Paulson's pulpit

by the St. Louis Post-Dispatch

The Bush administration reportedly is close to a deal that would prevent hundreds of thousands of Americans from being tossed out of house and home next year. The deal apparently would extend current interest rates for many of the 1.5 million families whose subprime mortgage payments otherwise would jump through the roof next year.

Families threatened with foreclosure would be the biggest winners, of course. But the tentative deal would establish a floor under the sagging housing market and help head off a general credit crunch. It would help the American economy avoid a recession, securing the jobs of ordinary Americans who have nothing to do with the subprime mess.

Still, many players in the mortgage industry are resisting the deal, each player looking out for his own interest. Treasury Secretary Henry Paulson must continue preaching common sense, and cajoling the mortgage industry into acting in the overall best interests of the industry and the country.

The problem lies with adjustable rate mortgages issued to people with credit problems. Those people now are paying rates of 7 or 8 percent. Those rates will jump to 10 or 11 percent when the introductory "teaser" rates expire. Many - perhaps hundreds of thousands - won't be able to afford the higher payments. Foreclosures already are up sharply, but a tidal wave is expected next year, thanks to a big bulge in the number of mortgages due for a reset in their rates.

Details of Paulson's proposal are sketchy, but in broad terms, the deal might divide families with subprime loans into three types. Those who can afford the higher payments would have to pay them. Those who can't afford their current payments would lose their homes. But those who can afford the current payments but not higher payments would get to keep today's payments at least for a while.

It's unclear how many years a payment freeze might stay in effect. But even a temporary freeze would give families time to dig themselves out of their financial hole.

The good news for the housing market: We'll avoid a new wave of foreclosed homes flooding the market next year and driving prices even lower.

The good news for mortgage investors: They'll still be getting interest payments, instead of taking giant losses as they sell foreclosed houses at discount prices into a falling market.

The good news for taxpayers: There's no government bailout here.

Lots of mortgages sit in the portfolios of banks and large investment houses. With the foreclosure crisis worsening, the value of those mortgage investments has fallen into a pit, and no one can see the bottom yet. That's why so many financial firms recorded multi-billion dollar losses.

If those losses get deep enough, some weakened banks will have to cut back on business and consumer loans that have nothing to do with mortgages. Sound borrowers with good credit won't get loans. That's called a credit crunch, and it could weigh down the American economy.

There's no real crunch at the moment, but the possibility is worrisome. Citibank, America's biggest bank, last month turned to Arab banks in Abu Dhabi for $7.5 billion needed to shore up its shrinking capital base. The bank already has written down billions in subprime debt and stands to lose billions more.

Even if the mortgage industry signs on, some mortgages may not be eligible for the program. Many mortgages have been repackaged into mortgage bonds and sold to thousands of investors scattered around the globe. Some of those bonds have rules restricting mortgage-servicing companies from granting breaks to struggling families.

Paulson can't order the mortgage industry to buy into his plan, but the treasury secretary preaches from a bully pulpit. Industry executives should listen to him. Otherwise, the mortgage mess may get a whole lot worse.

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