

'Walking away' not immoral, professor says

He expands defense of homeowner in default

by **J. Craig Anderson** - Jan. 31, 2010 12:00 AM, The Arizona Republic

Arizona law professor Brent White says the only thing standing between many "underwater" homeowners and a better financial future is a misguided sense that walking away from a [loan](#) commitment is morally wrong.

White, an associate professor at University of Arizona's James E. Rogers College of Law, has spent the past few months presenting his argument to other lawyers, real-estate professionals and the national media.

It started with a 50-page discussion paper he published in October, in which White argues that underwater homeowners, those whose unpaid loan balance exceeds the value of their home, are being manipulated into picking up the tab for a real-estate crash that borrowers and lenders created equally.

"I'm all for a society where people must take personal responsibility, but that should also apply to the banks and [financial institutions](#)," he said.

Although he stops short of advocating for underwater mortgage holders to walk away from their loans, White does argue that banks might be more inclined to lower the principal balance on inflated [home loans](#) if more borrowers did just that.

White is quick to admit that the concept of "strategic default," when a borrower with the means to continue paying defaults on a loan by choice, is distasteful to many Americans.

His critics have argued that a tidal wave of strategic defaults would wreak untold havoc on an already fragile financial system and promote a lawless society in which contracts are essentially meaningless.

White said his argument is mostly academic. Despite all of the attention strategic default has received, statistics indicate that only a tiny fraction of the country's more than 5 million homeowners whose loans are upside-down have stopped making payments by choice.

Still, he said it's quite reasonable to believe that a wave of strategic defaults would spur a faster recovery in the housing market by creating stronger incentive for banks to lower the principal value of upside-down home loans, thus making it more attractive for borrowers to continue paying.

White said his primary aim is to give borrowers a rational alternative to the rhetoric of guilt and shame coming from financial leaders and politicians, which labels a practice that is perfectly acceptable in the business world as immoral and irresponsible if tried at home.

His discussion paper, titled "Underwater and Not Walking Away: Shame, Fear and the Social Management of the Housing Crisis," points out that lenders and other businesses are not saddled with the same moral constraints that would prevent most individuals from defaulting by choice.

"It's a double standard that says corporations can look out for their best interests, but individuals can't," White said in an interview Thursday.

A number of metro Phoenix real-estate professionals said they see merit in White's argument that lenders should meet borrowers halfway by writing down a portion of upside-down loan balances, but they were far less comfortable with the notion that strategic default is a valid solution to the housing problem.

"I don't think we should be encouraging people to walk away," said Bob Stahl of Keller Williams Realty in Scottsdale, who also writes a real-estate blog that has focused heavily on the discussion of strategic default in recent months. "I think people do need to be responsible. ... I think it is a moral issue."

Stahl said he's concerned a wide-scale walkout would damage the mutual sense of trust and confidence in contracts that makes it possible to do business.

He added that walking away from a [mortgage loan](#) can have severe consequences that borrowers need to understand before making any decisions.

Controversial though it may be, White noted that his argument is not merely a philosophical one, and that there actually is a solid legal basis for his conclusion that it's OK to walk away.

A legal concept known as "efficient breach" holds that it is ethical to breach a contract in cases where the ramifications for doing so are less harmful to the party than adhering to the contract would be.

White said he's in the process of crafting another legal argument, based on Arizona's non-deficiency statute, that says lenders don't have the legal right to report mortgage defaults to the credit bureaus, and that walking away should not have any negative effect on the borrower's [credit score](#).

Scottsdale civil-rights attorney Donald Loeb said he thinks White is absolutely correct.

Non-deficiency statutes such as the ones in Arizona and California essentially say that lenders trying to collect on an unpaid mortgage loan have a right to foreclose on the home but cannot pursue any other legal claim against the former borrower.

For instance, the lender can't sue for the difference between the original loan value and the proceeds from a foreclosure sale of the home.

The reason it's called a "non-deficiency" statute, Loeb said, is that it establishes default and subsequent foreclosure as a valid means of fulfilling a mortgage contract, as opposed to being a breach of contract in which one party's actions are considered "deficient."

Loeb said he thinks much of the criticism aimed at homeowners who default is based on a poor understanding of what a contract is.

A contract is nothing but a legally binding agreement between parties with competing interests that sets forth mutually acceptable terms for their interaction.

Loeb said every mortgage loan agreement includes default and home repossession as a possible outcome.

"If you stop making payments, you're not breaching the contract, because default and foreclosure are valid means of fulfilling the contract," he said.

White said it's not uncommon for commercial-property owners or investors to default on loans that they no longer consider beneficial, and while it might affect their ability to obtain future loans, no one is calling them immoral.

Traditional business ethics, which weigh heavily the fiduciary responsibility to shareholders, practically require commercial-property owners to consider strategic default if a mortgage loan is costing the business more than the mortgaged property is worth, Valley commercial real-estate experts said. To do otherwise would be considered irresponsible.

Jim Achen, senior vice president of commercial real-estate services firm Transwestern, in Phoenix, said many underwater commercial-property owners are expected to walk away from mortgage debts this year, as a large number of those loans reach maturity and must be repaid or refinanced.

It is also expected that lenders in some cases will significantly reduce the balance of commercial borrowers' [mortgages](#) to keep them in those loans, he said.

That's a concession most banks have not made to homeowners.

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