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REAL ESTATE

'05 rules leading to more loan defaults

Bankruptcy laws tougher now on credit card debt instead of mortgages

By KATHLEEN M. HOWLEY
Bloomberg News

Washington Mutual Inc. got what it wanted in 2005: A revised bankruptcy code that no longer lets people walk away from credit card bills.

The largest U.S. savings and loan didn't count on a housing recession. The new bankruptcy laws are helping drive foreclosures to a record as homeowners default on mortgages and struggle to pay credit card debts that might have been wiped out under the old code, said Jay Westbrook, a professor of business law at the University of Texas Law School in Austin and a former adviser to the International Monetary Fund and the World Bank.

"Be careful what you wish for," Westbrook said. "They wanted to make sure that people kept paying their credit cards, and what they're getting is more foreclosures."

Washington Mutual, Bank of America Corp., JPMorgan Chase & Co. and Citigroup Inc. spent $25 million in 2004 and '05 lobbying for a legislative agenda that included changes in bankruptcy laws to protect credit card profits, according to the Center for Responsive Politics, a non-partisan Washington group that tracks political donations.

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The banks are still paying for that decision. The surge in foreclosures has cut the value of securities backed by mortgages and led to more than $40 billion of writedowns for U.S. financial institutions. Even as losses have mounted, banks have seen their credit card businesses improve. The amount of money owed on U.S. credit cards with payments more than 30 days late fell to $7.04 billion in the second quarter from $8.37 billion two years earlier, according to data compiled by Federal Deposit Insurance Corp.

In the same period, the dollar volume of repossessed homes owned by insured banks doubled to $4.2 billion, the federal agency said. New foreclosures rose to a record in the second quarter, led by defaults in subprime adjustable-rate mortgages, according to the Mortgage Bankers Association in Washington.

People are putting their credit card payments ahead of their mortgages, said Richard Fairbank, chief executive officer of Capital One Financial Corp., the largest independent U.S. credit card issuer. Of customers who are at least three months late on their mortgage payments, 70% are current on their credit cards, he said.

"What we conclude is that people are saying, 'Honey, let the house go,' " but keep the cards, Fairbank said. The new bankruptcy code makes it harder for debtors to qualify for Chapter 7, the section that erases non-mortgage debt. It shifted people who get paychecks higher

Please see **RULES, 5F**

A Milwaukee couple are ready to celebrate their first year of homeownership, after fending off lending pressures and unforeseen expenses

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Vicky and Keith Newson are happy owning their first home on Milwaukee's northwest side, even with the financial concerns that go with homeownership.

Walking the tightrope

By JOANNE CLEAVER
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Keith and Vicky Newson appeared destined to become subprime lending statistics. Three years ago, at the height of the housing and lending boom, the longtime renters and parents of three children started house hunting in earnest. They quickly found real estate and mortgage brokers intent on persuading them to take on more house and more debt than they thought they could afford.

At that time, such was the common wisdom of the housing boom. Annual house appreciation in working-class neighborhoods in the city of Milwaukee hit double digits in 2005. Anyone could get a mortgage, even without a down payment or proof of a steady income.

Some of the easy loans of 2005 and 2006 were bound to sour, but lenders figured that borrowers could get out of them by selling their houses, maybe even at a profit. The great mortgage mess of 2007 was but an economist's frown line.

Meanwhile, moderate-income families who bought during the great real estate run-up often found that holding on to their new houses was at least as much work as buying them.

Keith Newson started searching for a house in 2003, driving around on weekends looking for "For Sale" signs, driving down alleys to check out yards and garages.

Keith, 40, and Vicky, 39, were renting a house for $640 a month. It was crowded, with three adolescents. Keith wanted a place of his own — "a piece of America," he said — something solid to show for years of work, rooms of their own for the kids and a garage for the 1993

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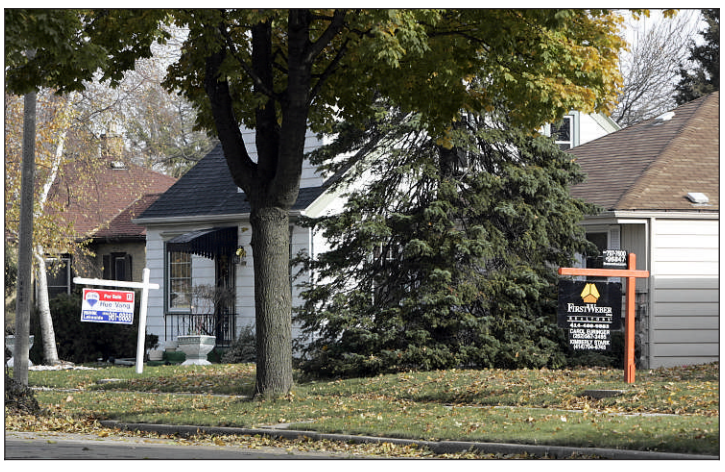

Houses are for sale around the corner, but so far the Newsons have avoided getting mired in too much consumer debt.

68.1%
Current homeownership rate in the U.S.

69.3%
Peak homeownership rate, in 2004

70%
Proportion of the recent rise in homeownership due to new types of mortgages.

Census Bureau; Federal Reserve Bank of Atlanta; Bloomberg News

Burden of consumer debt

Many subprime borrowers have taken on additional consumer debt. That debt, combined with rising interest rates on adjustable-rate loans, may overwhelm some homeowners.

- An analysis by Synovate, a market research firm, indicates that U.S. household income averages $60,000 and the amount of revolving credit available to each household averages $26,317.
- Subprime borrowers have lower household incomes than the national average but carry credit card balances that absorb 30% or more of the available credit, according to Synovate.
- The average revolving balance for those households: $9,890, up from $8,069 four years ago.
- Experian, a national credit-rating service, released a study in June that found that those with credit scores below 620 — subprime territory — are more likely to pay their credit cards on time and let their mortgage payments slide.
- Since 2003, credit card lending to subprime consumers has risen by 137 percent and mortgage lending to them has risen by 58 percent, according to Experian — a setup for mortgage defaults.