ROCHDALE RESEARCH

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Forced Mass Refinancing

Attempting to Increase Homeowner Cash Flows

Richard X. Bove
Vice President Equity Research
Financial Sector
rbove@rochdalesecurities.com
813.909.1111

Circular Reasoning

Apparently the Administration is close to suggesting a new program that could result in the mass refinancing of home mortgages. The theory behind the program is that if $85 billion in interest payments are taken away from the holders of mortgages and given to the borrowers, under these mortgages, it will stimulate more spending and an economic recovery.

Press Reports

One week ago, the *New York Times* published an article that indicated that the Administration was testing a number of concepts that would allow Americans with relatively high cost mortgages to refinance this debt at current rates which are much lower. The article indicated that in July, Fannie Mae and Freddie Mac held $2.4 trillion in mortgages that had interest rates that were 4.5% or higher. It was suggested that if all of these loans were refinanced at 4.0%, the current mortgage rate, homeowners would save $85 billion.

The objections to putting a program in place immediately was that it was realized that if the homeowners saved $85 billion, the GSEs would lose $85 billion. This would increase their losses and the taxpayers need to replace that money.

However, the idea seems to be resurfacing. The *Wall Street Journal* wrote a lengthy article on it in today's edition. Moreover, declines in GSE bond prices suggest that at least some observers think that some type of refinance program may be mandated by the Administration.

Fed's View

Apparently, Ben Bernanke, the Chairman of the Federal Reserve has been frustrated by the fact that interest rates are low but mortgages are not being refinanced. It had been his assumption that by lowering interest rates, homeowners would take advantage of the situation by refinancing their homes. It was also believed that the banks would not be hurt by the process because short-term rates were also being lowered so banks could maintain their margins. Plus, bank mortgage fees tend to rise rapidly during refinance booms.

The hoped for boom never developed. Home prices had dropped. "Un" and under employment was soaring. Bank lending standards had been meaningfully tightened. The net result was mortgages were not being refinanced. Not only was this frustrating but home buying did not pick up either even though housing affordability was at relatively high levels.

Incompetence

The point that neither the Administration, the Treasury nor the Fed can seem to understand is that they have strangled bank lending with their capital and liquidity rules and their price fixing requirements. This was a core reason why bank lending did not open up to facilitate a refinancing boom. Suing and fining banks is not the way to increase lending activity particularly if the suits and fines are related to mortgages the very product desired to be increased.

The policymakers also failed to understand that the infrastructure needed to support a refinancing boom had been disassembled. It no longer existed. All these people were working on foreclosures and stiffer government regulations concerning foreclosures. The government had shut down the refinance apparatus and expected interest rate cuts to take its place.

It is a classic example of how badly the people who are supposed to understand banking do not have a clue as to how it works. They love to pass laws and new regulations but they do not care nor do they understand what these regulations will do. Then they get frustrated when the simplistic monetary theories they put in place do not work. Classic!!! Pathetic!!!

Banking Policy

Now these little gremlins are at work again trying to figure out how to solve the problem of getting a refinance boom underway. The program cannot result in big losses to the taxpayer and they must get the banks on board. This would not be hard to accomplish. All they need to do is change the capital and liquidity rules and allow mortgage rates to shift slightly higher to increase bank profits. Will they do this? Who knows?

If the program they come up with has in it big losses for the GSEs and big mark downs for the banks it will be another failure. The biggest failure is that these people are still working on consumption rather than production programs. Until they figure out that more production is what is required we will continue to take money out of one pocket to put it into another and assume that we have accomplished something.

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Rochdale Securities LLC
750 E. Main St., 7th Floor
Stamford, CT 06902
Main 203.274.9100

Management

Dan Crowley
President
djc@rochdalesecurities.com
203.274.9101

Kevin Cassidy
Senior Vice President
Chief Operating Officer
kjc@rochdalesecurities.com
203.274.9116

Trading

Kris Talgo
Senior Vice President
Trading Co-Head
klt@rochdalesecurities.com
203.274.9125

Hal Tunick
Senior Vice President
Trading Co-Head
ht@rochdalesecurities.com
203.274.9124

Financial Analyst

Richard X. Bove
Vice President Equity Research
Financial Sector
rbove@rochdalesecurities.com
813.909.1111

Merger Arbitrage and Special Situations

Barry D. Kaplan
Merger Arbitrage and Special Situations
bdk@rochdalesecurities.com
203.274.9121

Institutional Sales

Keith Arnott
jka@rochdalesecurities.com
732.758.6981

Trey Bauer
tbauer@rochdalesecurities.com
203.274.9137

Richard Bennett
rbw@rochdalesecurities.com
732.758.6982

Joseph Bove
jab@rochdalesecurities.com
813.963.2999

Patrick Burke
prb@rochdalesecurities.com
203.274.9127

Pete Doehla
pkd@rochdalesecurities.com
203.274.9128

David Miller
dmiller@rochdalesecurities.com
203.274.9131

Niall Morrissey
nmm@rochdalesecurities.com
203.274.9130

Richie Oddo
ro@rochdalesecurities.com
732.758.6988

John Ratkoski
jratkoski@rochdalesecurities.com
732.758.6986

Kristen Talgo
klt@rochdalesecurities.com
203.274.9125

Hal Tunick
ht@rochdalesecurities.com
203.274.9124

Jeff Wicker
jdw@rochdalesecurities.com
925.253.1030

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-- Richard X. Bove