

# Flash Comment

February 19, 2009

*Signe Roed-Frederiksen, Senior Analyst, +45 45 12 82 29, sroe@danskebank.dk*

*Peter Passing Andersen, Senior Analyst, +45 45 13 70 19, pa@danskebank.dk*

## USA: Obama's housing plan

**Overview:** The Obama administration yesterday evening released the details of their "Homeowner Affordability and Stability Plan", which has three main components: 1) Improve access to refinancing, 2) Restructure mortgages that are at risk of default, 3) Support low mortgage rates through Fannie Mae and Freddie Mac.

**Details:** The refinancing part of the program will allow homeowners, who have existing loans already backed by Fannie Mae or Freddie Mac, to refinance even if their loan-to-value has risen above 80%. The Obama administration estimates that the looser refinancing rules would provide the opportunity for 4-5 million homeowners to eventually refinance via the GSEs. This will make the Treasury and the Fed's MBS purchase programmes somewhat more powerful, as more borrowers would have the opportunity to refinance at the lower rate.

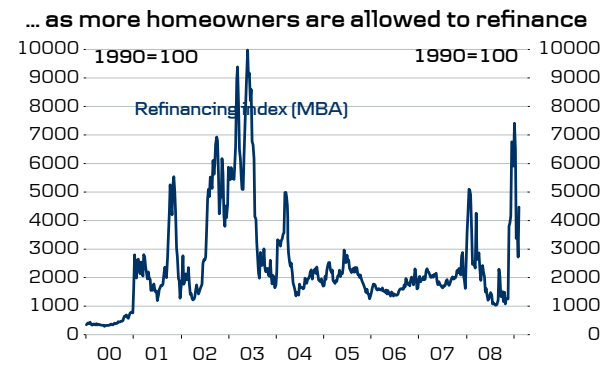
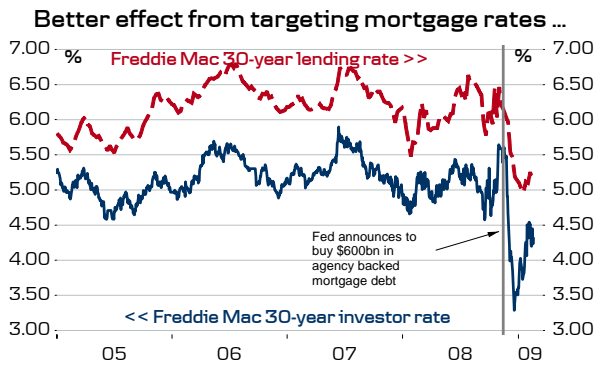
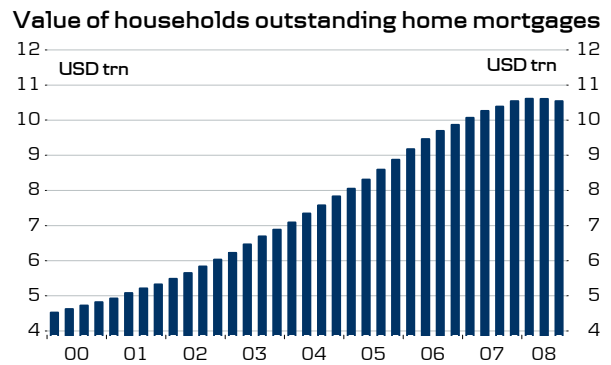
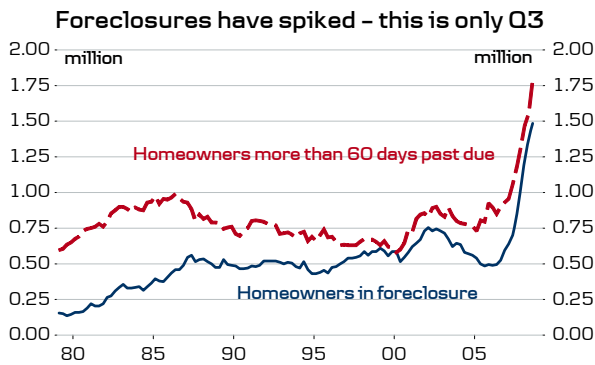
The plan also includes aid and guidelines for **loan modifications**. The government will provide \$75bn in support for the program financed by TARP funds. The plan will encourage lenders to reduce the monthly mortgage payment to 31% of the borrower's gross income for so-called "at risk" homeowners. The costs will be shared between mortgage holders and the government. The lender would bear the cost of reducing the monthly payments down to 38% of income and the government would match dollar-for-dollar further reductions in monthly payments down to 31% of income. Lenders or servicers will receive \$1,000 for each loan modification meeting the guidelines in the plan and the Treasury will provide \$1,000 to the servicer each year (for three years) and the borrower (for five years) if the loan stays current. After five years, the mortgage rate would gradually reset to the conforming loan rate in place at the time of the modification. Lenders will also be able to bring down monthly payments by reducing the principal owed on the mortgage, with the Treasury sharing the cost. Finally an incentive of \$1,500 will be paid to the mortgage holders if they modify at-risk loans before the borrower falls behind.

The plan also includes a partial guarantee of principal on modified loans. A \$10bn fund will be designed to discourage lenders from opting to foreclose on mortgages out of fear that home prices could bring restructured mortgages under water. The insurance payment will be linked to declines in the home price index. The full eligibility of requirements for the programme and the exact details of the programme will be announced on March 4

The Obama administration estimates that the plan could help as many as 3-4 million homeowners at risk of foreclosure. The latest data shows that nearly 1.5 million homeowners were in foreclosure in Q3 and another 1.8 million were more than 60 days past due on their payments. So helping 3-4 million homeowners at risk seems significant.

The final part of the program is securing lower mortgage rates by **supporting GSEs**. The Treasury will increase its preferred stock purchase agreement with each GSE from USD 100bn to USD 200bn in order to boost their capital if needed. The extra USD 200bn is not taken from the TARP fund but is funded by commitments made under the Housing and Economic Recovery Act. In addition, the size of GSEs' retained mortgage portfolio allowed will be increased by USD 50bn to USD 900bn.

**Assessment & Outlook:** The US housing market continues to struggle and the rise in foreclosures is putting additional downward pressure on home prices. It is therefore positive that the US government is now targeting foreclosures directly - the estimated decline of 3-4 million in the number of homeowners at risk of foreclosure is significant. However, it remains to be seen whether the plan will ultimately have a major effect on prices and activity in the housing market. Regarding the refinancing part of the plan, we see this as generally good. It will make the Treasury and the Fed's MBS purchase programmes more powerful, as more borrowers would have the opportunity to refinance at the lower rate and it seems to be a relatively cheap way to support household income.



Sources for charts: Danske Bank, EcoWin

*This report has been prepared by Danske Research, which is part of Danske Markets, a division of Danske Bank. Danske Bank is under supervision by the Danish Financial Supervisory Authority. Signe Roed-Frederiksen, Senior Analyst.*

*Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high quality research based on research objectivity and independence. These procedures are documented in the Danske Bank Research Policy. Employees within the Danske Bank Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and to the Compliance Officer. Danske Bank Research departments are organised independently from and do not report to other Danske Bank business areas. Research analysts are remunerated in part based on the over-all profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.*

*Danske Bank research reports are prepared in accordance with the Danish Society of Investment Professionals' Ethical rules and the Recommendations of the Danish Securities Dealers Associations.*

**Financial models and/or methodology used in this report**

*Calculations and presentations in this report are based on standard econometric tools and methodology. Documentation can be obtained from the above named authors upon request.*

**Risk warning**

*Major risks connected with recommendations or opinions in this report, including a sensitivity analysis of relevant assumptions, are stated throughout the text.*

**First date of publication**

*Please see the front page of this research report.*

**Disclaimer**

*This publication has been prepared by Danske Markets for information purposes only. It is not an offer or solicitation of any offer to purchase or sell any financial instrument. Whilst reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation is made as to its accuracy or completeness and no liability is accepted for any loss arising from reliance on it. Danske Bank, its affiliates or staff, may perform services for, solicit business from, hold long or short positions in, or otherwise be interested in the investments (including derivatives), of any issuer mentioned herein. The Equity and Corporate Bonds analysts are not permitted to invest in securities under coverage in their research sector. This publication is not intended for retail customers in the UK or any person in the US. Danske Markets is a division of Danske Bank A/S. Danske Bank A/S is authorized by the Danish Financial Supervisory Authority and subject to limited regulation by the Financial Services Authority (UK). Details on the extent of our regulation by the Financial Services Authority are available from us on request. Copyright (C) Danske Bank A/S. All rights reserved. This publication is protected by copyright and may not be reproduced in whole or in part without permission.*