# Underwater Americans Skirt Default as HARP Use Rises: Mortgages
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By Kathleen M. Howley

March 13 (Bloomberg) -- Homeowners with underwater mortgages in U.S. states worst-hit by foreclosures are leading refinancings after the government expanded programs to aid borrowers, strengthening the weakest link in the housing recovery.

In Nevada, where property values fell by half in the real estate bust, the government's Home Affordable Refinance Program, or HARP, accounted for 68 percent of refinancing in December, the Federal Housing Finance Agency will say in a report today. For Florida, 58 percent went through HARP. The states topped the nation in loans more than three months overdue at 2012's end, according to the Mortgage Bankers Association.

The U.S. housing market is rebounding as foreclosure sales drop after a record number of seized properties had dragged on prices and sapped buyer confidence, said Diane Swonk, chief economist at Mesirow Financial in Chicago. The inventory of homes for sale dropped to 1.7 million in January, the lowest in more than a decade, according to the National Association of Realtors. Underwater borrowers, with mortgages that exceed their property values, are most at risk of default, Swonk said.

"The biggest hurdle the housing market has to overcome to stay on its upward trajectory is keeping the foreclosure inventory down," Swonk said. "HARP refis are keeping people in their homes, especially in the states where property is severely underwater."

## Banned Borrowers

HARP, which has been used by about 2 million borrowers whose loans are backed by Fannie Mae and Freddie Mac since the program started in 2009, originally banned borrowers whose mortgages were more than 25 percent underwater. The new version enacted last year, known as HARP 2.0, removed the restriction. It also lets borrowers refinance through any lender, instead of being restricted to using their existing servicer.

"HARP 2.0 is working," said Patrick Ahn, a mortgage bond trader at Los Angeles-based TCW Group Inc. "We've seen many more borrowers take advantage versus the first version."

The inventory of homes in foreclosure fell to 3.74 percent at the end of 2012 from 4.39 percent in the first quarter of 2012 when home prices began to recover, according to the Mortgage Bankers Association. In the same period, home prices rose 8.9 percent from a nine-year low, S&P/Case-Shiller home-price index data show. Home sales in January increased to 4.92 million at an annual rate, 43 percent above a record low two years ago.

## Raising Estimates

Prices may rise 8 percent this year, up from a previous estimate of a 4.7 percent increase, Bank of America Corp. analysts wrote last week.

A tight inventory of properties for sale, low interest rates and record affordability are fueling accelerated price gains, Michelle Meyer, a Bank of America U.S. economist, and Chris Flanagan and Justin Borst, mortgage-backed securities strategists, said in a note to investors titled “Someone say house party?”

“We believe a positive feedback loop has begun, where the rise in home prices fuels expectations of further appreciation and easing credit conditions, which in turn stimulates homebuying,” they wrote in the report. “It is a powerful positive relationship especially in this environment of historically low interest rates and a Federal Reserve determined to keep policy accommodative.”

## Subprime Bonds

The housing rebound has spurred a rally in home-loan bonds without the backing of the U.S. government. The debt returned an average of about 21 percent last year, according to Amherst Securities Group LP, with some notes tied to subprime borrowers rising more than 40 percent.

So-called non-agency debt will probably go higher in price and be the best-performing sector as the housing supply remains constrained, Jeffrey Gundlach, whose $39.5 billion DoubleLine Total Return Bond Fund beat 97 percent of its peers last year, said last week.

As home prices have risen, the percentage of borrowers that are underwater on their homes has dropped to fewer than 15 percent from more than 25 percent in 2011, JPMorgan Chase & Co. analysts wrote in a report last week.

That’s allowing more homeowners to take advantage of borrowing costs that have been pushed down by the Fed. The average 30-year mortgage rate was 3.5 percent last week, compared with the all-time low of 3.3 percent in November, according to data from McLean, Virginia-based Freddie Mac. This year, the rate probably will average 3.8 percent, compared with 3.7 percent in 2012, according to Fannie Mae in Washington.

## Mortgage Lending

Mortgage lending this year likely will fall 21 percent to $1.5 trillion, Fannie Mae said. Refinancing will account for 58 percent of that, the mortgage financier said. In the current quarter, lending will fall to $451 billion from $574 billion at the end of the year.

Banks can continue to profit from borrowers in the hardest hit states, like Nevada, because they've largely been unable to refinance until now and need HARP, said Anish Lohokare, a mortgage-bond strategist in New York at BNP Paribas SA in New York.

"Banks can depend on demand from these borrowers because they have mortgages at 6 percent or more," said Lohokare. "The lenders built all this capacity during last year's surge in refinancings, and now they can sustain their volume through HARP mortgages."

HARP has been the government's most successful housing program, exceeding the 1 million loans modified under the Home Affordable Modification Program, or HAMP, and the 114,417 homes in Home Affordable Foreclosure Alternative, or HAFA, that have been short sales, where lenders agree to let homes sell for less than the mortgages against them.

"Clearly there was pent up demand from people who didn't have options" before the program was modified last year, said Meg Burns, senior associate director for housing and regulatory policy at the FHFA in Washington.

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