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REAL ESTATE

Mortgage Meltdown Archive

Homeowners: Can't pay? Just walk away

More and more borrowers are watching their house values sink while the cost of their loans skyrockets. What to do? Skip out on the mortgage all together.

By Les Christie, CNNMoney.com staff writer
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NEW YORK (CNNMoney.com) -- Mortgage payments are set to jump. Home prices have plunged. "I'm outta here."

Homeowners are abandoning their homes and, more importantly, their mortgages, rather than trying to keep up with rising payments on deteriorating assets. So many people are handing their keys back to lenders that a new term has been coined for it: jingle mail.

"I stopped paying my mortgage in October, after shelling out about $70,000 in interest [over 15 months]," said one borrower, David, who doesn't want his last name used. "Now, I'm just waiting for the default notice."

The Los Angeles-based writer bought two properties in Hancock Park, west of downtown, using no-down, interest-only mortgages in 2006. He paid just over $1 million for both.

David had planned to sell them quickly but got caught in the slump. Soon his interest rate will jump by a few points, and his payments will go up by several hundred dollars a month for each place. He figures his properties have fallen in value by at least $60,000 each.

Tell us what you think: When is it ok to walk away?

Current lending practices have created an environment where a measure as extreme as abandoning a home actually makes sense to some people.

Many buyers put little or no money down, so they don't have much invested in them. That leaves them with little incentive to keep making payments when a home's market value dips below the balance of the mortgage.

The most serious consequence is a tremendous hit to credit scores. For some, that's better than throwing away money they'll never recover by selling their home.

And while a mortgage default can savage a person's credit record, trying to pay off a loan they can't afford could be worse for borrowers if it leads to bankruptcy, said Craig Watts, a spokesman for the credit reporting firm Fair Isaac.

Credit scores are hurt much more by missing multiple payments -

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What option would you consider if you were having difficulty with home payments?

- File for bankruptcy
- Abandon your home
- Seek government help
- Try to sell

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on credit cards, cars and so on - than by a single foreclosure.

"The time it takes to regain your credit score [after foreclosure] can be shorter than after bankruptcy," said Watts.

It typically takes three years of a spotless payment record after a bankruptcy before credit scores recover enough for someone to think about buying a home again, he said. After abandoning a mortgage, a person may be able to buy a new house in two years or less.

And now skipping out on a home is easier, thanks to the Mortgage Debt Relief Act of 2007. Previously, if a bank sold a foreclosed home for less than the mortgage balance and it forgave the difference, the borrower had to pay tax on that difference as if it were income. Now the IRS will ignore it.

"That's going to help a lot of people," said Mike Gray, a San Jose accountant who runs the web site Realestatetaxletter.com.

Most middle class still can't buy a house

The trend of walking away is most pronounced among real estate investors, according to Jay Brinkman, an economist with the Mortgage Bankers Association (MBA).

But families are doing it too. "If they have to stretch to make mortgage payments for a home that will not recover its value, then yes, they may walk away," he said.

Often they chose hybrid adjustable rate mortgages (ARMs) that came with low initial payments. After a few years, interest rates on these loans reset higher. But buyers thought they could count on the increased value of their homes to refinance into affordable, fixed-rate loans.

Now, that may not be possible. Take Susan (not her real name), a client of HouseBuyerNetwork.com, which specializes in arranging short sales. A short sale is when a bank agrees to accept the sale price paid for a home - even if it is less than the outstanding mortgage on it - as payment in full. An owner might sell a house with a $200,000 mortgage for $180,000, and then the bank forgives the difference.

HouseBuyerNetwork.com CEO Duane LeGate says that Susan's two-bedroom condo in Sonoma County is worth $340,000, but the mortgage balance is $380,000. She can't refinance and it's difficult to sell.

She's still trying for a short sale but, said LeGate, "She'll almost certainly end up walking away."

Beyond anecdotes, some statistics indicate that hard-pressed owners are deliberately courting foreclosure. An analysis by the consumer credit rating agency Experian last spring found that many borrowers were choosing to pay off credit card and other consumer debt before making mortgage payments. They were electing to put their mortgage at risk rather than their credit cards or auto loans.

Similarly, Richard DeKaser, chief economist for National City Corp., (NCC, Fortune 500) notes that while all credit metrics are deteriorating, mortgage delinquencies are rising disproportionately. "That makes sense if people are choosing to walk away," he said.

And now reports are emerging of homeowners skipping out on mortgages even though they can still afford to pay them.

Wachovia (WB, Fortune 500) CEO Ken Thompson described these people on an earnings call last month."[These are] people that have otherwise had the capacity to pay, but have basically just decided not to, because they feel like they've lost equity, value in their properties."

Lenders are afraid that borrowers may find it's worth the hit to their credit scores, if they can drastically reduce their housing expenses. Someone with good credit and a $600,000 home in a town with cratering real estate prices could buy a similar house nearby for $450,000, and then let the other $600,000 mortgage go into foreclosure.

The stage is set for this kind of thing particularly in California, where huge numbers of buyers used low or no-down deals to buy homes. The trend has even spawned at least one new business, San Diego-based

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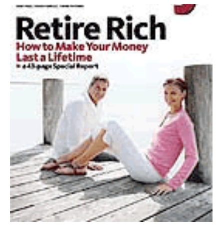

YouWalkAway.com, which for a fee of $1,000 purports to guide clients through the process of ditching their mortgages. It launched in early January, and says it has already signed up 180 clients.

California is a bit of a safe haven for these borrowers, since banks that repossess and then sell a foreclosed property for less than the mortgage that was owed on it cannot come after borrowers for the difference - as long as it's the initial mortgage, one that has not been refinanced. So if a borrower owes $200,000 and the bank sells the house for $170,000, the borrower comes out of it debt-free.

And for many homeowners, the prospect of becoming debt-free is growing increasingly alluring. ■

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