THE WALL STREET JOURNAL.

Friday, January 8, 2009

Senators to Bankruptcy Judges: Prepare to Strip Down

By Dan Slater

Wall Street Journal | January 8, 2009

Bankruptcy judges could soon add a new arrow to their quiver: the power to reset repayment terms for millions of mortgage holders who wind up in bankruptcy court.

This morning, the WSJ reported that Citigroup is leading other lenders in advanced talks with key senators on so-called "cramdown" (or "strip down") legislation. It's an about-face for the financial industry and the National Association of Home Builders. Banks have long said that cramdowns — when bankruptcy judges force lenders to modify mortgages — would raise borrowing costs for all home buyers.

A recent NYT story reported that nearly one in six U.S. homes is worth less than the mortgage owed on it. With the new legislation, judges could potentially reduce the balance of the mortgage to equal the amount of the current property value. That's the "cram down." 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.

Jerry Howard, president of the National Association of Home Builders, told the WSJ that the NAHB has reversed its yearslong opposition to cramdowns, as foreclosures choke the market for new homes. "This is an about-face for our organization."

For past coverage of cramdowns, which were kicked around in September as a possible add-on to the proposed bailout legislation, click here. At the time, Samuel L. Bufford, a U.S. bankruptcy judge in Los Angeles, told the Journal: "The government is providing a trillion dollars in assistance to financial institutions to deal with the people that can't afford to pay mortgages, so there ought to be something in the program to help people pay their mortgages. It's a matter of fairness."

Introducing the legislation in a recent statement, Sen. Dick Durbin (D., Ill.), mirrored that sentiment. "The question that faces us now is this: After committing over one trillion dollars in taxpayer money to address the financial crisis, why don't we take a step that would indisputably reduce foreclosures and that would cost taxpayers nothing?"

Correction: An earlier version of this post incorrectly stated that judges overseeing bankruptcy cases can approve the modifications of the terms of auto loans. In fact, judges can approve modifications of the terms of some auto loans.