Buyers have no moral duty to lenders, by Brent T. White Brent T. White - Apr. 25, 2010 Associate professor of law, UA, The Arizona Republic

As a result of the housing collapse, many Arizonans have seen their homes lose half of their value. Many owe several hundred thousand dollars more than their homes are worth and are unlikely to dig out of their negative equity hole for decades.

For these homeowners, the American dream has become a nightmare - and their financial future is dim. To compound the stress and anxiety, when they've called their lender to work out a solution, they've discovered that their lender won't even talk to them about a loan modification or a short sale as long as they are current on their mortgage.

With no help in sight, some of these underwater homeowners have decided that they would be better off letting go of their homes and have stopped making their mortgage payments. Many have done so with the hope that defaulting will finally bring their lender to the table, but they are also resigned to the fact that they will likely lose their homes.

It has been suggested that such homeowners are immoral or, at least, irresponsible. I disagree. Before explaining why, it is important to emphasize that the decision to strategically default on a mortgage involves many complex, localized and individualized factors. No one should decide to strategically default on their mortgage without sitting down first with a knowledgeable professional.

But let's say that you've actually sat down with a professional to do the calculations and have concluded that defaulting on your mortgage is the only way out of your financial nightmare. Would it be immoral or irresponsible for you to do so?

The arguments against homeowners intentionally defaulting on their mortgages generally center on the same three basic points. First, underwater homeowners "promised" to pay their mortgages when they signed the mortgage contract. Second, foreclosures lead to depreciation of neighborhoods, so underwater homeowners should hang on in order to help preserve their neighbors' property values. And, third, if all underwater homeowners defaulted, the housing market might crash. Homeowners thus have a social obligation to pay their underwater mortgage in order to save the economy.

While all three of these arguments might hold some initial appeal, none holds water. First, a mortgage contract, like all other contracts, is purely a legal document - not a sacred promise. Think of it this way: when you got your cell phone, you likely signed a contract with your carrier in which you "promised" to pay a set monthly payment for two years. Would it be immoral for you to break your contractual "promise" to pay for two years if you decided that you no longer needed the cell phone and elect instead to pay the early termination fee? Of course not. The option to breach your "promise" to pay is part of the contract.

Though involving more money and something of great sentimental value to most people, a mortgage contract is simply a contract. Like a cell phone contract, a mortgage contract explicitly sets out the consequences of a breach of contract. In other words, the lender has contemplated in advance that the mortgagor might be unable or unwilling to continue making payments on his mortgage at some point and has decided in advance what fair compensation to the lender would be. Specifically, the lender included clauses in the contract providing that the lender can foreclose on the property and keep any payments that have been made. By writing this penalty into the contract, the lender has agreed to accept the property and any payments already made in lieu of the remaining payments.

Moreover, lenders charge Arizona borrowers on average an extra $800 per $100,000 borrowed because Arizona is a non-recourse state, meaning the lender cannot come after the borrower for a deficiency judgment on a purchase money loan. In other words, borrowers in Arizona pay for the option to default on a purchase money loan without recourse. The lender can only take the house.

That's the agreement. No one forced the lender to make the loan or sign the contract. Indeed, the lender wrote it. And, to be sure, the lender wouldn't hesitate to exercise his right to take a person's house if it was in his financial interest to do so. Concerns of morality or socially responsibility wouldn't be part of the equation.

In short, as far as the law is concerned, choosing to exercise the default option in a mortgage contract is no more immoral than choosing to cancel a cell phone contract. Indeed, exercising the default option in your mortgage contract is similar to cashing in on an insurance policy. You paid for it - and have you a right to exercise it.

But what about the argument that mortgage default hurts neighborhoods and the economy? Well, first, in a capitalist society, we don't generally expect individuals to make personal economic decisions for the collective good. Aside from this fact, however, it's unfair, in my opinion, to ask underwater homeowners to prop up neighborhood property values, or the housing market, on their backs - especially if means sacrificing their ability to send their children to college or save adequately for their own retirement.

Why take homeowners, and not lenders, to task for putting their own financial interest ahead of the common good? Indeed, if lenders were less intransigent and more willing to negotiate, underwater homeowners wouldn't have to walk away from their homes in order to save themselves from financial ruin. And we wouldn't have to worry about the fragile housing market crashing again.

Why it is that we speak of morality and social responsibility only when talking about the little guy, who must take his lumps for the common good, while financial institutions are free to protect their bottom line? It just can't be the case that it's morally acceptable for banks to look out for their financial best interest, but it's not OK for the average American do to exactly the same thing.

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