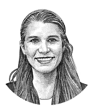
OPINION LIFE SCIENCE

Biden's Mortgage 'Relief' Fuels Higher Housing Prices

It has created another subprime housing bubble and put taxpayers at risk. Trump should end it.



By Allysia Finley Follow
Feb. 23, 2025 at 2:25 pm ET

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Why do housing prices keep climbing despite higher interest rates? The federal government has allowed borrowers to take out bigger mortgages than they can afford. To prevent foreclosures, it's bailing them out when they miss payments. Behold another subprime housing bubble.

The problems began when the Obama administration eased underwriting standards by enabling more home buyers whose debt payments exceed 43% of income to qualify for government-backed loans. Such borrowers are risky because they might not be able to make payments if their income drops or expenses rise.

As home prices climbed, the Federal Housing Administration insured more loans to financially stretched borrowers with as little 3.5% down. No skin off lenders' backs if borrowers later defaulted, since the mortgages were backed by the government.

In 2007, 35% of new FHA borrowers had debt-to-income ratios above 43%. By 2020, 54% did. As housing prices and inflation surged, borrowers became more stretched. The FHA kept insuring mortgages to borrowers who were increasingly leveraged. About 64% of FHA borrowers last year exceeded the 43% threshold.

The FHA loan portfolio is far riskier than it was before the 2008 housing crisis. The American Enterprise Institute's Ed Pinto and Tobias Peter estimate that 79% of FHA first-time borrowers have a month or less in financial reserves—not enough to make mortgage payments if their household expenses rise, as most have owing to inflation.

No surprise, many are missing payments, especially recent borrowers. About 7.05% of FHA mortgages issued last year went seriously delinquent—90 or more days past when a payment is due—within 12 months. That's more than at the 2008 peak of the subprime bubble (7.02%).

Under the guise of Covid relief, the Biden administration masked the growing troubles in the housing market by paying off borrowers and mortgage servicers to prevent foreclosures. Of the 52,531 FHA loans last year that went seriously delinquent within their first year, only nine resulted in foreclosure.

The FHA instituted a program that pays mortgage servicers to make borrowers' missed payments for them. Missed payments are added to the loan's principal, but without interest. The FHA also pays servicers to cut monthly payments for delinquent borrowers by 25% for three years, with the payment reductions also added to the principal without interest.

Consider a borrower who misses five $4,000 monthly mortgage payments. The servicer will add the $20,000 in missed payments to the mortgage and reduce monthly payments by $1,000 for three years—adding another $36,000 to their mortgage. So the borrower is $56,000 deeper in debt, though with no additional interest. If he misses payments again, the servicer rinses and repeats, getting paid $1,750 every time it lathers up. The FHA also lets servicers charge borrowers legal fees—typically several thousand dollars—that are added to the mortgage principal.

The FHA made 556,841 "incentive payments" to servicers over the past year to prevent foreclosures—nearly as many as the new mortgages it insured. Government-backed mortgage relief has become a cash cow for servicers, some of which originated the risky loans they are paid not to foreclose. Moral hazard, anyone?

One result is that many FHA borrowers owe more than their original mortgage and more than their homes are worth. They are essentially trapped in their homes even if they want to sell and move.

Another result is that home prices keep increasing because borrowers who don't pay their mortgages—and never should have qualified for loans—can't get foreclosed on or be forced to sell their homes. Getting foreclosed on these days is like flunking out of college—it takes effort. You have to reject repeated offers for mortgage relief.

Government-sponsored enterprises Fannie Mae and Freddie Mac instituted similar "home retention" programs for delinquent borrowers with the Biden administration's blessing. The cost of their mortgage relief gets socialized in higher rates charged to home buyers whose mortgages they guarantee.

Taxpayers are on the hook if the FHA insurance fund—financed by premiums on mortgages it backs—goes broke paying off borrowers and servicers to prevent foreclosures. The FHA annual report to Congress doesn't disclose the cost of such payments, and the agency didn't furnish them on my request. Perhaps the Department of Government Efficiency could dig into its financial books.

The Biden administration built a house of cards that could collapse if Trump officials dare to end the mortgage giveaways, as they should. Foreclosures would inevitably increase, which could cause home prices to fall sharply in lower-income neighborhoods with more FHA mortgages. More borrowers would then fall underwater, ballooning taxpayer losses, though homes might also become more affordable for people who don't already own them.

But what a mess. And who will get blamed? Not the folks who inflated the bubble.

Appeared in the February 24, 2025, print edition as 'Biden's Mortgage 'Relief' Fuels Higher Housing Prices'.

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