Impact

A regulatory impact analysis must accompany every economically significant federal rule or regulation. The Office of Policy Development and Research performs this analysis for all U.S. Department of Housing and Urban Development rules. An impact analysis is a forecast of the annual benefits and costs accruing to all parties, including the taxpayers, from a given regulation. Modeling these benefits and costs involves use of past research findings, application of economic principles, empirical investigation, and professional judgment.

The Impact of the HOPE for Homeowners Program Rule

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This article reflects the views of the authors and does not necessarily reflect the views of the U.S. Department of Housing and Urban Development.

Abstract

The HOPE for Homeowners program allows homeowners to avoid foreclosure, using the Federal Housing Administration (FHA) insurance program structure already in place. Certain borrowers facing difficulties with their mortgages are eligible to refinance into FHA-insured mortgages. The benefit of the program is the prevention of foreclosures, which have associated economic costs on the foreclosed-on household, lenders, neighboring properties, and the local government. The cost of the HOPE for Homeowners program to the taxpayer is the subsidy paid to the FHA to cover the cost of the credit guarantee not covered by program revenues. We estimate the expected net benefit of the program to range from $6,200 to $35,500 per refinancing. Thus, with only 10,000 participants annually, the program will generate $62 million to $355 million of net benefits to society. Program participation could be as high as 100,000 annually, however, with commensurately higher benefits.

Overview of HOPE for Homeowners Program

The Housing and Economic Recovery Act (HERA) of 2008 established the temporary HOPE for Homeowners program. The program allows homeowners to avoid foreclosure, using the Federal Housing Administration (FHA) insurance program structure already in place at the U.S. Department of Housing and Urban Development (HUD). Under the program, certain borrowers facing difficulties with their mortgages are eligible to refinance into FHA-insured mortgages. The program was implemented on October 1, 2008, and will last through September 30, 2011. The FHA will insure up to $300 billion in new loans. Borrowers will pay the FHA an upfront mortgage insurance premium of 3 percent of the original insured mortgage amount and an annual premium of 1.5 percent of the outstanding balance thereafter.[1]

Participation in the program is voluntary; thus, there must be agreement among all involved parties: the senior mortgage holder, all junior mortgage holders, and the homeowner. Mortgage lenders that might otherwise pursue foreclosure on a loan may find that they can minimize their losses by helping the homeowner refinance into a new mortgage loan insured by the FHA under the program.[2]

HERA sets both general and specific requirements for affected parties. Senior mortgage holders are required to accept, as payment in full, no more than 90 percent of the current appraised value of the property (87 percent after payment of the upfront premium to the FHA). Subordinate mortgage holders must write off the entire amount due to them, in exchange for a share of future property-value appreciation. To qualify, borrowers' debt-to-income ratio on their previous mortgage must be at least 31 percent. The homeowner must agree to pay HUD a portion of the property equity created in the new mortgage (defined as the difference between the appraised value and the initial balance of the new mortgage) and 50 percent of any future property value appreciation. HUD would then pay the subordinate mortgage holders from that 50-percent share.[3] Positive profits (if any) earned by the FHA from the program through the premiums and appreciation-sharing provisions will be used to pay down the national debt. Net losses arising from the cost of providing the credit-guarantee will be paid for by the Treasury but may be reimbursed by Fannie Mae and Freddie Mac to an extent described in Section 1338(b) of HERA.

Cost-Benefit Analysis

The economic impacts of the rule stem largely from congressional mandates, because the final rule adheres closely to the prescriptive language of the statute. The expected net benefits of the HOPE

[1] For more information on the rule, please see the FHA website on the HOPE for Homeowners program (HUD/FHA, 2008) and the regulation itself (Docket No. B-2009-F-01).

[2] Although HUD and the FHA are to administer the program, a statutorily created Board of Directors (consisting of HUD, the Treasury, the Federal Deposit Insurance Corporation, and the Federal Reserve) is charged with establishing the program's standards and policies and providing program oversight.

[3] After the HOPE for Homeowners program was launched, the Troubled Assets Relief Program (TARP) legislation (or the Emergency Economic Stabilization Act of 2008, which became Public Law 110-343) modified some of the program's provisions. Specifically, the TARP authorizes the Board to consider loan-to-value ratios higher than 90 percent and make direct payments to junior lien holders to provide greater incentives for these lien holders to release their liens.

for Homeowners program are substantial. We estimate that, with only 10,000 participants annually, the program will generate $62 million to $355 million of net benefits to society. Program participation could be as high as 100,000 annually, however, with commensurately higher benefits.[4]

Benefits

A benefit of HERA that the rule implements is the prevention of foreclosures, which have associated economic costs. The Joint Economic Committee of the U.S. Congress (Joint Economic Committee, 2007) estimates the costs per foreclosure at almost $80,000. The foreclosed-on household pays moving costs, legal fees, and administrative charges of $7,200 (Moreno, 1995). Lenders also bear significant costs in terms of legal fees. A study from the Federal Reserve Bank of Chicago reported that lenders alone can lose $50,000 per foreclosure (Hatcher, 2006). The $50,000 loss is estimated for a $210,000 property. Standard & Poor's (2008) describes these costs as consisting of loss on loan/property, property maintenance, appraisal, legal fees, lost revenue, insurance, marketing, and cleanup. Of these costs, the primary cost to lenders is the cash loss on property sale.

If the loss to a lender from foreclosure is $50,000, the gain to the lender from participating in the program will be less than $50,000. To enter the program, the lender must accept, as payment in full, an amount equal to no more than 87 percent of the current property value. In the case of our example property, currently valued at $210,000, the amount the lender would accept would be $183,330. In a typical situation in which the senior mortgage lender had an 80-percent loan on the property but local property values have declined by 25 percent, then the original property value would have been $280,000, and the amount of outstanding indebtedness owed would be $224,000 for a property currently valued at $210,000. The loss incurred by the first lien holder from the requirements of the program would then be $40,670 ($224,000 less $183,330). Thus, the gain from participating in the program is the $50,000 loss in foreclosure, less the $40,670 cost of program participation, for a net benefit to the lender of $9,330.

The benefits to the lender from participating could be greater than $9,330. It is possible that the loss of property value ($210,000 before foreclosure) via foreclosure in target areas of the program will be substantially more than the $50,000 estimate provided in the Federal Reserve study. In a distressed market, the loss of value on the property could be substantially higher. Vacant homes in distressed neighborhoods are also more likely to suffer vandalism, forcing the lender to incur property-rehabilitation expenses. Thus, the final loss to the lender from foreclosure could exceed the $50,000 estimate. If the lender loss from foreclosure were $75,000, the lender benefit from program participation in this example would be about $35,000.

Foreclosures resulting in long-term vacancies have a negative impact on the value of neighboring properties by reducing the physical appearance of the neighborhood, attracting crime, and

[4] Note that the estimates presented in this article are slightly different than the ones in the original Regulatory Impact Analysis, which was written before the submission of the final rule. First, we are using the credit subsidy estimates made by the Board and approved by the Office of Management and Budget. These estimates were not finalized at the writing of our initial analysis. Second, we adopt assumptions concerning the program foreclosure rates consistent with the final estimates. Third, our thinking concerning the benefits of participation to lenders has evolved, resulting in a slightly lower estimate of the expected loss to lenders in the event of a foreclosure of one of the new FHA loans.

depressing the local economy. The Joint Committee of the U.S. Congress cites an estimate of $1,508 by Immergluck and Smith (2006) of the negative externality of a single foreclosure on nearby properties. In addition, the local government loses money from a foreclosure through lost taxes from the foreclosed property, unpaid utility bills, property upkeep, and a shrinking tax base as home prices decrease. The Joint Committee uses an estimate of $19,227 of the average cost per foreclosure to local governments from a study by Apgar and Duda (2005).

HUD's estimate of the average gross economic benefits of averting foreclosure is $37,265; however, this benefit will not be realized for every household assisted. Some households will default on their new FHA loan and eventually lose their homes in foreclosure even after the loan writedown. Although the program maintains the FHA's requirement that new loans be based on a family's long-term ability to repay the mortgage, some foreclosure is experienced on all types of FHA loans.

The first lien lenders will retain their full benefit of $9,330 per loan sent through the program, because these benefits are not affected by foreclosures on the new loans. The lenders who originate the new FHA-insured loans at the writtendown amounts, however, will bear losses of about $3,780 on each insured loan that ultimately goes to foreclosure, because FHA-insured lenders typically absorb some of the foreclosure costs, estimated to be 2 percent of the unpaid balance. Thus, the net benefit to lenders as a group would fall from $9,330 to $8,574 per participant if 20 percent of the participants eventually end up in foreclosure. The net benefit to lenders as a group falls to $7,818 if 40 percent of participants fail to repay their loans.

The expected benefit per refinancing for other categories (cost avoided for homeowners, local governments, and neighboring properties) is equal to our estimated benefit multiplied by the probability that a property does not go into foreclosure after the writedown.

Costs

The cost of the HOPE for Homeowners program to the taxpayer is the subsidy paid to the FHA to cover the cost of the credit guarantee not covered by program revenues.[5] The subsidy is the difference between the present value of the cost to the FHA and the future stream of revenues. It is only in scenarios with high program foreclosure rates that positive costs of assistance could be expected. The Board estimates that, as long as the program foreclosure rate is below 34 percent, the credit subsidy rate would be negative. A negative rate implies that the program would generate net budget receipts in present value terms. The possibility of net receipts even under a high program foreclosure rate scenario is due to the very large revenue streams built into this program. HERA mandates that the FHA charge an upfront premium that is twice its normal charge and an annual premium three times its normal charge; the act also mandates that the homeowner agree to pay the FHA a significant portion of the property equity created at the time of the program refinance and to share one-half of all property appreciation with the FHA. Gains by the FHA from the program's credit guarantee would go to the Treasury and would ultimately be used to pay down the national

[5] The figure of $300 billion, which is the amount available through mid-2011 to insure new FHA-issued mortgages to qualified homeowners, is not the cost to taxpayers. First, because participation in the program is voluntary, the total cost of the program is uncertain. Second, the average cost of assistance is not the upfront cash required to purchase the loan but the subsidy required to the FHA to break even on the deal.

debt, while losses would be ultimately reimbursed by Fannie Mae and Freddie Mac to the extent described under Section 1338(b).

If the program foreclosure rate were 40 percent, HUD estimates a positive subsidy rate of 10 percent, or $18,333 per loan. If the program foreclosure rate were 20 percent, HUD estimates a negative subsidy of 2.5 percent, or $4,583.[6] Exhibit 1 shows the economic benefits to various individuals and entities of participation in the HOPE for Homeowners program.

Exhibit 1

Expected Economic Benefits per Refinancing

Category of Benefit	Estimated Benefit per Foreclosure Prevented ($)	Expected Benefit per Refinancing at Program Foreclosure Rate of 20% ($)	Expected Benefit per Refinancing at Program Foreclosure Rate of 40% ($)
Homeowner	7,200	5,760	4,320
Lender	9,330	8,574	7,818
Local government	19,227	15,382	11,536
Neighboring home value	1,508	1,206	905
Total costs of foreclosure	**37,265**	30,922	24,579
Subsidy to the FHA		– 4,583	18,333
Net benefit to public		35,505	6,246

FHA = Federal Housing Administration.

Net Benefits

The net benefit of the program to society is equal to the gross benefits of avoiding foreclosures less the cost to the public of providing those benefits. At a high program foreclosure rate of 40 percent, which was assumed by the Board, the expected benefits per household assisted would be $24,579. Even if the program costs were extremely high, at $18,333 per household, net economic benefits would amount to $6,246. At a lower program foreclosure rate, the expected benefits of preventing a foreclosure would be higher and the cost would be lower; thus, the net benefit would be higher because the program foreclosure rate is lower. In the lower foreclosure rate scenario of 20 percent, the expected benefits are greater, at $30,922, and the FHA receives an average profit of $4,583 per loan. Because this negative subsidy will be contributed to the Treasury, it can be considered a transfer to the taxpayer. Under a foreclosure rate of 20 percent, the net benefit of the program to the public is $35,505.[7]

[6] The estimates of the credit subsidy are very sensitive to assumptions concerning the path of future housing prices. The Board's estimates, used here, are based on an allowance for an immediate price decline of 5 percent due to appraisal error, a significant price decline over the next 3 years, and a return to a long-run annual growth trend of 3.4 percent. Using the same model, but assuming no initial drop due to appraisal error, the same decline over the next 2 years, and an eventual long-run growth rate of 3.0 percent, yields a positive subsidy of 2 percent at the 40-percent program foreclosure rate and a negative subsidy of 9 percent at the 20-percent program foreclosure rate.

[7] Under the alternative housing price scenario of lower short-run price depreciation, the net benefit to the public of this rule per refinancing would be $47,400 for a program foreclosure rate of 20 percent and $20,900 for a program foreclosure rate of 40 percent.

Aggregate Impact

The level of participation in the program is a major unknown. The Board estimates that up to 400,000 participants may be in a position to use the program over its 3-year lifespan. In a slightly less optimistic scenario of 100,000 participants annually, the gross benefits could be as high as $3.1 billion and the net benefits to the taxpayer could be even greater, at $3.6 billion.

Many reasons suggest that annual program participation will be less than 100,000. Lenders may not find sufficient incentives to participate, even compared with the costs of foreclosure. A lender must be willing to assume a 10-percent loss if it allows mortgage holders to refinance. Foreclosure and the HOPE for Homeowners program are not the only alternatives available to a lender. The lender also has the option of proposing to the borrower a workout plan of the lender's own design.[8]

Some features of the program could discourage homeowners from participating. For example, the homeowner must sign agreements to pay unknown amounts of money to HUD in the future. Although unknown, these amounts might be substantial in dollar terms. For every refinancing, the senior mortgage holder must reach an agreement with the homeowner as well as the junior mortgage holder and the new FHA lender, and must do so relatively quickly. The burden of negotiating among four parties, and doing so quickly, may lead to the failure of some efforts to effect a workout.

If the annual level of participation proves to be 10,000, then the gross benefits are $309 million annually and the net benefits to the public are $355 million annually at a 20-percent program foreclosure rate. The gross benefits are $246 million annually and the net benefits to the public are $62 million annually at a 40-percent program foreclosure rate. Calculated over the program's 3-year lifespan and discounted at 7 percent, these amounts add up to a net benefit of $175 at a 40-percent foreclosure rate and $997 million at a 20-percent foreclosure rate.[9] Exhibit 2 displays

Exhibit 2

Aggregate Annual Benefits of Program

Number of Participants	Gross Benefit ($MM)	Benefit Net of FHA Subsidy ($MM)	Gross Benefit ($MM)	Benefit Net of FHA Subsidy ($MM)
	20% Program Foreclosure Rate		*40% Program Foreclosure Rate*	
5,000	155	178	123	31
10,000	309	355	246	62
25,000	773	888	614	156
50,000	1,546	1,775	1,229	312
100,000	3,092	3,551	2,458	625

FHA = Federal Housing Administration.

[8] A high participation rate may come to fruition despite some of the barriers discussed for several reasons. For example, Bank of America Corporation has agreed to settle claims brought by state attorneys general regarding certain risky loans originated by Countrywide Financial Corporation. Under the terms of the deal, which involves up to 390,000 loans, Bank of America will first try to refinance borrowers into FHA loans under the HOPE for Homeowners program (Simon, 2008).

[9] Under the alternative housing price scenario of lower short-run depreciation, the aggregate net benefits would be $474 million for a program foreclosure rate of 20 percent and $209 million for a program foreclosure rate of 40 percent. The present value of the aggregate net benefits over the 3 years of the program and discounted at 7 percent is $587 million at a 40-percent foreclosure rate and $1.3 billion at a 20-percent foreclosure rate.

the aggregate annual benefits of program participation based on the number of participants and likely scenarios under 20- and 40-percent foreclosure rates.

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