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The Obama foreclosure plan

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More than 2 million families lost their homes to foreclosure over the past two years while the Bush administration negligently watched from the sidelines as the housing market spiraled downward. If nothing were done to break this self-reinforcing cycle, another 2.3 million homeowners this year alone will suffer foreclosure. This bleak scenario by itself well justifies the plan President Barack Obama unveiled Wednesday to address the foreclosure crisis.

One part of the plan would pump $75 billion into mortgage adjustment incentives for banks from the already-approved TARP bailout funds. A second part of the plan will allow Freddie Mac and Fannie Mae, the government's mortgage corporations, enough flexibility in mortgage underwriting guidelines to refinance up to another $200 billion worth of troubled mortgages for qualified homeowners.

The nation's housing and foreclosure crisis clearly warrant the Obama plan. Larger circumstances, as well, make the plan necessary and welcome.

Waves of foreclosures have not only poisoned the housing market and blighted many developments. They also have become central factors in dragging down local economies, and the nation's overall economic strength.

Like a contagion that fuels an epidemic, the foreclosure cycle and accompanying decline in housing and equity values overall has eroded the sense of economic well-being and assumed financial worth of homeowners generally, regardless of how sound and secure the jobs and mortgages may be of people not remotely threatened by foreclosure.

These larger losses, both attitudinal and on paper, work against the economy broadly by restraining the normal consumer spending on which our broad economy depends for 70 percent of economic activity. The chain-cycle of layoffs and soaring unemployment costs resulting from such constrained consumer spending is literally accelerating the downward spiral, leading in turn to even more layoffs and further depressed levels of spending.

Breaking this vicious cycle may be the most important economic priority — and stimulus plan — that the Obama administration can undertake. In this sense, as with the congressional stimulus plan, the mistake may be to err on the side of doing too little, not too much. It is yet unknowable if the Obama plan is too little, but it certainly is not too much.

At the moment it is more robust than any previously mentioned plan. The $75 billion in incentives that it opens to lenders to encourage them to modify mortgage loans to stem foreclosure is 50 percent higher than FDIC chairwoman Sheila Bair suggested last year. President Obama apparently can establish this incentive by executive order, as it will derive from second half of the $700 billion bailout fund initiated by former President Bush to stabilize the banking system.

The Obama plan also includes a stick to go with this carrot to prompt recalcitrant banks to adjust unaffordable loans for homeowners who qualify for such aid under the attached guidelines. That stick is the administration’s support for bankruptcy reforms which would allow bankruptcy judges to modify mortgage loans over a bank’s objections — a move long opposed by banks.

Inaction by banks to stem foreclosures the past two years demonstrate how necessary that cram-down provision has become, however. Banks have been all too willing to allow foreclosures, even if they end up taking losses that loan modifications would have avoided. In doing so, they have stymied a large portion of the lending that the TARP funds were meant to lubricate. Mr. Obama should hold firm on the bankruptcy reform.

Allowing Freddie Mac and Fannie Mae more leeway in underwriting troubled mortgages is necessary, as well. The deeper the housing market has sunken, the more homeowners have found themselves “under water” on their mortgages. When their equity exceeds the marked-down value of their homes, they’re more apt to walk away from their houses if they run into financial trouble.

The plan’s refinancing standards clearly won’t help all people trapped in newly unaffordable mortgages. The screening standards aren’t recklessly loose. But they would help people with some equity and a good chance of repaying an adjusted mortgage loan.

Overall, the plan will help millions of homeowners, and it should go a long way toward stabilizing home values and bank stability. That can’t happen too soon.