Wall Street Journal

OCTOBER 9, 2008

The Next $300 Billion

John McCain wants your mortgage.

John McCain got the diagnosis right in Tuesday night's debate with Barack Obama -- the economy won't recover until home prices find a bottom. We're less convinced that his plan to buy underwater mortgages at taxpayer expense is the cure this patient needs.

The principle that underlies the idea is not new: If there were some way to halt the tide of foreclosures and distressed sales, the supply of unsold homes should fall and prices should stabilize. If that could be accomplished, investors and lenders alike would have a much clearer idea what the losses would be on mortgages and mortgage securities. That, in turn, would bring buyers back into the market for the mortgage securities and related products that are crippling credit markets.

So far, so good. But can the McCain "Resurgence Plan" get us there? In the past year, we've had other attempts to put a floor under the market by reducing foreclosures. The Treasury's 2007 HOPE program was an attempt to orchestrate voluntary loan refinancings, and the $300 billion Federal Housing Administration mortgage program, slated to start this month, has a similar goal.

The "Resurgence" is different, the McCain campaign says, because it is more "aggressive." By this, it means that this one doesn't require lenders or investors to share the pain. Instead, the government will buy the mortgages for their full amount and write a new mortgage that reflects the current (lower) value of the home. The taxpayer -- not the lender or homeowner -- absorbs the losses on loans that exceed the value of the home.

The McCain campaign said yesterday this program would help 10 million homeowners, which is close to the 12 million whose mortgages are thought to be worth more than the current value of their homes. The campaign adds that the $300 billion estimate might be high, since the program could reduce the need to buy mortgage-backed securities under the Hank Paulson rescue plan.

On the other hand, home prices are likely to keep falling despite the McCain plan if the economy goes into recession, so the best defense against that is to unfreeze the credit markets more quickly via capital infusions from the Paulson facility. And unlike the Paulson plan, the McCain proposal appears to offer no upside for taxpayers. They take all the losses up front and don't participate in any rebound in house prices, so borrowers who overextended and lenders who made reckless loans are made whole, and taxpayers get the bill. At least the $300 billion FHA program imposes at least a 10% haircut on lenders.

Senator McCain's advisers allow for the possibility that the Treasury could receive some kind of equity kicker in the refinance. Thus a homeowner who later profited from the sale of a house that Treasury had written down would reimburse some of that cost. But there's no mention of that in the campaign's materials on the plan.

Meanwhile, it's far from clear how the Treasury would appraise, underwrite and issue millions of loans in a short space of time. There are entire industries devoted to that task in this country. And each of them, in their way, contributed to the present situation -- although with plenty of help from government subsidies for mortgage credit at every step.

We're all for thinking creatively to solve the country's housing correction, and Mr. McCain's obvious political intention is to show struggling homeowners that he cares. Perhaps the best argument for the McCain idea is that it is likely to be far less expensive than the Second New Deal that Barack Obama is likely to propose on January 20 if he wins. But Mr. McCain's plan to transform Treasury into a major mortgage lender, and running the operation at a potential $300 billion loss, raises more questions than it answers