CNNMoney.com

States: Let taxpayers cover your mortgage

PHOTO: JOE RAEDLE/GETTY IMAGES

By Tami Luhby, senior writer

May 12, 2010: 8:24 AM ET

NEW YORK (CNNMoney.com) -- Unemployed? Owe more on your mortgage than your home is worth? Your state might one day pay your mortgage.

Giving people free money to cover their home loans is just one of the radical ways that four states -- Florida, Michigan, California and Arizona -- plan to use $1.4 billion the Obama administration is sending their way to help the unemployed and underwater avoid foreclosure.

Many consumer advocates have said the government should help cover the payments of these troubled homeowners, lest the mortgage crisis continue spinning out of control and dragging down everyone's property values. But other housing experts warn that paying off loans creates a moral hazard and could actually dissuade people from looking for work.

Innovative programs, however, are exactly what the administration was hoping for when it unveiled the Hardest Hit Fund initiative in February.Officials are looking to help the unemployed and underwater, who are now at the heart of the crisis. Despite the administration's best efforts to stabilize the market, home prices are still sliding and foreclosure filings are at record highs.

The federal governmentis doling out a total of $2.1 billion to 10 states, which also include Nevada, North Carolina, South Carolina, Rhode Island, Ohio and Oregon. The others have not yet submitted their plans to Treasury for approval or have not made them public.

To be sure, the proposals will only a touch a small percentage of the unemployed and underwater homeowners who need help. But it will provide assistance to some of those who presently don't qualify traditional loan modifications.

CNNMoney.com

Administration officials will spend the next few weeks reviewing the proposals, but Assistant Treasury Secretary Michael Barr told CNNMoney.com that they contained some good ideas.

The recently unveiled initiatives are not identical, but they have two common themes: Helping the unemployed by subsidizing part or all of their monthly mortgage payments for up to two years and paying down underwater homeowners' loan balances.

The states want the loan servicers and investors to match their largess, hoping to woo them by paying down as much as $50,000 of underwater homeowners' loan balances.

But until now, financial institutions have been reluctant to reduce principal.

These proposals may irk Americans who are keeping up with their mortgage payments or don't want tax dollars used to help their neighbors. But Alan White, a law professor at Valparaiso University, said all homeowners will suffer if neighboring properties fall into foreclosure.

"There are benefits for all of us for stopping foreclosures any way we can," White said.

Plus, he added, many of the people who would be helped are those capable of paying their mortgages again once they find work. By example, he pointed to a longstanding Pennsylvania program that provides loans to the unemployed, which gives them assistance while they look for new jobs.

Also, covering homeowners' mortgages is a better use of government funds than giving incentives to the servicers and relying on them to assist borrowers, said Paul Willen, senior economist at the Federal Reserve Bank of Boston. This way, he said, states have more control over who benefits from the initiatives.

"Every dollar spent will go to families who need it," he said.

But delinquent homeowners aren't the only ones who would benefit from these subsidies. In fact, the banks would come away with a huge win, said Mark Calabria, director of financial regulation studies at The Cato Institute. Not only would they have government money securely in hand, but they'd avoid the time and expense of the foreclosure process.

"This is a lot more than they would have collected otherwise," Calabria said. "The lenders should bear the losses for this. They are the one who made the loans."

Another concern is that these proposals will dissuade the unemployed from finding work

CNNMoney.com

or from relocating to an area with better job prospects, said Casey Mulligan, an economics professor at the University of Chicago. Such programs incent people to maintain their financial hardships.

"Why should anybody work if you are going to be in your house either way?" he said.