

Mortgage follies

by *The San Diego Union-Tribune*

The U.S. mortgage crisis will be with us for some time. With 7 million subprime mortgages on the books - some held by homeowners who will be unable to come up with their monthly payments when initial "teaser" interest rates ratchet upward - hundreds of thousands of foreclosures appear inevitable this year alone. Now Congress appears to have decided an unprecedented intervention by the federal government is necessary to deal with this mess.

The Senate is considering legislation that would allow judges to unilaterally change the terms of mortgage contracts and reduce mortgage debt to current fair-market value - both without lenders' consent. The House is considering a plan to set up a massive government agency to buy up bad mortgages and revise their terms to head off foreclosures.

These are extraordinarily bad ideas. Not only are they grossly unfair to the great majority of homeowners and businesses who behaved rationally during the housing bubble, but they would make a future encore of the current debacle much more likely. The Senate proposals would drive up the cost of lending for everyone, perhaps permanently, by saddling lenders with massive costs they would have to recoup in other ways. The House measure would be a pure taxpayer bailout and a likely massive boondoggle. And the direct beneficiaries would be people and institutions who are far from innocent - the lenders who made irrational loans; the brokers who packaged these dubious loans into hugely risky securities; and the homeowners who displayed gross irresponsibility and worse by taking out mortgages they could never pay. According to the Mortgage Asset Research Institute, 60 percent of borrowers who took out loans that didn't require documentation overstated their income by more than half. So much for the image of innocents being gulled by "predatory" lenders.

This doesn't mean the government should sit by idly, however. It just means lawmakers and regulators should act in prudent ways - building off a key fact that few people seem to appreciate. That fact: Lenders have an enormous incentive to revise mortgages, given that the transaction costs of foreclosures can run as much as 40 percent of a home's value.

This explains why it didn't take much prodding from the Bush administration for several big lenders to aggressively seek to restructure troubled loans. More than a half-million mortgages were revised in the last half of 2007 alone. Experts say far more homeowners could seek similar deals. The government should strongly encourage this by making it easy for homeowners to do so. This is not a sexy approach. It has no great drama and certainly won't help the millions of people who bought homes that are simply beyond their means. But it holds the promise of significantly reducing the turmoil and displacement looming in coming years - and in a fair, responsible way that doesn't punish everyone for the foolishness of a relative handful of individuals and institutions.

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