More homeowners are opting for 'strategic defaults'

Underwater on their mortgages and angry at banks, more borrowers are choosing to hand over the keys, even if they can afford the payments.

Wynn Bloch bought her Palm Desert house for $385,000 in 2006. Now she says it will never be worth anywhere near the amount of her mortgage, so she stopped paying on her loan and moved out. (Bret Hartman / For The Times / March 4, 2010)

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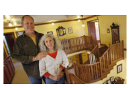

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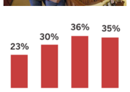

CHART: Strategic defaults

By Alana Semuels

March 17, 2010

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Wynn Bloch has always dutifully paid her bills and socked away money for retirement. But in December she defaulted on the mortgage on her Palm Desert home, even though she could afford the payments.

Bloch paid $385,000 for the two-bedroom in 2006, when prices were still surging. Comparable homes are now selling

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prices were still surging. Comparable homes are now selling in the low-$200,000s. At 66, the retired psychologist doubted she'd see her investment rebound in her lifetime. Plus, she said she was duped into an expensive loan.

The way she sees it, big banks that helped fuel the mess all got bailouts while small fry like her are left holding the bag. No more.

"There was not a chance that house was ever going to be worth anywhere near what my mortgage was," said Bloch, who is now renting a few miles away after defaulting on the $310,000 loan. "I haven't cheated or stolen."

Time was when Americans would do almost anything to hang on to their homes. But that commitment appears to be fraying as more people fall behind on their loans while watching the banks and lenders that helped trigger the financial crisis return to prosperity.

Nearly one-quarter of U.S. mortgages, or about 11 million loans, are "underwater," i.e. the houses are worth less than the balance of their loans. While home values are regaining ground -- median prices rose 10% in Southern California last month to $275,000 compared with a year earlier -- they remain far below the July 2007 peak of $505,000.

Many homeowners are just coming to grips with the idea that prices will take years to reach the pre-crash peak: as long as 14 years in California, according to economist Chris Thornberg.

Stuck with properties whose negative equity won't recover for years, and feeling betrayed by financial institutions that bankrolled the frenzy, some homeowners are concluding it's smarter to walk away than to stick it out.

"There is a growing sense of anger, a growing recognition that there is a double standard if it's OK for financial institutions to look after themselves but not OK for homeowners," said Brent T. White, a law professor at the University of Arizona who wrote a paper on the subject.

Just how many are walking away isn't clear. But some researchers are convinced that the numbers are growing. So-called strategic defaults accounted for about 35% of defaults by U.S. homeowners in December 2009, up from 23% in March of 2009, according to Luigi Zingales, a professor at the University of Chicago's Booth School of Business.

He and colleagues at Northwestern University's Kellogg School of Management reached that conclusion by surveying homeowners about their attitudes and experiences with loan defaults.

They found that borrowers were more willing to walk away if someone they knew had done it, and that the greater a homeowner's negative equity the more likely he or she was to default, even if the monthly payment was affordable.

An analysis released last year by credit bureau Experian and consulting firm Oliver Wyman estimated that nearly 1 in 5 homeowners who were seriously delinquent on their mortgages in the last three months of 2008 were walkaways.

"The fact that people are strategically defaulting -- there is no question," Zingales said. "The risk that the number of people doing this might explode is significant."

A flood of walkaways could damage the nation's fledgling housing recovery by swamping the market with foreclosed properties. Still, some experts are dubious that millions of underwater homeowners will pull the plug as Bloch did. Homeownership remains the cornerstone of the American dream. Moving is a hassle. And the stigma associated with a foreclosure is likely to keep many hanging on for

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The biggest surprise is that so many underwater homeowners continue to pay, said White, the Arizona law professor. He's convinced that personal shame, as well as moral suasion by the government and financial institutions, has kept many homeowners from walking away, even when they'd be better off financially by dumping their homes.

But real estate veterans said old taboos were eroding fast. Jon Maddux, a former real estate investor who in 2007 founded You Walk Away, a for-profit company that guides homeowners through the process of default, said his earliest customers struggled with emotional ties to their homes as well as remorse about reneging on an obligation. That's changed as more homeowners have concluded that the housing market isn't going to rebound quickly and they'd be better off cutting their losses.

"Now, it's more of a business decision -- it's people who could afford their house but it's an inconvenience," Maddux said.

He and other experts said average Americans are fed up with hearing how they're supposed to honor their debts while businesses operate by another set of rules.

Case in point: Maguire Properties Inc., one of the largest commercial landlords in California, walked away from seven prime office buildings in Los Angeles and Orange counties last year, defaulting on loans worth more than $1 billion.

Consumers typically begin to think about walking away once the value of the property has fallen to 25% less than the value of the debt, according to research conducted by Sam Khater, senior economist at real estate research firm First American CoreLogic. About 5 million people nationwide are in that situation, he said.

Some purchased their homes at the peak of the market only to see the value drop precipitously when the bubble burst. Others bought low but couldn't resist borrowing against their rising equity to make home improvements and pay off other bills. When home values fell, they too found themselves underwater.

Ken Henrich purchased his Marysville, Calif., home for $187,000 in 2004. He and his wife later refinanced the property, tapping their increased equity to pay off credit cards. They now owe around $300,000 on a place that's worth about $132,000. They let the four-bedroom residence slip into foreclosure and are waiting for it to be sold at auction. They're planning on renting for a few years until they can perhaps buy again.

"We can more than make the payment," the 54-year-old sales rep said. "The way we look at it, our credit would still be perfect years from now but we'd still owe tons more than it's worth."

There are consequences to walking away. A default will knock down a credit score by at least 100 points, said Craig Watts, a spokesman for FICO, the company that developed credit scores. That could make it tough to borrow money, rent an apartment or get a job because many employers now routinely check the credit histories of potential hires.

To some homeowners those consequences are a small price to pay to gain a measure of revenge against the financial institutions whose loose money helped fuel the crisis.

Joseph Shull, a 68-year-old marketing professor, said he's planning to walk away from the town house he bought in Moorpark in June 2006.

"I'm angry, and there are a lot of people like me who are angry," he said.

He purchased the home for $410,000 and spent $30,000 renovating. Now the house is worth around $225,000.

Shull admits he overpaid for his property. But he said it fell in value in part because of "regulatory mismanagement."

"The bank stabbed me, but at least I got in a pinprick back," he said. "This is the new economy. The old rules don't apply any more."

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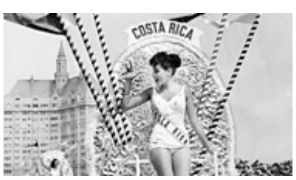

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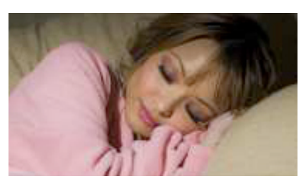

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