Home A Loan

Equity: A House bill rewards people who bought houses they couldn't afford by letting judges rewrite private contracts. Did anyone notice that most foreclosures are in four states, including Harry Reid's Nevada?

The House continued on Thursday to mortgage everyone's future by approving 234-191, largely along party lines, a measure giving bankruptcy judges the power to reduce the interest rate and principle on a home mortgage.

Provisions were added to the measure requiring home loan companies to show they had made a "reasonable" offer to work out a deal with those facing foreclosure. The homeowners would also have to show they had exhausted all other possibilities before filing for bankruptcy. It will be up to a judge to decide what reasonable is.

The net effect will likely be — surprise! — more bankruptcies to avoid the consequences of making bad decisions such as buying more house than one can afford or cashing out one's equity to finance a lifestyle one can afford. Frugality is no longer rewarded, as the grasshopper has won out over the ant.

The consequences of this government intrusion into the free market by violating the sanctity of private contracts are unknown. But we suspect it will drive up mortgage rates and further destabilize the housing market. Lenders will be more reluctant to lend if a judge can reduce what is owed with the stroke of a pen.

This further rewards those who bought too much house. And, as CNBC's Diana Olick points out, it will bail out those who used their homes as ATM machines. And took out second mortgages or home equity loans to finance that new addition, patio deck or car parked in the foreclosed driveway.

The Obama administration talks a good game about helping "responsible borrowers," and we feel for the homeowner who used his or her equity to finance junior's college education.

We also feel for the guy next door who gets nothing out of this. He's one of the 90% who bought houses they could afford with substantial and long-saved down payments, then worked hard and paid their mortgages on time. Obama insists we are our neighbor's keeper, but do we have to pay for remodeling his kitchen too?

A revealing study by researchers at the University of Virginia took a look at foreclosures in all 50 states, 35 metropolitan areas and 236 counties. They found that 87% of housing value loss, including foreclosures, is taking place in just four states — California, Florida, Arizona and Nevada.

They found that "66% of potential housing value losses in 2008 and subsequent years may be in California, with another 21% in Florida, Nevada and Arizona, for a total of 87% of national declines."

Nevada, California, Arizona and Florida rank first, second, third and fourth in foreclosure activity, together accounting for 55% of foreclosure activity. What do they have in common? They are Sun Belt states, the location of second homes, investment properties and the playground of flippers who invested in properties hoping to ride the housing bubble to a quick profit.

As Alan Reynolds, senior fellow with the Cato Institute, points out, one out of 76 homes in Nevada went into foreclosure in January. The figure for California was one out of 173, with Arizona and Florida close behind. In New York state, by contrast, only one out of 2,271 homes went into foreclosure in January. Not much call for summer or vacation homes in Buffalo.

"California had only 10% of the nation's housing units, but it had 34% of foreclosures in 2008," according to the study's authors, University of Virginia professor William Levy and graduate student Jeff Herlitz.

California was vulnerable to foreclosures because the median value of owner-occupied housing in 2007 was 8.3 times the median family income. The national average was only 3.2 times higher than the median family income.

Forget that adage about letting the buyer beware. Just go take a dip in your neighbor's pool. You'll soon be paying for it.