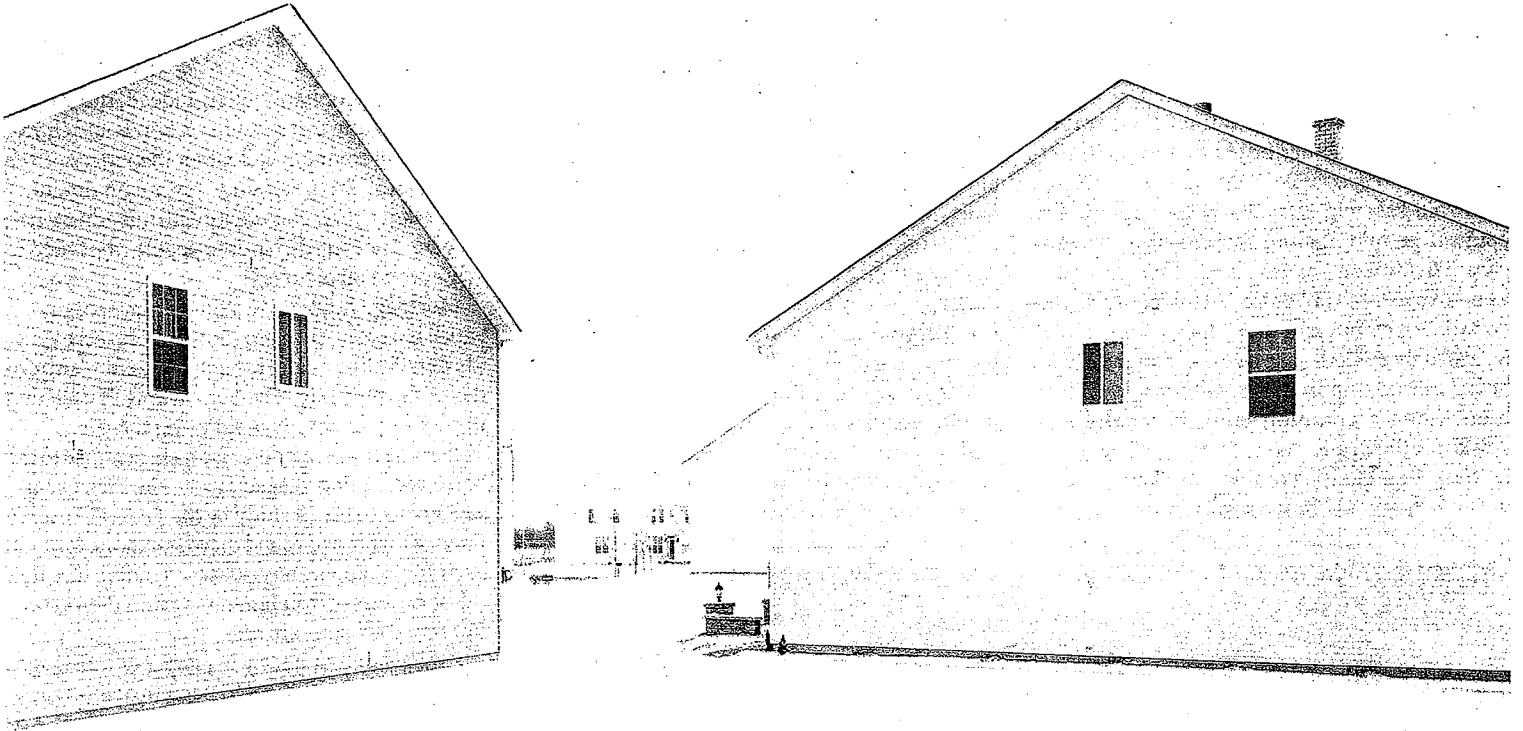


65% of all residential properties with mortgages in Nevada are UNDERWATER

THE WAY WE LIVE NOW



Just Walk Away

Why should underwater homeowners behave any different from banks? By Roger Lowenstein

John Courson, president and C.E.O. of the Mortgage Bankers Association, recently told *The Wall Street Journal* that homeowners who default on their mortgages should think about the “message” they will send to “their family and their kids and their friends.” Courson was implying that homeowners — record numbers of whom continue to default — have a responsibility to make good. He wasn’t referring to the people who have no choice, who can’t afford their payments. He was speaking about the rising number of folks who are voluntarily choosing not to pay.

Such voluntary defaults are a new phenomenon. Time was, Americans

would do anything to pay their mortgage — forgo a new car or a vacation, even put a younger family member to work. But the housing collapse left 10.7 million families owing more than their homes are worth. So some of them are making a calculated decision to hang onto their money and let their homes go. Is this irresponsible?

Businesses — in particular Wall Street banks — make such calculations routinely. Morgan Stanley recently decided to stop making payments on five San Francisco office buildings. A Morgan Stanley fund purchased the buildings at the height of the boom, and their value has plunged. Nobody has said Morgan Stanley is immoral — perhaps because no one assumed it was moral to

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begin with. But the average American, as if sprung from some Franklinesque mythology, is supposed to honor his debts, or so says the mortgage industry as well as government officials. Former Treasury Secretary Henry M. Paulson Jr. declared that "any homeowner who can afford his mortgage payment but chooses to walk away from an underwater property is simply a speculator — and one who is not honoring his obligation." (Paulson presumably was not so censorious of speculation during his 32-year career at Goldman Sachs.)

The moral suasion has continued under President Obama, who has urged that homeowners follow the "responsible" course. Indeed, HUD-approved housing counselors are supposed to counsel people against foreclosure. In many cases, this means counseling people to throw away money. Brent White, a University of Arizona law professor, notes that a family who bought a three-bedroom home in Salinas, Calif., at the market top in 2006, with no down payment (then a common-enough occurrence), could theoretically have to wait 60 years to recover their equity. On the other hand, if they walked, they could rent a similar house for a pit-

tance of their monthly mortgage.

There are two reasons why so-called strategic defaults have been considered antisocial and perhaps amoral. One is that foreclosures depress the neighborhood and drive down prices. But in a market society, since when are people responsible for the economic effects of their actions? Every oil speculator helps to drive up gasoline prices. Every hedge fund that speculated against a bank by purchasing credit-default swaps on its bonds signaled skepticism about the bank's creditworthiness and helped to make it more costly for the bank to borrow, and thus to issue loans. We are all economic pinballs, insensibly colliding for better or worse.

The other reason is that default (supposedly) debases the character of the borrower. Once, perhaps, when bankers held onto mortgages for 30 years, they occupied a moral high ground. These days, lenders typically unload mortgages within days (or minutes). And not just in mortgage finance, but in virtually every realm of our transaction-obsessed society, the message is that enduring relationships count for less than the value put on assets for sale.

Think of private-equity firms that close a factory — essentially deciding that the company is worth more dead than alive. Or the New York Yankees and their World Series M.V.P. Hideki Matsui, who parted company as soon as the cheering stopped. Or money-losing hedge-fund managers: rather than try to earn back their investors' lost capital, they start new funds so they can rake in fresh incentives. Sam Zell, a billionaire, let the Tribune Company, which he had previously acquired, file for bankruptcy. Indeed, the owners of any company that defaults on bonds and chooses to let the company fail rather than invest more capital in it are practicing "strategic default." Banks signal their complicity with this ethos when they send new credit cards to people who failed to stay current on old ones.

Mortgage holders do sign a promissory note, which is a promise to pay. But the contract explicitly details the penalty for nonpayment — surrender of the property. The borrower isn't escaping the consequences; he is suffering them.

In some states, lenders also have recourse to the borrowers' unmortgaged assets, like their car and savings accounts. A study by the Federal Reserve Bank of Richmond found that defaults are lower in such states, apparently because lenders threaten the borrowers with judgments against their assets. But actual lawsuits are rare.

And given that nearly a quarter of mortgages are underwater, and that 10 percent of mortgages are delinquent, White, of the University of Arizona, is surprised that more people haven't walked. He thinks the desire to avoid shame is a factor, as are overblown fears of harm to credit ratings. Probably, mortgagees also labor under a delusion that their homes will quickly return to value. White has argued that the government should stop perpetuating default "scare stories" and, indeed, should encourage borrowers to default when it's in their economic interest. This would correct a prevailing imbalance: homeowners operate under a "powerful moral constraint" while lenders are busily trying to maximize profits. More important, it might get the system unstuck. If lenders feared an avalanche of strategic defaults, they would have an incentive to renegotiate loan terms. In theory, this could produce a wave of loan modifications — the very goal the Treasury has been pursuing to end the crisis.

No one says defaulting on a contract is pretty or that, in a perfectly functioning society, defaults would be the rule. But to put the onus for restraint on ordinary homeowners seems rather strange. If the Mortgage Bankers Association is against defaults, its members, presumably the experts in such matters, might take better care not to lend people more than their homes are worth. ♦