Provision to Alter Loans Is Sought

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By Amir Efrati

A push by Democrats to include in the proposed Wall Street bailout new legislation that would allow U.S. judges to modify mortgages for people in bankruptcy potentially could save hundreds of thousands of homeowners from future foreclosure, judges and other legal experts say.

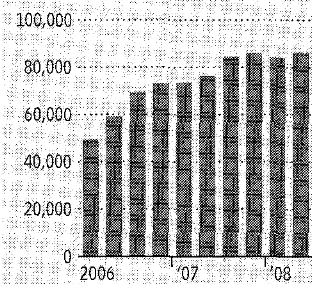
The provision is being demanded as part of an effort to make the $700 billion bailout plan for financial institutions more populist, so that individuals will see more of its direct benefits. "The government is providing a trillion dollars in assistance to financial institutions to deal with the problem that people can't afford to pay mortgages, so there ought to be something in the program to help people pay their mortgages," said Samuel L. Bufford, a U.S. bankruptcy judge in Los Angeles. "It's a matter of fairness."

Several federal bankruptcy judges said in interviews that they support including the provision in the bailout package—the second attempt this year by Democratic lawmakers to change bankruptcy laws. About two-thirds of debtors who file for Chapter 13 bankruptcy have a mortgage, and half of them aren't able to keep paying the mortgage as part of their reorganization, judges and lawyers say.

Seeking Protection

Consumer-bankruptcy filings have grown as the mortgage crisis has worsened.

Chapter 13 filings, by quarter:



Source: American Bankruptcy Institute

Changing bankruptcy law might be a long shot. The provision is stoking opposition from the Bush administration, Republican lawmakers and the mortgage industry, who beat back a similar provision in a housing bill earlier this year.

John Courson, chief operating officer of the Mortgage Bankers Association, an industry group, said the proposed change would increase mortgage rates for consumers because investors who typically buy the loans might deem new mortgage contracts too risky. Opponents also say the language of the new bill is so expansive that any mortgage—not just the riskier mortgages that have the highest default rates—would be covered. Homeowners who simply made bad borrowing decisions could be bailed out.

The number of people filing for Chapter 13 bankruptcy—in which debtors can pay back their debt over three to five years—rose to 170,423 in the first half of 2008, up from 150,000 in the same period last year, according to the American Bankruptcy Institute.

Currently, judges overseeing bankruptcy cases can approve the modifications of the terms of auto and student loans and second-home mortgages, but not those of primary homes. Under the Democrats' proposal, judges could approve reorganization plans that would allow debtors to pay a lower, fixed interest rate for their primary-residence mortgage and pay it over as many as 40 years. And, if the value of the property falls below the loan amount, debtors potentially could reduce the loan's outstanding balance to equal the current value of the property—commonly called a "cram down."

The provision also would allow debtors already in bankruptcy who are on the verge of foreclosure to modify their mortgages. Cathleen Cooper Moran, an attorney in Mountain View, Calif., said she can look at the blackboard in her office and see the names of a dozen families who would benefit from the proposed change. Among them are Marcus and Mary Leavitt of Aptos, Calif., who filed for Chapter 13 bankruptcy in May.

The Leavitts had first and second loans—both refinances—leaving them with debt on their house totaling $876,500. Today the house is worth only $535,000. While the smaller, second mortgage can be modified, the Leavitts must pay the $714,000 first mortgage under the original terms. "As the economy softens, they wonder about their ability to generate enough income to service the first loan," said Ms. Moran. Changing the law "would be a godsend for them."