that previous plans to aid the financial and housing markets had failed. He has used almost half of the Troubled Asset Relief Program to inject capital into financial firms, which has yet to result in an increase in bank lending.

Lawmakers criticized his announcement last month to abandon the original intent of the TARP, saying Paulson had failed to use the funds to aid homeowners. The Treasury chief last week reiterated that his department was studying ways to use TARP money to stabilize the housing market.

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