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TALKING BUSINESS

Shouldn't We Rescue Housing?

By JOE NOCERA

Now that the government has "saved" Wall Street — at least for the moment — hasn't the time finally come to save Main Street too?

The Treasury Department just pumped $125 billion into the country's largest financial institutions, and it promises to use another $125 billion — more, if necessary — to recapitalize regional and community banks. They are vital steps. This week, at long last, the credit markets thawed, at least a little, and the global recapitalization of the banking system is the reason.

But the job isn't done yet. The government now needs to tackle what R. Glenn Hubbard, the former chairman of the Council of Economic Advisers under President Bush, calls "the elephant in the room": the continuing decline of housing prices. That decline means more and more homeowners are saddled with "impaired mortgages" (to use the current lingo), meaning their homes are worth less than what they owe on them. They didn't necessarily do anything wrong; they just bought a house near the peak of an unsustainable bubble. Now they have little economic incentive to keep making mortgage payments.

Of course, millions of additional homeowners did make a big mistake: they took advantage of "liar loans" and other too-good-to-be-true deals to buy homes they couldn't afford. Many are still in those homes, hanging on for dear life. Many others have already faced foreclosure proceedings.

I've seen estimates suggesting as many as one out of every six homeowners has a troubled mortgage. This is an enormous social problem. It is also a continuing economic problem. In the year since the crisis began, the world's financial institutions have written down around $500 billion worth of mortgage-backed securities. Unless something is done to stem the rapid decline of housing values, these institutions are likely to write down an additional $1 trillion to $1.5 trillion. In other words, we ain't seen nothin' yet.

And please don't raise the specter of moral hazard, the notion that people who did dumb things need to take their lumps so they won't do it again. First of all, you would have to be an absolute idiot to repeat the folly of the housing bubble, even if you don't lose your house in the crisis. I contend that this financial crisis is going to cause an entire generation to become debt-averse, as our parents were after the Depression.

Second, there is the question of justice. For Wall Street, which made plenty of its own dumb mistakes, moral hazard went out the window the minute the government realized what a catastrophic error it made when it allowed Lehman Brothers to go bankrupt. The government is not going to let another big institution fail. Why should homeowners have to pay more for their sins than Wall Street is paying for its sins? As anger across the country rises, this is becoming a political issue as well.

Yes, there were lots of Americans who were not greedy or foolish during the housing bubble, and many resent the idea that their neighbors might get a bailout they don't deserve. They need to get over themselves. If housing prices keep falling, many millions of additional homeowners will find themselves, through no fault of their own, with underwater mortgages. Besides, foreclosures damage property values for everyone, not just those losing their homes.

Finally, and perhaps most important, the housing bubble and its aftermath form the core problem from which all other problems flow. If the government doesn't do anything about it, the economy will remain in chaos. Banks will still be afraid to write mortgages because they won't trust the value of the collateral. Giant financial institutions will continue to post multibillion-dollar write-downs. And homeowners will continue to face the stark reality that their primary asset is in jeopardy.

And yet, so far the government's response to this part of the crisis — the part that most directly affects voters, for crying out loud — has been anemic. The Hope for Homeowners program, signed into law in July, is both too complicated and too narrow. The new $700 billion bailout bill contains some toothless pleas to help homeowners. Efforts to jawbone the mortgage industry have largely failed.

Just a few days ago, the chairman of the Federal Deposit Insurance Commission, Sheila Bair, publicly broke with her counterparts at the Treasury and the Federal Reserve and criticized the Bush administration for not doing enough for homeowners. "We're attacking it at the institution level as opposed to the borrower level, and it's the borrowers defaulting," she told The Wall Street Journal. "That is what's causing the distress at the institution level. So why not tackle the borrower problem?"

Why not, indeed. It turns out there are plenty of plans out there to do just that. But not one has broken through to gain wide backing.

For instance, both presidential candidates have homeowner assistance plans, but they are poorly conceived and would cost the government billions of additional dollars. Mr. Hubbard, now the dean of the Columbia Business School, and a Columbia colleague, Chris Mayer, say they believe the answer lies in having "the Bush administration and Congress allow all residential mortgages on primary residences to be refinanced into 30-year fixed-rate mortgages at 5.25 percent (matching the lowest mortgage rate in the last 30 years), and place those mortgages with Fannie Mae and Freddie Mac," as they wrote recently.

A Yale economist named John D. Geanakoplos suggests a new system to "modify mortgage loans to keep homeowners in their homes," as he put it in a recent paper. He also says the government should give financial incentives to renters to buy homes — and thus create a floor for housing prices. Both of these ideas are far better than the proposals of the two candidates.

But recently a proposal came across my desk that I believe is so smart, and so sensible, that I hope our nation's policy makers will give it a serious look. It comes from Daniel Alpert, a founding partner of Westwood Capital, a small investment bank. I have quoted Mr. Alpert frequently in recent columns, because he has been both thoughtful and prescient on the subject of the financial crisis.

Here's his idea: Pass a law that encourages homeowners with impaired mortgages to forfeit the deed to their lenders but allows them to stay in the homes for five years, paying prevailing market rent. Under the law Mr. Alpert envisions, the lender would be forced to accept the deed, and the rent. After five years, the homeowner-turned-renter would have the right to buy the home back, at fair market value, from the lender.

There are so many things I like about this idea that I hardly know where to begin. Let's start with the fact that it doesn't require a large infusion of taxpayers' money. Indeed, it doesn't require any government money at all. It also doesn't let either homeowners or lenders off the hook, as many other plans would. The homeowner loses the deed to his home, which will be painful. The lending institution, in accepting prevailing market rent, will get maybe 60 or 70 percent of what it would have gotten from a healthy mortgage-payer. (Rents are considerably lower than mortgage payments right now.) That will be painful too. Moral hazard will not be an issue.

As Mr. Alpert told me the other day, his proposal "admits the truth: the homeowner doesn't have equity, and the lender has taken a loss. They should exchange interest, but not in a way that throws the homeowner out in the street."

Which is the other key part of his plan. It has the best chance of preventing, as he puts it, "the massive disruption of the economy and the social dislocation" that will come from large numbers of foreclosures. And it is the continuing foreclosures that are likely to cause housing prices to fall so hard that they will drop below the real value of the shelter.

That, of course, is exactly what happened during the bubble, albeit in reverse — prices wildly overshot the true value of the home — and it has to be prevented on the way down. Otherwise we face further economic calamity.

Why did Mr. Alpert choose five years? Two reasons. First, he feels confident that housing prices will have stabilized by then. "We continue to have a growing population," he said. "And there is zero chance there will be a material increase in housing stock over the next five years that will exceed demand. Those two factors alone will cause housing to stabilize."

Second, he says five years will give the renters enough time to get their financial affairs in order — to pay down their various debts and save enough to make the 10 percent down payment an F.H.A. loan requires. (Many of the homeowners affected by this plan would be eligible for F.H.A. loans, Mr. Alpert believes.)

If they don't have enough for a down payment, they would have to leave, of course, but it would be far less disruptive to the economy than it would be right now, in the middle of the crisis.

Does the plan have stumbling blocks? Sure it does. One obvious one is that ideologues will view its being mandatory as an improper "taking" of homeowners' property rights and a violation of the mortgage contract. But, as Mr. Alpert puts it, "the homes involved are economically without value to the existing homeowners." He adds, "What the plan buys is time to heal for both sides in a fairly equitable and controlled manner."

Mr. Alpert calls his plan "The Freedom Recovery Plan." On my blog (www.nytimes.com/executivesuite), I have linked to Mr. Alpert's detailed description of how it would work, which runs eight pages. I have also posted a series of short "comments" that he sent me recently, which outline the severity of the problem. I encourage you to read both documents, and weigh in on the plan's merits.

That goes for you, too, government policy makers. I acknowledge that this may not be the perfect solution. It may have some fatal flaw that neither Mr. Alpert nor I can see. But if you don't like this idea, it is incumbent upon you to come up with something better.

Actually, it's long overdue.