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No Help in Sight, More Homeowners Walk Away

By DAVID STREITFELD

In 2006, Benjamin Koellmann bought a condominium in Miami Beach. By his calculation, it will be about the year 2025 before he can sell his modest home for what he paid. Or maybe 2040.

“People like me are beginning to feel like suckers,” Mr. Koellmann said. “Why not let it go in default and rent a better place for less?”

After three years of plunging real estate values, after the bailouts of the bankers and the revival of their million-dollar bonuses, after the Obama administration’s loan modification plan raised the expectations of many but satisfied only a few, a large group of distressed homeowners is wondering the same thing.

New research suggests that when a home’s value falls below 75 percent of the amount owed on the mortgage, the owner starts to think hard about walking away, even if he or she has the money to keep paying.

In a situation without precedent in the modern era, millions of Americans are in this bleak position. Whether, or how, to help them is one of the biggest questions the Obama administration confronts as it seeks a housing policy that would contribute to the economic recovery.

“We haven’t yet found a way of dealing with this that would, we think, be practical on a large scale,” the assistant Treasury secretary for financial stability, Herbert M. Allison Jr., said in a recent briefing.

The number of Americans who owed more than their homes were worth was virtually nil when the real estate collapse began in mid-2006, but by the third quarter of 2009, an estimated 4.5 million homeowners had reached the critical threshold, with their home’s value dropping below 75 percent of the mortgage balance.

They are stretched, aggrieved and restless. With figures released last week showing that the real estate market was stalling again, their numbers are now projected to climb to a peak of 5.1 million by June — about 10 percent of all Americans with mortgages.

“We’re now at the point of maximum vulnerability,” said Sam Khater, a senior economist with First American CoreLogic, the firm that conducted the recent research. “People’s emotional attachment to their property is melting into the air.”

Suggestions that people would be wise to renege on their home loans are at least a couple of years old, but they are turning into a full-throated barrage. Bloggers were quick to note recently that landlords of an 11,000-unit residential complex in Manhattan showed no hesitation, or shame, in walking away from their deeply underwater investment.

“Since the beginning of December, I’ve advised 60 people to walk away,” said Steve Walsh, a mortgage broker in Scottsdale, Ariz. “Everyone has lost hope. They don’t qualify for modifications, and being on the hamster wheel of paying for a property that is not worth it gets so old.”

Mr. Walsh is taking his own advice, recently defaulting on a rental property he owns. “The sun will come up tomorrow,” he said.

The difference between letting your house go to foreclosure because you are out of money and purposefully defaulting on a mortgage to save money can be murky. But a growing body of research indicates that significant numbers of borrowers are declining to live under what some waggishly call “house arrest.”

Using credit bureau data, consultants at Oliver Wyman calculated how many borrowers went straight from being current on their mortgage to default, rather than making spotty payments. They also weeded out owners having trouble paying other bills. Their estimate was that about 17 percent of owners defaulting in 2008, or 588,000 people, chose that option as a strategic calculation.

Some experts argue that walking away from mortgages is more discussed than done. People hate moving; their children attend the neighborhood school; they do not want to think of themselves as skipping out on a debt. Doubters cite a Federal Reserve study using historical data from Massachusetts that concludes there were relatively few walk-aways during the 1991 bust.

The United States Treasury falls into the skeptical camp.

“The overwhelming bulk of people who have negative equity stay in their homes and keep paying,” said Michael S. Barr, assistant Treasury secretary for financial institutions.

It would cost about $745 billion, slightly more than the size of the original 2008 bank bailout, to restore all underwater borrowers to the point where they were breaking even, according to First American.

Using government money to do that would be seen as unfair by many taxpayers, Mr. Barr said. On the other hand, doing nothing about underwater mortgages could encourage more walk-aways, dealing another blow to a fragile economy.

“It’s not an easy area,” he said.

Walking away — also called “jingle mail,” because of the notion that homeowners just mail their keys to the bank, setting off foreclosure proceedings — began in the Southwest during the 1980s oil collapse, though it has never been clear how widespread it was.

In the current bust, lenders first noticed something strange after real estate prices had fallen about 10 percent.

An executive with Wachovia, one of the country's biggest and most aggressive lenders, said during a conference call in January 2008 that the bank was bewildered by customers who had "the capacity to pay, but have basically just decided not to." (Wachovia failed nine months later and was bought by Wells Fargo.)

With prices now down by about 30 percent, underwater borrowers fall into two groups. Some have owned their homes for many years and got in trouble because they used the house as a cash machine. Others, like Mr. Koellmann in Miami Beach, made only one mistake: they bought as the boom was cresting.

It was April 2006, a moment when the perpetual rise of real estate was considered practically a law of physics. Mr. Koellmann was 23, a management consultant new to Miami.

Financially cautious by nature, he bought a small, plain one-bedroom apartment for $215,000, much less than his agent told him he could afford. He put down 20 percent and received a fixed-rate loan from Countrywide Financial.

Not quite four years later, apartments in the building are selling in foreclosure for $90,000.

"There is no financial sense in staying," Mr. Koellmann said. With the $1,500 he is paying each month for his mortgage, taxes and insurance, he could rent a nicer place on the beach, one with a gym, security and valet parking.

Walking away, he knows, is not without peril. At minimum, it would ruin his credit score. Mr. Koellmann would like to attend graduate school. If an admission dean sees a dismal credit record, would that count against him? How about a new employer?

Most of all, though, he struggles with the ethical question.

"I took a loan on an asset that I didn't see was overvalued," he said. "As much as I would like my bank to pay for that mistake, why should it?"

That is an attitude Wall Street would like to encourage. David Rosenberg, the chief economist of the investment firm Gluskin Sheff, wrote recently that borrowers were not victims. They "signed contracts, and as adults should also be held accountable," he wrote.

Of course, this is not necessarily how Wall Street itself behaves, as demonstrated by the case of Stuyvesant Town and Peter Cooper Village. An investment group led by the real estate giant Tishman Speyer recently defaulted on $4.4 billion in debt that it had used to buy the two apartment developments in Manhattan, handing the properties back to the lenders.

Moreover, during the boom, it was the banks that helped drive prices to unrealistic levels by lowering credit standards and unleashing a wave of speculative housing demand.

Mr. Koellmann applied last fall to Bank of America for a modification, noting that his income had slipped. But the lender came back a few weeks ago with a plan that added more restrictive terms while keeping the payments about the same.

“That may have been the last straw,” Mr. Koellmann said.

Guy D. Cecala, publisher of Inside Mortgage Finance magazine, says he does not hear much sympathy from lenders for their underwater customers.

“The banks tell me that a lot of people who are complaining were the ones who refinanced and took all the equity out any time there was any appreciation,” he said. “The banks are damned if they will help.”

Joe Figliola has heard that message. He bought his house in Elgin, Ill., in 2004, then refinanced twice to get better terms. He pulled out a little money both times to cover the closing costs and other expenses. Now his place is underwater while his salary as circulation manager for the local newspaper has been cut.

“It doesn’t seem right that I can rent a place somewhere for half of what I’m paying,” he said. “I told my bank, ‘Just take a little bite out of what I owe. That would ease me up. Isn’t that why the president gave you all this money?’ ”

Bank of America did not agree, so Mr. Figliola, who is 48, sees no recourse other than walking away. “I don’t believe this is the right thing to do,” he said, “but I’ve got to survive.”