

Finally -- unlike most of the sell-side mortgage shops who are positioned off-sides -- a note was put out in Reuters this morning from James Pethokoukis about a potential **Administration August GSE surprise** analyzing such a move from a political standpoint. It is getting a lot of play. While I like the political rationale of the note, I think the basis for this communiqué -- that the Admin is about to announce some massive mortgage principal balance forgiveness program in a couple of weeks -- is **not accurate**. He claims that "rumors running wild" than the Admin is about to order the GSE's to forgive mortgage debt of millions of underwater homeowners".

Remember, HAMP 2.0, which was announced in March, is supposed to roll out in the "fall" according to Treasury. We already know this. It consists of a **1) GSE Principal balance modification program 2) a short-term mod program for unemployed borrowers 3) and an FHA short refinance/principal balance reduction program. I would expect it to be of huge importance during the August 17th GSE Bazaar and bake-sale.**

Below are the components of HAMP 2.0, which fit in nicely with the "rumors" of such. It's hard to imagine that the Admin would step on Treasury and the much hyped HAMP 2.0 GSE and FHA principal balance reduction mod program in order to hand out hundreds of billions in reductions en masse.

HAMP Principal Reduction	Principal reduction for HAMP-eligible borrowers with high loan-to-value ratios	<ul style="list-style-type: none">• Announced in March 2010• Estimated implementation by Fall 2010• Expected cost and number of borrowers to be helped unknown
HAMP Unemployed Borrowers	Temporary principal forbearance for unemployed borrowers	<ul style="list-style-type: none">• Announced in March 2010• Estimated implementation in July 2010• No expected TARP funds and number of borrowers to be helped unknown
Federal Housing Administration (FHA) Refinance	Principal reduction and loan refinancing into an FHA loan	<ul style="list-style-type: none">• Announced in March 2010• Estimated implementation by Fall 2010• \$14 billion designated, but number of borrowers to be helped unknown

<http://blogs.reuters.com/james-pethokoukis/2010/08/05/an-august-surprise-from-obama/>

An August Surprise from Obama?

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Main Street may be about to get its own gigantic bailout. Rumors are running wild from Washington to Wall Street that the Obama administration is about to order government-controlled lenders Fannie Mae and Freddie Mac to forgive a portion of the mortgage debt of millions of Americans who owe more than what their homes are worth. An estimated 15 million U.S. mortgages -- one in five -- are underwater with negative equity of some \$800 billion. Recall that on Christmas Eve 2009, the Treasury Department waived a \$400 billion limit on financial assistance to Fannie and Freddie, pledging unlimited help. The actual vehicle for the bailout could be the Bush-era Home Affordable Refinance Program, or HARP, a sister program to Obama's loan modification effort. HARP was [just extended](#) through June 30, 2011.

The move, if it happens, would be a stunning political and economic bombshell less than 100 days before a midterm election in which Democrats are currently expected to suffer massive, if not historic losses. The key date to watch is August 17 when the Treasury Department holds a much-hyped meeting on the future of Fannie and Freddie. A few key points:

1) Republican leaders believe this is going to happen since GOPers and Democratic moderates in the Senate are unwilling to spend more taxpayer money on more stimulus. But such a housing plan would allow the White House to sidestep congressional objections and show voters it is doing something tangible about an economy that seems to be weakening.

2) Wall Street banks are alerting their clients privately to this possibility. Here is what some are cautiously saying publicly. This from Goldman Sachs:

GSE policies are one of a dwindling number of policy levers the administration has left to pull, so it is conceivable that changes could be made, though there is no sign that a policy change is imminent. The Treasury's essentially unlimited ability to provide financial support to the GSEs creates an interesting situation over the next twelve months: the GSEs could potentially be used to provide additional support for the housing market and, to a lesser extent, the broader economy in 2H 2010.

And this from Mizuho Securities:

As policy makers ponder their next move the data suggests that they face not only a stalling recovery but a growing risk of deflation taking root in the economy. As a result, the Administration has turned back to industrial policies by approving the purchase of a sub-prime auto lender by GM as a means for pumping up domestic sales, especially since the latest auto sales data indicates that consumers are still responsive to incentives. This precedent increases the risk that the government will use its control of Fannie and Freddie to increase consumer cash flow and juice the economy again.

Moreover, Morgan Stanley is pushing a mortgage relief plan directly to Congress. On August 3, a top Morgan Stanley economist recommended to the Senate Budget Committee that Fannie and Freddie ease their lending standards to allow millions of Americans to refinance their mortgages.

3) Keep in mind the political and economic context. The nascent recovery is already running out of steam. Wall Street economists just downgraded the government's second-quarter GDP estimate of 2.4 percent to around 1.7 percent. And as even Treasury Secretary Timothy Geithner is warning, the unemployment rate may well begin to rise back toward the politically toxic 10 percent level given such sluggish growth. Many in the White House thought the unemployment rate would be dropping sharply by this point in the recovery.

But that is not happening. What is happening is that the [president's approval ratings](#) are continuing to erode, as are Democratic election polls. Democrats are in real danger of losing the House and almost losing the Senate. The mortgage Hail Mary would be a last-gasp effort to prevent this from happening and to save the Obama agenda. The political calculation is that the number of grateful Americans would be greater than those offended that they -- and their children and their grandchildren -- would be paying for someone else's mortgage woes.

4) And don't think the White House is worried about financial market reaction. If they thought it would pass Congress, they would be submitting a \$200 billion Stimulus 2.0 (3.0?, 4.0?) right now.

August is supposed to be a slow month for Washington politics. But maybe not this one.

Best Regards,

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