In Washington, Aid to Homeowners Debated

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WASHINGTON, Aug. 24 — Faced with a possible tidal wave of home foreclosures beginning this fall, Democrats and Republicans are battling over a philosophical question with huge practical implications: should the government ride to the rescue?

Both the Bush administration and Democratic leaders in Congress agree that legions of homeowners could be overwhelmed in the next 18 months, as low teaser rates expire on more than two million adjustable-rate mortgages, causing monthly payments increase sharply.

More ominously, falling real estate prices and a pullback among mortgage lenders are expected to make it more difficult for overstretched homebuyers to either refinance their way out of trouble or simply sell their houses.

“This is really just the beginning,” said Karen Weaver, global director for securitization research at Deutsche Bank. “There’s a big wave of defaults coming over the next 12 to 18 months.”

From a political perspective, the wave would be crashing during the primary and general election campaigns next year.

But the Bush administration and Congressional Democrats are ideologically divided about what Washington should do. Administration officials are reluctant to bail out people who bought homes they could not afford or simply gambled that easy credit and rising real estate prices would lead to quick profits.

Democrats, though opposed to a broad bailout, are proposing an array of measures to help lower-income people renegotiate their loans and stay in their homes.

“You cannot simply decree that there will be no foreclosures,” Representative Barney Frank, Democrat of Massachusetts and chairman of the House Financial Services Committee, said. “You can’t just give people a free ride.”

Mr. Frank and other Democrats are pushing for changes that they hope will free more money for lower-income families and shift the balance of power between borrowers and lenders.

The proposals would expand the program of insuring home loans under the Federal Housing Administration, part of the Department of Housing and Urban Development; create a national fund for “affordable housing”; expand the ability of Fannie Mae and Freddie Mac, the government-sponsored finance companies, to buy renegotiated subprime mortgages; and give bankruptcy judges more power to order easier terms for borrowers.

The Bush administration, with the Treasury Department heading the efforts, is looking for more limited solutions. Administration officials are working on their own ideas to let the F.H.A. insure slightly more expensive homes, which could make it easier for people with low incomes or weak credit to switch out of subprime mortgages and into more traditional fixed-rate loans.

Robert K. Steel, under secretary of the Treasury for domestic finance, has been put in charge of developing other ideas, but administration officials have said little about what those might be.

“The president has asked Treasury to be clearly focused on actions that can be taken, things we can do, to help mortgage holders who are in danger of losing their homes,” a spokeswoman for the Treasury Department, Jennifer Zuccarelli, said. “We are looking at all other options to help stressed borrowers.”

For the last six years, administration officials have followed a laissez-faire approach, saying they did not want to restrict innovative mortgage products.

But it may be difficult to continue that hands-off policy much longer. The number of foreclosure filings in July was almost double that of a year ago, according to RealtyTrac, which provides real estate data. About 13 percent of adjustable subprime mortgages are past due, but most of the problems are on loans whose monthly payments have not yet been adjusted upward.

Deutsche Bank estimates that about $400 billion in subprime loans are scheduled for rate increases of 30 percent or more by the end of 2008.

Consequently, many Democratic lawmakers are pushing for measures that would make it easier for imperiled homeowners to replace their adjustable subprime mortgages with more traditional 30-year fixed-rate mortgages.

Democrats also want the administration to let Fannie Mae and Freddie Mac buy a larger volume of mortgages for their own portfolios. The two government-sponsored companies buy billions of dollars in mortgages each year, up to a loan limit of $417,000, and package them into securities that can be traded. They also hold some of the bundles of mortgages in their own portfolios to increase returns to shareholders.

Democrats, including Mr. Frank in the House and Senator Christopher J. Dodd of Connecticut, chairman of the Senate banking committee, contend that Fannie Mae and Freddie Mac could help thousands of people refinance their subprime mortgages if the two finance giants were allowed to hold those loans in their portfolios.

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The Treasury Department has opposed that kind of expansion, arguing that the two companies crowd out commercial rivals because they exploit an implied government guarantee to borrow money at lower rates than their rivals.

Treasury officials have indicated a willingness to let Fannie and Freddie play a bigger role, but they argue that letting the two companies hold more mortgages — the current regulatory limit is about $700 billion for each — would pose a risk to taxpayers without helping homeowners.

Mr. Frank has argued that Congress should also increase the size of mortgages that Fannie and Freddie can buy, from $417,000 now to $500,000 or even $650,000 in markets like San Francisco and New York.

Some specialists warn that simply switching out of an adjustable loan will not keep all homeowners from losing their houses.

“The problem is that a lot of people have bought more house than they can afford and in many cases the price has dropped a great deal,” said Dean Baker, co-director of the Center for Economic Policy Research, a liberal research group in Washington. “If we do a workout that allows someone to pay off a $240,000 mortgage on a house that would only sell for $220,000, have we really done them a favor?”

Democratic lawmakers have proposed changes that would give borrowers more power to negotiate lower interest rates or even a lower loan amount.

Supporters say such a move might benefit lenders, because foreclosing and re-selling a property can be costly — especially if real estate prices are declining.

This year, lawmakers persuaded the Financial Accounting Standards Board to allow companies that service mortgages, as opposed to the investment funds that may actually own the mortgage, to negotiate changes.

Senator Charles E. Schumer of New York, chairman of the Joint Economic Committee, has proposed that the government distribute $300 million to nonprofit groups that could advise families on how to refinance or renegotiate their mortgages. The Senate recently included $100 million for such programs in a spending bill for HUD.

Another idea, being considered by Senator Richard J. Durbin, Democrat of Illinois, would give bankruptcy judges the ability to revise mortgage contracts, much as they already do when sorting out payments to other kinds of creditors.

“The most important thing in the mortgage market is not about money, but about the rules of the game,” said Eric Stein, senior vice president at the Center for Responsible Lending, a nonprofit organization based in Charlotte, N.C., that has long criticized subprime lending.

Mr. Stein and other industry critics would ban the steep penalties for prepaying mortgages. Such penalties, which are rare for prime borrowers, or those with good credit, often make it prohibitively expensive for people to refinance.

Mortgage lenders are expected to fight such a prohibition, arguing that prepayment penalties make it possible to offer very low initial interest rates to higher-risk borrowers.

Some advocates for low-income homeowners argue that the government may have to rescue people, at a cost of billions of dollars.

Democratic presidential candidates, including Senator Hillary Rodham Clinton and former Senator John Edwards, have called for a billion-dollar fund to help low-income homeowners.

“We have entered the arena of ‘too big to fail,’ ” said John Taylor, president of the National Community Reinvestment Coalition, a nonprofit group in Washington. “We need to pony up and prevent the market from deteriorating further.”

For the moment, neither Democratic leaders in Congress nor Mr. Bush have much appetite for a true bailout. But that could change as the elections draw nearer.

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