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The One Housing Solution Left: Mass Mortgage Refinancing

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MORE than four million Americans have lost their homes since the housing bubble began bursting six years ago. An additional 3.5 million homeowners are in the foreclosure process or are so delinquent on payments that they will be soon. With 13.5 million homeowners underwater — they owe more than their home is now worth — the odds are high that many millions more will lose their homes.

Housing remains the biggest impediment to economic recovery, yet Washington seems paralyzed. While the Obama administration's housing policies have fallen short, Mitt Romney hasn't offered any meaningful new proposals to aid distressed or underwater homeowners.

Late last month, the top regulator overseeing Fannie Mae and Freddie Mac blocked a plan backed by the Obama administration to let the companies forgive some of the mortgage debt owed by stressed homeowners. While half a million homeowners could be helped with a principal writedown, the regulator, Edward J. DeMarco, argued (we believe incorrectly) that helping some homeowners might cause others who are paying on their loans to stop so that they also could get their mortgages reduced.

With principal writedown no longer an option, the government needs to find a new way to facilitate mass mortgage refinancings. With rates at record lows, refinancing would allow homeowners to significantly reduce their monthly payments, freeing up money to spend on other things. A mass refinancing program would work like a potent tax cut.

Refinancing would also significantly reduce the chance of default for underwater homeowners. With fewer losses from past loans burdening their balance sheets, lenders could make more new loans, and communities plagued by mass foreclosures might see relief from blight.

Well over half of all American homeowners with mortgages are paying rates that would appear to make them excellent candidates to refinance. Many of those with stable jobs, good credit scores and even a modest amount of home equity have already done so, taking out 30-year loans at rates around 3.5 percent, some of the lowest rates since the 1950s. But many others can't refinance because the collapse in house prices has wiped out their home equity.

Senator Jeff Merkley, an Oregon Democrat, has proposed a remedy. Under his plan, called Rebuilding American Homeownership, underwater homeowners who are current on their payments and meet other requirements would have the option to refinance to either lower their monthly payments or pay down their loans and rebuild equity.

A government-financed trust would be used to buy the mortgages of homeowners who had refinanced at an interest rate that was about 2 percentage points more than the record-low Treasury rates at which the government borrows. This would generate enough interest income to cover the costs of any defaults, administration of the trust and other expenses. Families would have three years to refinance; after that, the trust would stop buying loans and eventually wind itself down as homeowners repaid their loans.

Homeowners would see lower mortgage payments and rebuild equity more quickly. Taxpayers would get their money back, with interest, and would gain further as a stronger economy lifted tax revenues. Banks and other mortgage investors would get potentially troubled loans off their books. Some banks won't like losing the large amounts of interest income they are earning on their current mortgages, but if the refinancing market were working properly these loans would have been refinanced long ago.

If the program was very successful, we envisage that two million outstanding loans could be placed in a Rebuilding American Homeownership trust at its peak. If the average mortgage balance was $150,000, then at the peak there would be $300 billion outstanding.

The federal government could finance the plan directly, through the Federal Housing Administration, or indirectly, through the Federal Home Loan Banks, which offer government-backed credit. Or the Federal Reserve could underwrite the plan; the central bank's chairman, Ben S. Bernanke, recently talked about the Fed's doing something akin to the Bank of England's new Funding for Lending program, which offers incentives to banks to increase lending to households and nonfinancial businesses.

Opponents of additional borrowing or Fed lending will say that a program like this is an unacceptable risk, but the greater risk is to do nothing and let the housing market continue to hold back the economy.

Mr. Merkley's plan resembles the Obama administration's Home Affordable Refinance Plan, or HARP, which was designed to help underwater homeowners refinance loans backed by Fannie and Freddie. It has made possible 1.4 million refinancings, far fewer than the goal set in 2009 of 3 million to 4 million. The administration has made some improvements to HARP and proposed others. But the Merkley plan has the potential to go further, reaching the 20 million households with mortgages that aren't backed by Fannie or Freddie.

The Merkley plan has a successful precedent in the Home Owners' Loan Corporation, established in 1933. It swept more than a million Americans out of foreclosure and into the long-term, stable mortgages that would become the hallmark of the middle class during the 1950s and '60s. It's time to revive this idea.

Since the Great Recession began almost five years ago, housing has been at the heart of our economic woes. If we do nothing, the problem will eventually resolve itself, but only with significant pain and a long wait. Mr. Merkley's plan would speed the healing.

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