Foreclosures: Rescue on the way?

by the St. Louis Post-Dispatch

The U.S. House last week passed a mortgage rescue package that could save half a million American families from losing their homes to foreclosure and do so at little risk to taxpayers.

The plan, though larded up with tax breaks that the Senate should trim, generally is a sensible approach to the subprime mortgage mess. President George W. Bush is threatening a veto but hinting at compromise. With a little tinkering, the Senate could get this rescue on the road.

The plan is the brainchild of House Banking Committee Chairman Barney Frank, D-Mass., and heavily relies on a resuscitated Federal Housing Administration.

Long before the subprime madness, would-be home buyers who had little in the way of savings and questionable credit had to rely on the FHA to back their mortgage applications. FHA mortgages involved lots of red tape, mostly because the FHA insisted on lending to people who actually could make the payments.

Subprime lenders then entered the game, making adjustable-rate loans with low "teaser" rates to almost anyone who could sign his name. Then they sold these mortgages to banks, which repackaged them as mortgage-backed securities and unloaded them on unsuspecting investors.

The scheme worked fine as long as housing prices continued to rise. But when the teaser rates expired, many mortgage holders discovered they no longer could afford their monthly payments. The housing bubble burst.

Frank's plan would allow the FHA to guarantee refinanced mortgages at rates the homeowner could afford. But the current lender - the one who made the suspect loan - would have to take a significant loss, reducing the loan to 85 percent of the current value of the house.

Should the house's value rise in coming years, homeowners would have to share the profit with the FHA when they sell. Frank's plan also protects participating mortgage companies from being sued by investors unhappy with the 15 percent reduction.

The result should be a win all around. A 15 percent cut is a lot less than the 50 percent loss that lenders often endure in a foreclosure. But in St. Louis, where prices have fallen only slightly, mortgage holders may balk at taking that 15 percent cut. They may prefer to take their chances on foreclosure and selling the house.

Nationwide, the plan should slow the decline in home prices by lessening the flood of foreclosed properties on the market. The Congressional Budget Office puts the cost of the plan to taxpayers at $2.7 billion through 2013.

So far, so good. The problems lie in the rest of the bill. Among them:

- It increases the amounts that Fannie Mae and Freddie Mac can guarantee in high-cost areas; those increased limits could place those critical companies, which keep the mortgage business functioning, at increased financial risk.

- It grants a $7,500 tax credit to first-time home buyers and a property tax credit for homeowners who don't itemize their tax returns. The bill pays for that largely by delaying a tax break for businesses. Bush may well view that as a veto-worthy "tax increase." The House also hopes that an increase in "tax compliance" will help pay for the program. That's much too vague.

- An accompanying bill, also passed by the House, would hand state governments up to $15 billion to buy and fix up foreclosed homes. That's a gift to the banking industry, which would dearly love to unload its foreclosed houses on the government. Bush has threatened to veto that bill, too, and he's right.

The Senate should shave off the tax breaks and pass the FHA rescue portion of Frank's bill. And Bush should sign it, giving homeowners a lifeline and helping stabilize the housing market.

Everyone involved here - homeowners, lenders and investors - has some suffering to do. By making reasonable compromises, they can lessen the pain for each other.

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