The New York Times

February 15, 2010

U.S. Housing Aid Winds Down, and Cities Worry

By DAVID STREITFELD

ELKHART, Ind. — Over the next six months, the federal government plans to wind down many of its emergency programs for housing. Then it will become clear if the market can function on its own.

People here are pretty sure the answer will be no.

President Obama has traveled twice to this beleaguered manufacturing city to spotlight the government's economic stimulus program. The employment picture here has indeed begun to improve over the last nine months.

But Elkhart also symbolizes the failure of federal efforts to turn around the housing slump at the heart of the economic crisis. Housing in this community has become almost entirely dependent on a string of federal support programs, which are nonetheless failing to prevent a fall in prices and a rise in mortgage delinquencies.

More than one in 10 mortgage holders in Elkhart is seriously behind on payments. The median sales price has plunged to the level of a decade ago. Many homeowners owe more than their home is worth, freezing them in place for years. Foreclosures recently hit a record.

To the extent that the real estate market is functioning at all, people here say, it is doing so only because of the emergency programs, which have pushed down interest rates on mortgages and offered buyers a substantial tax credit.

Equally important is an expanded mortgage insurance program run by the Federal Housing Administration, which encourages private lenders to accept borrowers with small down payments. The government takes the risk of default.

A few years ago, only one in 10 buyers in Elkhart used the housing agency program. Now about half do. Across the country, the agency has greatly expanded its reach so that it now insures six million mortgages.

“There has been all kinds of help for housing. I’m not unappreciative,” said Barb Swartley, president of the Elkhart County Board of Realtors. “But you can’t turn real estate into a government-sponsored operation forever.”

Many in Washington agree. With worries about the deficit intensifying, the government is eager to start withdrawing some of its support programs.

The first step could happen as early as next month, when the Federal Reserve has said it will end its trillion-dollar program to buy up mortgage securities. That program has driven mortgage interest rates to lows not seen since the 1950s.

Yet it is uncertain whether the government can really pull back without sending housing markets into another tailspin. “A rise in rates would kill us all by itself,” Ms. Swartley said.

The Obama administration has offered few ideas about reforming the housing market. Proposals for the future of Fannie Mae and Freddie Mac, the mortgage holding companies taken over by the government at the height of the crisis, were supposed to be introduced with the president’s budget this month. They were not.

The government programs, however crucial, are distorting the market. The tax credit produced sales last fall, but some lenders here say it has troubling implications.

“People are buying to get that tax credit, to get some reserve money. They’re saying, ‘If something happens, I will have a little bit of money to fall back on,’ ” said Denny Davis of Horizon Bank in Elkhart. “That’s not healthy.”

The programs favor first-time buyers, who have the fewest resources to bring to a deal. Heather Stevens, a 23-year-old nurse here, is closing on a three-bedroom house this week. Since her loan was insured by the Federal

Housing Administration, she had to put down only 3.5 percent of the $74,900 purchase price.

“It was a breeze to get approved,” she said.

The sellers are covering her closing costs, which agents say is often the case here. That meant Ms. Stevens had to come up with only the $2,600 down payment, which still took all her savings.

But the best part is the $7,500 tax credit. She will use that to remodel the kitchen. “If it wasn’t for the credit, we would have waited to buy,” said Ms. Stevens, who is getting married this year.

Buying houses with no money down was a feature of the latter stages of the housing bubble. It gave prices a final push into the stratosphere. But buyers with no equity were the first to abandon their properties as the market turned south.

With housing prices stagnant, bolstering the market by again letting people buy with hardly any money down is viewed in some quarters as a bad bet.

Neil Barofsky, the special inspector general for the government’s Troubled Asset Relief Program, wrote in his most recent report to Congress that “the federal government’s concerted efforts to support” housing prices “risk reinflating” the bubble.

He noted one difference from the last bubble: taxpayers, rather than banks, are now directly at risk in these new mortgages.

In Elkhart, the worries are less about the risks of doing too much and more about the perils of doing too little. If the Federal Reserve really ends its $1.25 trillion program of buying mortgage-backed securities, economists say, mortgage rates could rise as much as one percentage point. In recent weeks, rates on 30-year fixed mortgages have drifted below 5 percent.

The tax credit requires home buyers to make a deal by April 30, the middle of the prime spring selling season.

For now, the F.H.A. is modestly tightening the requirements on some of its programs, trying to strike a balance between stabilizing the market with qualified buyers and overwhelming it with unqualified borrowers.

John Katalinich, chief lending officer at the Inova Federal Credit Union in Elkhart, says there is danger in letting buyers get into properties with so little at stake, but those risks are minimal compared to the alternative.

"If the government were not to continue the same level of support, it would be very detrimental, like cutting the legs off a wobbling child and expecting it to run a marathon," he said. "It's very possible we'll still be at this level of need five years from now."

Elkhart, in the northeast corner of Indiana, became a symbol of distressed Middle America after Mr. Obama chose it as the place to introduce his stimulus plan last February. The region is a hub of recreational vehicle manufacturing, one of the first industries to falter in the recession. In less than a year, the unemployment rate tripled, peaking at 18.9 percent last March.

Mr. Obama returned in August to promote the effectiveness of the stimulus program and of government grants for the manufacture of battery-powered electric vehicles. Several companies have announced they are hiring. Unemployment in December was down to 14.8 percent.

No such improvement is visible with housing. In the last 18 months, the F.H.A increased its loans in Elkhart by 40 percent even as its defaults rose 174 percent.

As these troubled loans become foreclosures, the government takes over the property and tries to sell it. On Saturday, Gina Martin, an administrative assistant, examined a three-bedroom government house for sale southeast of Elkhart.

In late 2003, the house sold for $115,000, but in these depressed times the government was willing to let it go for $75,000.

Ms. Martin's agent, Dean Slabach, thought the government would eventually have to take a much lower bid, substantially increasing its loss. Most of the F.H.A. properties on the market in Elkhart carry notations like "significant price reduction" and "all reasonable offers considered."

"They'll end up selling this for $60,000 or less," Mr. Slabach said.

But Ms. Martin, a 47-year-old renter who has approval for an F.H.A. loan, said she was not tempted at any price.

“We’ll see what else is out there,” she said.