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Homeowners walking away from underwater mortgages

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Andres Duque, who stopped paying his mortgage a year ago, says he weighed which was worse … a hit to his credit score or years of paying more than his home is worth.

Andres Duque thought he got a real steal when he paid $125,000 for his Little Haiti condo. But four years later, similar units are selling for $35,000 and even less.

And so, faced with the prospect of being underwater on his mortgage -- owing more than the unit is worth -- for the next 20 years, Duque, 33, made what seemed to him like a rational choice: to cut and run.

He stopped paying the mortgage, basically forcing the lender to take the condo off his hands through foreclosure.

``I was able to pay off all my credit cards,'' said Duque, who is biding his time in the condo, waiting until they come and evict him. ``In a way, it was the best thing that happened to me because all my income is not being consumed by this freaking monster of a debt.''

Duque's game plan is known as a strategic default -- when borrowers walk away from loans, even if they can afford the payments. Here is a look at the benefits, the risks and the ethics of such a move.

As property values have plummeted by an average of 50 percent, such strategic defaults now make up a sizable chunk of South Florida's foreclosures. In the fourth quarter of last year, they accounted for an estimated 28 percent of all defaults in Miami-Dade and Broward counties, according to recent research from the credit bureau Experian and Oliver Wyman, a New York-based international consulting firm.

That's up from 8 percent in the same quarter two years ago. With property values down even further now, researchers are certain the numbers have risen even more.

With the social stigma of foreclosure eroding, experts say it is becoming easier for discouraged borrowers to justify throwing in the towel.

``People are saying, ` Everyone is doing this, and I do not feel any compunction in fashioning my own bailout,' '' said Roy Oppenheim, a Weston real-estate and foreclosure defense attorney who conducts weekly seminars that discuss strategic defaults and other financial options for distressed borrowers.

South Florida is already a veritable Atlantis of underwater borrowers. In September, homeowners here collectively owed $62.7 billion more than their homes were worth, according to an analysis by First American CoreLogic. The analysis found that about half of all outstanding mortgages in Miami-Dade and Broward are underwater.

Among those who bought in Broward in 2006, the median negative equity was $75,000 as of March. In Miami-Dade, the figure was $63,000, the Web-based real-estate service firm Zillow.com reports. Negative equity refers to the difference between a loan balance and the market value of a home.

``I wouldn't blame borrowers who knew they were facing significant losses even if they could afford to stay,'' said Andrea Heuson, a finance professor at the University of Miami. ``Every day you wake up, you are reminded how much you paid for something, and then you read every day in the newspaper how much prices have fallen.''

THE MANY CONSEQUENCES

Walking away, however, is fraught with financial, legal and ethical dilemmas. Lenders, government and the credit industry are starting to pay more attention to how strategic defaulters think and behave -- in an effort to convince them to tough it out.

``It's a huge problem, and it doesn't get addressed in the process right now,'' said Ron Kaniuk, a Boca Raton foreclosure and bankruptcy attorney. He said lenders are encouraging the trend by primarily offering loan modifications only to those who have fallen behind or are seriously at risk of foreclosure.

Duque, in fact, said he shunned a modification because it didn't reduce his balance.

``It's really a social change in the way debtors think, and it's taking creditors some time to absorb that,'' said Mark King, an attorney with the Miami office of Jones Walker who represents banks in commercial foreclosures. Commercial property owners also have started walking away.

William Hardin, a real-estate professor at Florida International University, said people have a moral obligation to honor their mortgages when they can.

``The vast majority knew what they were doing and were taking a risk, and the fact of the matter is [the mortgage] is a contract. We live in a world where contracts have to be honored. It's the way our economy works.''

High default rates have already meant higher loan costs and tougher underwriting standards for all borrowers.

Tracking strategic defaults is an inexact science. Experian researchers identified possible strategic defaulters as homeowners who have gone straight from current on their payments to not paying at all, but remained in good standing on other credit obligations. Nationally, Experian estimated 588,000 borrowers defaulted on purpose in 2008.

Also fueling the phenomenon has been a shift from viewing a home as a place to live to an investment, valued insofar as its potential resale price goes up.

Frustration with the tax-funded bailout of banks and Wall Street may have also emboldened depressed borrowers to default out of anger and a desire to stick it to the banks. Duque's resolve, for example, hardened after watching Michael Moore's movie *Capitalism: A Love Story*.

In the movie, Moore makes a case that corporations preying on consumers led to the housing crisis and recession.

``In the movie, there were Congress people telling the American public to stay in their homes, to squat and do what you have to do to fight. A lot of it struck home in many, many, many ways, and I am going to stay here until [my bank] comes to get me out,'' Duque said.

Aside from the new philosophical justification for stopping his payments, Duque said his decision was fundamentally an economic one. ``My mortgage was killing me, even before things went to hell. I was being choked by the property,'' said Duque, who works at the Mondrian Hotel in Miami Beach.

Most strategic defaulters find themselves weighing whether the hit to their credit scores is easier to bear than paying underwater mortgages for years to come.

The most optimistic analysts say it could be three years before prices begin to appreciate. Others say prices have another 30 percent-plus to fall before flat-lining.

Prepared for the worst, Duque has been surprised by the seemingly minimal consequences so far. His credit limits on two cards were slashed by a few thousand dollars, but they were not canceled.

``I went to BrandsMart and applied for a card, and they denied me, so my credit score must be pretty low,'' he said. ``That's fine with me, as long as I have a couple of credit cards.''

Surprisingly, strategic defaulters with good credit scores who remain current on their other credit lines can quickly rehabilitate their credit scores after foreclosure -- faster than many realize, according to Sarah Davies, a senior vice president at VantageScore, a credit scoring and consumer analytics firm owned jointly by the nation's three major credit reporting agencies. ``You can pull yourself out of any major impact from foreclosure in 24 months,'' she said.

And five years down the road?

``A foreclosure is going to be very easy to explain, seeing there are thousands of others who have also defaulted. So, there is a safety-in-numbers issue there,'' Heuson said, referring to a possible borrower rationale.

Consumers are essentially putting a price on their credit score, said Piyush Tantia, a partner in the retail and business banking practice of Oliver Wyman.

But there are other risks.

Foreclosure defense attorneys warn of the growing threat that lenders will obtain deficiency judgments against borrowers. Such judgments allow them to collect the difference between the loan balance and the market value of the properties. They also allow lenders to garnish wages and seize assets.

While the risk is not great now statistically, Marc Ben Ezra, a Fort Lauderdale attorney who files foreclosures for banks, said it's possible that lenders may begin pursuing legal rights to collect.

Jim Angleton, senior vice president of Miami-based Republic Federal Bank, estimated lenders are going after borrowers 15 percent of the time. ``You know they are not being forthright with you about their assets when they are keeping their credit cards, their very fine cars and other assets current.''

Oppenheim recommends homeowners bulletproof themselves by hiring a lawyer and perhaps an accountant to explore the possible consequences.

Other real-estate experts say walking away may not be worth it in the short term, when you factor in the cost of finding new shelter and the increased consumer interest rates that stem from any foreclosure.

TACTIC NOT FOR EVERYONE

Defaulting, though, is not for everybody whose mortgage is underwater, and plenty of people stick with their homes out of a sense of financial responsibility, integrity and faith that prices will recover eventually. There are also people who forked over tens of thousands of dollars in down payments and face a real financial loss by walking away.

Analia Vence, who is renting her underwater town house in Homestead to a tenant for less than the monthly mortgage payment, said she has no intention of walking away. She paid $170,000 in 2006, and now nearby foreclosed homes are selling for $80,000.

``We bought the property as an investment, and we never thought to sell it immediately. We're only paying $200 or $300 for the mortgage, so it doesn't make sense to hurt our credit for that much,'' Vence said.
