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Holding Housing's Head Above Water

A proposal for the U.S. government to run a real-estate investment trust.

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AFTER A PERIOD OF NOTABLE improvement in U.S. housing, the news again looks bleak. Foreclosures show no signs of abating, despite multiple attempts by the U.S. government to address this issue. Although Washington continues to intervene in the housing market, with subsidies on mortgages and tax breaks for home ownership, these attempts to stabilize prices clearly aren't working.

A debate about whether the government should be such a central actor in the housing market is moot under the current circumstances. Uncle Sam is, has been and still plans to be involved in this important segment of the economy. The real question is how the government can optimize its role so that it benefits the taxpayers.

There could be real benefits if the government established a real-estate investment trust to pool foreclosed housing stock into a single managed entity. The attractions of such an initiative are at least three-fold.

Through a REIT, the federal government and taxpayers would be able to participate in any upside in the property market. Currently, the Washington acts simply as a guarantor of mortgage loans. It lacks an equity interest and can recoup no more than the principal plus interest.



Dan Picasso for Barron's

THE BENEFITS of government involvement in housing only accrue to the Americans who take out mortgages, borrowing at below-free-market rates. This same group receives tax deductions on interest charges.

Current U.S. housing policy is failing the broad American tax-paying base. As the upside is garnered by only some Americans, the downside costs are borne by all taxpayers.

A REIT is the type of structure that would allow the government to act in a more optimal way. Rather than participating in the home market only as a debt guarantor, Uncle Sam could participate in the property market as an equity holder, intending to gain if house prices rise.

A federally sponsored realty trust would convert struggling mortgage holders from owners to renters—a more accurate status for people who have no equity and make monthly payments. This would also eliminate the sizeable friction in labor markets, generated by people who can't move to take a new job.

If necessary, the U.S. REIT could reduce the residents' rent, producing the social good that the government ostensibly wants—affordable housing for all.

Most importantly for the broader economy, a government real-estate investment trust would help stabilize house prices. Under the REIT proposal, a large-scale buyer would identify and absorb most, if not all, of the shadow housing inventory. The price signals produced by this event would encourage other large pools of capital to get involved.

THE FUNDAMENTAL STEPS to establishing the real-estate investment trust would be along these lines:

Delinquent homeowners would be foreclosed upon, and the REIT would accept ownership of these housing assets from the mortgage holders at negotiated prices—lower than the face value of the loans, but higher than the banks could realize by selling them one at a time.

In place of traditional mortgages, the government would offer the former homeowners long leases to occupy their homes for five or 10 years. The leases would provide incentives (such as rent deferrals or bonus payments) for the tenants to take care of their houses. Sitting tenants would attend to leaky pipes, broken windows and dilapidated picket fences, rewarded by how well they looked after and maintained the homes, and not by their hope of price increases for the dwellings.

The U.S. REIT should stipulate that it would not sell any of its housing assets for a specified period, say, five or 10 years. This would immediately steady housing prices, and that would add a positive force to the broader financial markets.

A government realty trust would remove overvalued housing collateral that weighs on bank balance sheets. It would firm up valuations of the equity of the homeowners who have been paying their mortgages and haven't been foreclosed. It would create a real floor in the housing market and stem the tide of losses.

Fannie Mae's Deed-for-Lease program, which allows homeowners facing foreclosure to stay in their homes and rent them for as long as a year, is a small step in the right direction. However, more needs to be done.

Given that America's housing remains relatively cheap by many metrics, the U.S. property market is a good long-term bet. Now is a good time for Uncle Sam to put a REIT in place.

MAKING HOUSING AFFORDABLE by subsidizing rents, rather than encouraging people to own homes that they can't afford, is much much more sensible than our current policies.

As the largest player in the economy, the federal government has the power to improve the real-estate marketplace, and it should use its official predilection to offer market guarantees in positive ways, to align broader market interests and to give taxpayers an opportunity to garner some of the potential upside.

A real-estate investment trust run by Uncle Sam would satisfy all these needs.

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