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Who will pay the mortgage when the homeowner walks? You

Sean Olender
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California's housing market may be entering a scarier phase: the point at which homeowners walk because the house isn't appreciating, not because they can't afford it. Banks are worried.

A Federal Reserve survey in January 2008 found that loan officers "are concerned with borrowers' reduced motivation to retain possession of their properties."

And Calculated Risk, a blog, posted a quote from Wachovia Bank's January 2008 conference call: "One of the challenges is... a lot of these current losses have been coming out of California... from people that have otherwise had the capacity to pay, but have basically just decided not to because they feel like they've lost equity, value in their properties, and ... we're just going to have to see how the patterns

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unfold here."

Bank of America CEO Kenneth Lewis said, "There's been a change in social attitudes toward default ... We're seeing people who are current on their credit cards but are defaulting on their mortgages ... I'm astonished that people would walk away from their homes."

If income indicates ability to pay, down payment is an incentive to pay - skin in the game.

In California, lenders are generally barred from getting money from a defaulting borrower. The lender gets the house and that's it, even if the borrower has $1 million in the bank. Only judicial foreclosure allows the lender to get the borrower's other assets, but it's slow, expensive and encourages a defense of loan origination fraud. Buying a house with little down is like having your cake and eating it, too. If the house appreciates, you keep the riches; if it doesn't, you walk and lose only what you put down, often nothing. It's wrong to insure such losses with taxpayer money.

Laws limiting investor liability are everywhere. If you own stock in a company that goes bankrupt, you don't feel a moral obligation to pay the company's creditors, because the law limits your liability. But the government doesn't guarantee those creditors' losses - and it shouldn't do so in the housing market, either.

Visit www.uwalkaway.com, a company that sells kits explaining a homeowner's right to walk if the house isn't a good deal anymore. And "60 Minutes" recently featured a couple who explained they could afford their mortgage payments, but the house was "worth less," so why pay?

Who loses if the trend grows? The biggest loser will be mortgage bond investors, and next is originating banks and investment banks (because investors will try to sue for fraud and misrepresentation). Homeowners who put zero or 5 percent down lose little more than outsized hopes of future riches. And as *uwalkaway.com* notes, eight months of "free rent" will help them feel better.

Now that Congress has passed higher loan limits for Fannie Mae, Freddie Mac and the Federal Housing Administration, Americans will lose because investors facing losses can get paid by Fannie, Freddie and FHA.

In the future, Congress should require California to allow lenders to garnish wages of affluent borrowers who walk away from their homes. It's dishonest to have it both ways: (1) federal tax money backstops investor and bank losses when homeowners walk away from homes, and (2) California law allows homeowners to walk away without liability - even if they have money to pay. It's not that the California statute is bad alone; it's that it's wrong for federal taxes to guarantee huge loans without homeowners guaranteeing those loans too.

Gov. Arnold Schwarzenegger wrote last Monday, "Unfortunately, the California families most hurt (by inability to get affordable mortgage credit) are in lower- and moderate-income brackets." Then, he magically ties this to raising the loan caps to $729,750. But 2006 California median family income was $64,563. This isn't an anti-poverty plan.

Even Marin, California's top 2006 county for median family income, was $99,713 - too low to benefit from the higher caps. I see how politicians could confuse median family income, because they don't hang out at places where they'd meet a median income earner.

The new increase in the loan caps is nothing more than a handout. It's welfare for the wealthy - a group that tirelessly touts free market principles. Raising the caps is morally wrong, and it's also bad policy.

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