"Strip-down" Could Ease Subprime Mortgage Crisis

By Ning Zhu and Michelle White

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Nearly all debtors who file for bankruptcy under Chapter 13 are homeowners, according to researchers at the University of California, Davis, Graduate School of Management and UC San Diego.

Ning Zhu, an associate professor of management at UC Davis, and Michelle White, a professor of economics at UC San Diego, report their findings in a working paper, "Saving Your Home in Chapter 13 Bankruptcy," available online at http://www.gsm.ucdavis.edu/Faculty/Zhu/Chapter13.

The researchers argue that even more debtors would save their homes rather than default if Chapter 13 permitted filers who owe more on their homes than the homes are worth to "strip-down" their mortgage obligation using a formula tied to the home's current fair market value and mortgage principal. The study examined all bankruptcies filed in Delaware in 2006.

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"Overall, introducing strip-down could save an addition 109,000 homes from default each year," Zhu says. "While that's a small number relative to the volume of foreclosures that may occur in the next year or two, introducing strip-down nonetheless could make an important contribution to solving the subprime mortgage crisis by providing a mechanism for saving homes from foreclosure when debtors wish to save their homes, even when lenders are unwilling to renegotiate or to consent to a refinancing."

Zhu notes that foreclosures are costly not just to borrowers and lenders but to neighborhoods, because foreclosed homes tend to deteriorate and cause blight that pushes down housing prices and makes it difficult for other homeowners to refinance. This in turn leads to additional defaults by homeowners whose mortgages are "underwater" -- where the amount owed is higher than the value of the house. And as housing values drop, property tax revenues shrink, squeezing local government budgets.

Source: http://www.news.ucdavis.edu/search/news_detail.lasso?id=8742