

## IS IT MORALLY WRONG TO DEFAULT ON A MORTGAGE?

According to researchers of the Financial Trust Index<sup>1</sup> (University of Chicago and Northwestern University) 81% of homeowners interviewed agreed with the statement that “it is morally wrong to walk away from a house when one can afford to pay the monthly mortgage.” Are these survey respondents correct? Is it really morally wrong to intentionally default on a mortgage debt? And, if it is, is it what we might call a grave or really serious moral wrong, or might it better be classified along with “white lies” and other “technically wrong” behaviors that many would think do not reflect a serious defect of character? To lean on some classic Roman Catholic distinctions, might “walking away” be more of a venial sin than a mortal one?

An examination of these questions is not simply an idle academic exercise. The Financial Trust Index research estimates that 26% of present foreclosures are “strategic”. A strategic foreclosure occurs when the borrower is able to make the payments, but simply chooses not to. Moral considerations play a major role in preventing strategic defaults.

Of course, moral considerations are not the only ones that play a role in deterring strategic defaults. There are also credit, and sometimes tax, issues as well. Nonetheless, the moral component has been shown to be an important one.

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<sup>1</sup> Guiso, Sapienza, and Zingales, “Moral and Social Constraints to Strategic Default on Mortgages”

Depending on whose statistics you believe, somewhere around 20% of homeowners in the United States are “under water”. That is to say, they owe more on their mortgage than their home is worth. Many of these are candidates for strategic default. Moreover, Deutsche Bank recently released an analysis predicting that about 48% of homeowners would be under water by the first quarter of 2011. Lots more candidates.

Why shouldn't one voluntarily default on a mortgage that substantially exceeds the value of the home? Why throw “good money after bad”? Wouldn't walking away represent a prudent allocation of available assets? Without a doubt, doing so will entail a cost in terms of available credit. But this may well not be determinative.

What about the moral constraint? Is it really wrong – or how wrong is it – to voluntarily default on a mortgage?

Before addressing this question directly, it would be appropriate to mention at least two points of view. One is that something is wrong if, and only if, you feel that is wrong. Essentially, you cannot be wrong about your moral evaluations. Another is that all wrongs are equally wrong. There are no gradations. If a person holds either of these views, there is probably nothing more to say.

Having noted these minority exceptions, let us address the majority.

Among those who were surveyed, the immorality (or the seriousness of it) of walking away from a mortgage loan had a lot to do with the circumstances. If a home were only (only!) \$20,000 under water, only 7% of those who thought it morally wrong would walk away. But the percentages increased as the negative equity increased. 37% of those who thought that voluntary default would be morally wrong would, nonetheless, walk away from a home that was \$200,000 upside down.

Does this show moral weakness, or does it show moral sense? Those with a moral sense know that, on the face of it, it is morally wrong to break one's promise. But conditions, most would agree, have a bearing on that judgment. Promise-keeping is not the highest moral value. If I promised to lend you my gun, and you are now in a clearly dangerous psychotic stage, breaking my promise would be the right thing to do, not a wrong.

Here, the duty to keep a promise is outweighed by the duty not to put others – perhaps even one's self – in preventable danger.

Analogous thinking provides moral justification, in some cases at least, for strategic default.

While a person may have a moral obligation to keep his or her promise to pay, other

considerations – moral considerations – can outweigh the obligation. Maintaining the overall welfare of one’s family is a duty that would have a higher moral priority.

Beyond the observation that promise-keeping is not the highest moral value, it is also important to remember that a mortgage note is not like a typical promise. To be sure, almost all notes contain the phrase “I promise to pay...” Still, with a mortgage, the borrower and the bank make a deal. The deal is: “if I don’t pay, you can have the property.”

Mortgages are secured notes. They are not like borrowing from your grandmother. If you willingly default to her, shame on you. She has no recourse. But, if you default to the bank, they can take your property. That is the deal they made. The property may not be worth what they lent you, but whose fault is that? They are big boys and girls. They made a business decision, and in today’s market, they lost. (No wonder that so many appraisals are now coming in under current market value.)

Moral considerations are one of the chief barriers to strategic defaults. They probably exert more weight than they should. The lender made a deal. If you don’t pay, he gets the property. So now, in 2009, he gets the property; and he doesn’t like it. That is regrettable; but a deal is a deal.

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Bob Hunt has been a real estate broker in Orange County for more than twenty-five years. Prior to that he taught ethics at the university level. Among his works are the books: *Ethical Issues in Modern Medicine*, with John Arras (Mayfield), *Ethics at Work* (Pearson/Prentice Hall), and *Real Estate the Ethical Way* (Bella Vista).