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The Morality of Strategic Default

Brent T. White

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Responding to the argument that homeowners who strategically default on their mortgages are immoral and socially irresponsible, this Article argues that defaulting on a mortgage contract is not only morally acceptable, it may be the most responsible course of action when necessary to fulfill more important obligations to one's family.

As a result of the housing collapse, many Americans have seen their homes lose half their value,[1] owe several hundred thousand dollars more on their homes than their homes are worth,[2] and are unlikely to climb out of this hole for decades.[3] For these individuals, the American dream of homeownership has become a nightmare, and their financial future is dim.

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1. For example, the median sale price of a Las Vegas home was approximately $280,000 in 2006 and $130,000 in early 2010. *Las Vegas Home Prices and Home Values*, ZILLOW, http://www.zillow.com/local-info/NV-Las-Vegas-home-value/r_18959 (click on "Sale price ($)") (last visited Oct. 28, 2010). In Phoenix, the median sale price was $245,000 in late 2007 and $125,000 in early 2010. *Phoenix Home Prices and Home Values*, ZILLOW, http://www.zillow.com/local-info/AZ-Phoenix-home-value/r_40326 (click on "Sale price ($)") (last visited Oct. 28, 2010). In Salinas, CA, the median sale price peaked at over $600,000 in 2006, but stood at just $225,000 in early 2010. *Salinas Home Prices and Home Values*, ZILLOW, http://www.zillow.com/local-info/CA-Salinas-home-value/r_54288 (click on "Sale price ($)") (last visited Oct. 28, 2010).

2. In the fourth quarter of 2009, over 10 percent of all homeowners with a mortgage owed more than 25 percent of what their homes were worth. FIRST AMERICAN CORELOGIC, UNDERWATER MORTGAGES ON THE RISE ACCORDING TO FIRST AMERICAN CORELOGIC Q4 2009 NEGATIVE EQUITY REPORT DATA 4 (2010), *available at* http://www.loanperformance.com/infocenter/library/Q4_2009_Negative_Equity_Final.pdf. In Nevada, over half of homeowners were more than 25 percent underwater, approximately 30 percent were underwater in Arizona and Florida, and approximately 20 percent were underwater in California. *Id.* Nationally, the value of all negative equity in the fourth quarter of 2009 totaled $801 billion, with $660 billion of this concentrated in homes with at least 25 percent negative equity. *Id.* at 1.

3. For example, assuming a historical appreciation rate of 3.5 percent, it will take nearly thirty years for an average home purchased for $600,000 in Salinas during 2006—and now worth roughly one-third of the purchase price—to regain its 2006 value. *See* HYE JIN RHO ET AL., CHANGING PROSPECTS FOR BUILDING HOME EQUITY 3 (2008), *available at* http://www.cepr.net/documents/publications/Changing_Prospects_for_Building_Home_Equity_2008_10.pdf. Moreover, assuming that a Salinas family purchased such a home in 2006 with a thirty-year loan at a 6.5 percent interest rate with a 5 percent down payment, it would take a little under twenty years for the home's value to appreciate enough to satisfy the concurrent outstanding mortgage debt. By this time, the homeowners

To compound their stress and anxiety, when they've called their lenders to work out a solution, they've discovered that their lenders won't even discuss the possibility of a loan modification or a short sale so long as they are current on their mortgages.[4]

Out of desperation, some of these underwater homeowners have decided that they'd be better off letting go of their homes and have thus intentionally stopped paying their mortgage.[5] Many have done so with the hope that defaulting on their mortgage will finally bring their lender to the table, but also resigned to the fact that they will likely lose their home.

In a recent article, economist Luigi Zingales suggests that these homeowners are immoral.[6] He also criticizes me, along with Roger Lowenstein of the *New York Times*, for supposedly contributing to the social menace of strategic default.[7] Others have joined Zingales in his condemnation of underwater homeowners who strategically default.[8]

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would have made a little under $600,000 in interest payments, in addition to approximately $200,000 in payments against the principal. Thus, even without considering additional costs of homeownership or other lost opportunity costs, a family that purchased an average home in Salinas at the market's peak is nearly two decades—and $800,000 in mortgage payments—away from recovering their lost equity.

4. *See* Manuel Adelino et al., *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization* 25–26 (Fed. Reserve Bank of Atlanta, Working Paper 2009-17, Aug. 2009), *available at* http://www.frbatlanta.org/filelegacydocs/wp0917.pdf.

5. *See* David Streitfeld, *No Aid or Rebound in Sight, More Homeowners Walk Away*, N.Y. TIMES, Feb. 3, 2010, at A1. In the third quarter of 2009, 14 percent of homes were in foreclosure or had at least one payment past due. MORTGAGE BANKERS ASS'N, NATIONAL DELINQUENCY SURVEY 2009 3RD QUARTER (2009). One study has estimated the strategic default rate at 17 percent. 1 EXPERIAN-OLIVER WYMAN MARKET INTELLIGENCE REPORT, UNDERSTANDING STRATEGIC DEFAULT IN MORTGAGES (2009).

6. Luigi Zingales, *The Menace of Strategic Default*, CITY J., Spring 2010, at 47, 50, *available at* http://city-journal.org/2010/20_2_strategic-mortgage-default.html.

7. *See id.* at 50–51. Zingales is referring to Brent T. White, *Underwater and Not Walking Away: Shame, Fear and the Social Management of the Housing Crisis*, 45 WAKE FOREST L. REV., (forthcoming) (manuscript at 4), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1494467. Strategic default means intentionally stopping mortgage payments even though one can afford to continue making payments. Of course, what it means to be able to afford one's payments is contested. For example, if one with limited financial resources chooses to pay one's credit card rather than one's mortgage, this might be called a strategic choice to default on the mortgage instead of the credit card. The purest strategic default would be a case in which one could easily afford to meet all one's financial obligations but nonetheless decides to stop paying one's mortgage because of the home's declining value.

8. *See, e.g.*, Kenneth R. Harney, *The Nation's Housing: Walking Away From a Mortgage*, WASH. POST, Nov. 28, 2009, http://www.washingtonpost.com/wp-dyn/content/article/2009/11/25/AR2009112504186.html (describing the "incendiary core message" of this Article, with Lewis Ranieri calling me "incredibly irresponsible and misinformed"); Liz Pulliam Weston, *Are You Foolish to Pay Your Mortgage?*, MSN MONEY, Dec. 9, 2009, http://articles.moneycentral.msn.com/Banking/HomeFinancing/weston-should-you-walk-away-from-your-home.aspx?page=1 (describing my discussion of walking away as "an assault on our integrity and our character" and saying that "[t]here's no price tag you can put on that").

Before responding to these critics, it is important to emphasize that the decision to strategically default on a mortgage involves many complex, localized, and individualized factors.[9] No one should decide to strategically default on their mortgage without sitting down first with a knowledgeable professional to discuss in detail the best course of action.[10] For that reason, I've never advised underwater homeowners as a group to strategically default on their mortgages, and I am not doing so here.

But let's say that an underwater homeowner has actually sat down with a professional to do the calculations and has concluded that defaulting on his mortgage is the only way out of his financial nightmare. Would it be immoral or irresponsible for him to do so?

The argument against homeowners intentionally defaulting on their mortgages generally centers on the same three basic points. First, underwater homeowners promised to pay their mortgages when they signed the mortgage contract, and it would be immoral to break this promise.[11] Second, foreclosures lead to depreciation of neighborhoods, so underwater homeowners should hang on in order to help preserve their neighbors' property values.[12] And, third, if all underwater homeowners defaulted, the housing market might crash.[13] Homeowners thus have a social obligation to pay their underwater mortgage in order to save the economy.

While all three of these arguments might have some initial appeal, none of them hold water.

First, a mortgage contract, like all other contracts, is purely a legal document, not a sacred promise.[14]

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. Let's say, though, that two months after you sign your contract,

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9. For example, whether strategic default would be a wise choice would depend on factors such as the particular laws in one's state, one's immediate need for credit, the cost of renting a similar home, the degree of negative equity, and the prospects for appreciation in one's neighborhood—to name just a few.

10. Getting good advice, however, is easier said than done. HUD-approved counseling agencies, for example, generally warn homeowners against foreclosure, even when it would be in a particular homeowner's best interest. *See* White, *supra* note 7, at 31–32 nn.140–41.

11. *See, e.g.*, Zingales, *supra* note 6, at 50.

12. *See, e.g.*, Weston, *supra* note 8 (arguing against strategic default because "more foreclosures would bring more pain to our neighbors, our communities and our economy").

13. *See, e.g.*, Zingales, *supra* note 6, at 51.

14. *See* RESTATEMENT (SECOND) OF CONTRACTS ch. 16, introductory cmt. (1981) (noting the common law tradition of breach for economic reasons); Steven Shavell, *Is Breach of Contract Immoral?*, 56 EMORY L.J. 439, 460 (2006) (noting that "the belief that there is a clear and overarching moral reason to alter contract law to enhance the keeping of contracts appears to be the product of an oversimplified view of moral sentiments and of a related failure to take into account the importance of the incompleteness of contracts").

the price of cell phone service drops by half—meaning that the same cell phone service for which you pay $100 a month could be had for $50 with another carrier. You decide that you would be financially better off paying the early termination fee of $300 rather than $100 a month for twenty-two more months of the same service that you can now get for $50.

Would it be immoral for you to break your contractual promise to pay $100 for two years 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, as is the consequence of breach—a $300 early termination fee. There is absolutely nothing immoral about exercising your option to breach, and you'd be financially wise to do so.

Though a mortgage contract is more substantial than a cell phone contract, it's no different in principle. Like a cell phone contract, a mortgage contract explicitly sets out the consequences of breach.

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 would be. The lender then wrote that compensation into the contract. Specifically, the lender probably included clauses in the contract providing that the lender may foreclose on the property, keep any payments previously made on the property, and may opt to pursue a deficiency judgment against the mortgagor if state law so allows.[15]

By writing this penalty into the contract and then signing the contract, the lender has agreed to accept the property and (in most states) the option to pursue a deficiency judgment in lieu of payment. Of course, even in states where they can, lenders frequently don't pursue borrowers for deficiency judgments because it's often not economically worthwhile to do so.[16] Nevertheless, that's the agreement. No one forced the lender to sign—or write—the contract,[17] and

15. While most states allow deficiency judgments, many states hardest hit by the housing crisis, including Arizona and California, are nonrecourse states—meaning that a lender may not pursue a borrower for a deficiency judgment on a purchase money mortgage. *See* Andra C. Ghent & Marianna Kudlyak, *Recourse and Residential Mortgage Default: Theory and Evidence From U.S. States* 5 (Fed. Reserve Bank of Richmond, Working Paper No. 09-10R, July 10, 2010), *available at* http://ssrn.com/abstract=1432437 (listing Alaska, Arizona, California, Iowa, Minnesota, Montana, North Carolina, North Dakota, Oregon, Washington, and Wisconsin as nonrecourse states).

16. *See* Zingales, *supra* note 6, at 50.

17. Freedom of contract includes the freedom to enter into contracts that others might deem unwise. *See* RESTATEMENT (SECOND) OF CONTRACTS, ch. 7, introductory cmt. (1981) ("Contract law has traditionally relied in large part on the premise that the parties should be able to make legally enforceable agreements on their own terms, freely arrived at by the process of bargaining."). For discourses on the freedom of contract, see Morris R. Cohen, *The Basis of Contract*, 46 HARV. L. REV. 553 (1933);

the lender wouldn't hesitate to exercise the right to take a defaulter's house if it were financially advantageous to do so. Concerns of morality or social responsibility wouldn't be part of the equation.[18]

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. The borrower must simply be willing to accept the consequences, which, in the case of a mortgage contract, typically include foreclosure and the risk of a deficiency judgment in most states.

Even though the law doesn't treat breach of a mortgage contract as a moral wrong, it might be argued that one should still keep one's promises.[19] That's a fine belief as far as it goes.

But why treat the promise to pay one's mortgage as any more sacred than any other promise? We break promises all the time when the consequences of fulfilling them become too great—without being considered immoral for doing so.[20] I recently promised my daughter, for example, that I'd pick her up early from preschool. Though I take promises to my children seriously, I had to break this one because an important meeting ran long at work. I had competing obligations and had to make a choice. Though some might quibble with my choice, it wasn't immoral.

In short, it's simplistic to suggest that it's always immoral to break a promise. A more accurate description of the social norm is that one should keep one's promises unless one has a compelling enough reason not to do so.[21] For example, needing to move in order to take care of a seriously ill family member would be a good reason, at least in most people's estimation, for a renter to

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Roscoe Pound, *Liberty of Contract*, 18 YALE L.J. 454 (1909); Samuel Williston, *Freedom of Contract*, 6 CORNELL L.Q. 365, 367 (1921).

18. *See* Shahien Nasiripour, *JPMorgan Chase Argues Against Mortgage Modifications, Citing Sanctity of Contracts*, HUFFINGTON POST, Apr. 12, 2010, http://www.huffingtonpost.com/2010/04/12/jpmorgan-chase-argues-aga_n_534898.html (reporting that the CEO of JPMorgan was to testify before Congress that modifying principal balances on underwater mortgages to stem foreclosures would be "irresponsible" because modification is not contemplated in the mortgage contract).

19. *See, e.g.*, CHARLES FRIED, CONTRACT AS PROMISE (1981); DAVID HUME, A TREATISE OF HUMAN NATURE (1739); IMMANUEL KANT, GROUNDWORK OF THE METAPHYSICS OF MORALS (1785); Charles Fried, *Philosophy Matters*, 111 HARV. L. REV. 1739 (1998); Zingales, *supra* note 6.

20. For a discussion of obligations toward promises in contract and "moral behavior in contingency," see Shavell, *supra* note 14, at 442–50 (discussing a theoretical approach where, even if they may form moral obligations to perform based on the established terms of the contract, parties do not inherently form moral obligations to perform under all possible contingencies).

21. Consider also the ramifications of a "rule-bound moralist" approach where breach under any and all contingencies is considered immoral regardless of the circumstances. The ultimate effect of such an ideology is not to increase the performances of contractual promises but to create "a greater deterrent to working out mutually beneficial arrangements." RUSSELL HARDIN, MORALITY WITHIN THE LIMITS OF REASON 108 (1988). In other words, where breaking a promise even under extreme contingencies is considered immoral, fewer mutually beneficial promises would be made.

break a lease agreement. The renter would still have to face the risk that the landlord might pursue the remainder of the lease payments, but few would think the renter immoral for taking that risk. Indeed, not only is breaking a promise frequently acceptable, sometimes it's the most moral thing to do.

This is no less true for a mortgage contract.

For many Americans, their home is their primary, and perhaps only, investment.[22] With encouragement from the government and the financial industry, most Americans came to see investing in a home as the primary route to retirement security, as well as a means of sending their children to college.[23] With the housing bust, however, many Americans' hope of using the accumulated equity in their homes to support themselves during retirement, or to pay for their children's college, has vanished.

Moreover, because housing prices were so high during the boom, many Americans were forced to stretch to buy even modest homes—meaning that all or most of their disposable income now goes to their mortgage, with little left for savings.[24] Pouring all of their disposable income into their homes might have worked out for most people if housing prices had continued to increase, or at least stayed stable.

But despite the forecasts of many of the world's top economists,[25] they didn't. As a result of a housing collapse unprecedented in its severity,[26] many

22. *See generally* A. Mechele Dickerson, *The Myth of Home Ownership and Why Home Ownership Is Not Always a Good Thing*, 84 IND. L.J. 189 (2009). In 2004, *Forbes* claimed, "Home ownership rewards most buyers and, barring a severe economic downturn, it's as close as it gets to a 'can't miss' investment." Scott Reeves, *Why Home Ownership Makes Sense*, FORBES, July 27, 2004, http://www.forbes.com/2004/07/27/cx_sr_0727ownership.html.

23. *See, e.g.*, THE WHITE HOUSE: PRESIDENT GEORGE W. BUSH, A HOME OF YOUR OWN: EXPANDING OPPORTUNITIES FOR ALL AMERICANS (2001), *available at* http://georgewbush-whitehouse.archives.gov/infocus/homeownership/homeownership-policy-book-background.html (extolling the benefits of homeownership, including building wealth and giving families borrowing power to finance important needs); Reeves, *supra* note 22; Alphonso Jackson, *Ask the White House*, http://georgewbush-whitehouse.archives.gov/ask/20070906.html (last visited Oct. 10, 2010) (in which HUD Secretary Alphonso Jackson proclaimed that "owning a home remains the best long-term investment a family can make"); *see also* Dickerson, *supra* note 22, at 190–91 (discussing the view that a major benefit of homeownership is using accumulated equity to benefit a family's future generations).

24. *See* Dickerson, *supra* note 22, at 207.

25. *See* Michael J. Burry, *I Saw the Crisis Coming. Why Didn't the Fed?*, N.Y. TIMES, Apr. 4, 2010, at WK10, *available at* http://www.nytimes.com/2010/04/04/opinion/04burry.html (noting that Former Federal Reserve Chairman Alan Greenspan recently proclaimed that no one could have predicted the housing bubble: "'Everybody missed it,' he said, 'academia, the Federal Reserve, all regulators'"); *see also* Nasiripour, *supra* note 18 (discussing that JPMorgan chairman and chief executive, Jamie Dimon, told a congressional panel investigating the roots of the financial crisis that JPMorgan Chase did not anticipate home prices falling: "I would say that was probably one of the big misses," Dimon said. "We stressed almost everything else, but we didn't see home prices going down 40 percent"). Indeed, even when the housing bubble began to deflate, experts remained optimistic. HUD Secretary Alphonso Jackson, for example, continued to

underwater homeowners now find themselves pouring all or most of their disposable income into a home that is no longer an investment, but rather a threat to their families' financial security. For many Americans, paying the mortgage means little to no savings for retirement or to send their children to college.

The moral course in such a case may, in fact, be to *stop* paying one's mortgage, even if one can afford it according to some arbitrary debt-to-income ratio established by the banking industry.[27] It might be more responsible to rent and put the money saved from giving up one's home into a retirement account, so that one is not a financial burden on others in old age, or into a college fund, so that one can give one's children chance at higher education.[28]

In other words, things aren't so black-and-white. And given the unprecedented nature of the housing collapse, it should at least be possible for reasonable people to disagree about the most moral or responsible course of action for seriously underwater homeowners.

I personally believe that one's promise to pay the mortgage should sometimes give way to the more important obligation to provide for one's family—especially when the lender specifically contemplated the possibility of default in the mortgage contract.

But what about the argument that mortgage default hurts neighborhoods and the economy?[29]

As an initial matter, we don't typically expect individuals to make personal economic decisions for the good of the "generalized other" in a capitalist society.[30] Aside from this fact, however, it's a lot to ask of underwater homeowners

proclaim in 2007 that "owning a home remains the best long-term investment a family can make." Jackson, *supra* note 23.

26. *See* David Anderson & Sarah Hodges, *Credit Crisis Litigation: An Overview of Issues and Outcomes*, BANKING & FIN. SERV. POL'Y REP., June 2009, at 1, 1 ("The subprime mortgage crisis . . . has exploded into a global financial crisis more severe than anything seen in the past 70 years.").

27. *See, e.g.*, Press Release, Making Home Affordable Program, Housing Program Enhancements Offer Additional Options for Struggling Homeowners (Mar. 26, 2010), *available at* http://makinghomeaffordable.gov/pr_03262010.html (setting 31 percent of annual income as the "affordability" cutoff).

28. For a discussion of the philosophical basis of the primary obligation to care for one's children, see John Eekelaar, *Are Parents Morally Obliged to Care for Their Children?*, 11 O.J.L.S. 340 (1991).

29. *See supra* text accompanying notes 12–13.

30. *See, e.g.*, ALAN WOLFE, WHOSE KEEPER? SOCIAL SCIENCE AND MORAL OBLIGATION 7 (1989) ("Society works best . . . when there exist[s] a mechanism for enabling people to maximize rationally their self-interest. Yet it is an extremely rare economist who stops at the point of simply asserting the ethical benefits of self-interest; most continue on to make a point about obligations to others as well: because the pursuit of my self-interest contributes to some collective good—economic growth or some form of welfare optimality—my obligation to you is to do what is best for me."); *see also* Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, 425 U.S. 748, 765 (1976) ("So long as we preserve a predominantly free enterprise economy, the allocation of our resources in large measure will be made through numerous private economic decisions."); ADAM SMITH, THE WEALTH OF NATIONS bk. IV, at 32

to prop up neighborhood property values or the housing market on their backs—especially if it means sacrificing their own financial security. In my view, it's also an unfair burden.

If we are to go down this collective path, however, why are only homeowners, and not financial institutions, called upon to sacrifice their own economic well-being for the common good?[31]

As their own behavior has evidenced by now, lenders generally modify mortgages for underwater homeowners only when it's in the lender's financial interest to do so.[32] From the lender's perspective, modifying a mortgage for a homeowner who is still making payments on time is potentially throwing money away because the homeowner might still make the payments even without a loan modification.[33] This is why underwater homeowners typically have to default on their mortgages before lenders will even talk to them.[34] Unfortunately, once a homeowner initially defaults, a home is statistically much more likely to end up in foreclosure.[35]

Why take homeowners, and not lenders, to task for putting their own financial interest ahead of the common good?

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

(Andrew Skinner ed., Penguin Books 1999) (1776) ("By pursuing his own interest [a capitalist] frequently promotes that of the society more effectually than when he really intends to promote it.").

31. *See* Zingales, *supra* note 6 (criticizing homeowners and not lenders for putting their financial self-interest first).

32. *See* Jean Braucher, *Humpty Dumpty and the Foreclosure Crisis: Lessons From the Lackluster First Year of the Home Affordable Modification Program (HAMP)* (Ariz. Legal Studies, Discussion Paper No. 09-37, Sept. 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1518098 ("Investors in loans and their servicers should have acted faster if more modifications were in their self-interest, and thus their failure to do so indicates that they were not."); Adelino et al., *supra* note 4.

33. Christopher L. Foote et al., *Reducing Foreclosures* 2 (Fed. Reserve Bank of Boston, Public Policy Discussion Paper No. 09-2, Apr. 8, 2009), *available at* http://www.bos.frb.org/economic/ppdp/2009/ppdp0902.htm ("Investors also lose money when they modify mortgages for borrowers who would have repaid anyway, especially if modifications are done *en masse*, as proponents insist they should be."); *see also* White, *supra* note 7, at 38–39.

34. *See* Edmund L. Andrews, *My Personal Credit Crisis*, N.Y. TIMES MAG., May 17, 2009, at 46, *available at* http://www.nytimes.com/2009/05/17/magazine/17foreclosure-t.html?pagewanted=all (describing the author's efforts to renegotiate his mortgage with his lender, including the fact that the lender informed him that it would not discuss a loan modification until he was late on his payments); White, *supra* note 7, at 40 (discussing lenders' unwillingness to negotiate with homeowners who are current on their payments).

35. *See* CONGRESSIONAL OVERSIGHT PANEL, OCTOBER OVERSIGHT REPORT: AN ASSESSMENT OF FORECLOSURE MITIGATION EFFORTS AFTER SIX MONTHS 25 (2009) (reporting that the self-cure rate for homeowners with prime loans who default on their mortgage dropped from an average of 45 percent between 2000 and 2006 to 6.6 percent in 2009—with current self-cure rates of 4.3 percent for Alt-A loans and 5.3 percent for subprime loans).

themselves from financial ruin.[36] In turn, we wouldn't have to worry about the fragile housing market crashing once again.

Why also speak of morality and social responsibility only when talking about strategic default by homeowners and not by financial institutions or large corporations?[37]

In the biggest real estate default in history, for example, real estate giant Tishman Speyer Properties strategically defaulted on $4.4 billion in loans on New York's Stuyvesant Town and Peter Cooper Village after the properties lost $2 billion in value—despite having billions in assets, including Manhattan's Rockefeller Center and the Chrysler Building, that it could have leveraged to meet its obligations under the loans.[38] Morgan Stanley did the same on a $1.5 billion mortgage on five buildings in San Francisco when the buildings lost half their value, despite raking in record profits the same year.[39] Neither entity was criticized for being immoral.[40] Apparently, what is good for Morgan Stanley or Tishman Speyer is good for the market.

Some have attempted to justify this double standard by arguing that commercial mortgage contracts are fundamentally different from residential mortgage contracts.[41] These commentators suggest that parties to commercial mortgage contracts contemplate the possibility of default in advance and agree on the remedy—typically, surrender of the property. They argue that parties to residential mortgages, on the other hand, contemplate only that the mortgage will be repaid—and thus residential mortgage contracts contain an implicit promise to pay regardless of market conditions that is absent from commercial mortgage contracts.[42]

This argument is thin, at best. Residential mortgage contracts, just like commercial mortgage contracts, contemplate the possibility of default and contain an agreed-upon remedy. It's true that sophisticated commercial parties

36. *See* Adelino et al., *supra* note 4, at 3 (claiming that "lenders rarely renegotiate" and noting that only 3 percent of seriously delinquent mortgages in their study had received concessionary modifications in the previous year).

37. *See* Zingales, *supra* note 6; *supra* note 8 and accompanying text.

38. *See* Charles V. Bagli & Christine Haughney, *Wide Fallout in Failed Deal for Stuyvesant*, N.Y. TIMES, Jan. 26, 2010, at A1; Lingling Wei, *Tishman Faces Office Downturn: Portfolio in Washington in Default; If No Risks, "Don't Have Any Rewards"*, WALL ST. J., Aug. 19, 2009, at C1.

39. *See* Dan Levy, *Morgan Stanley to Give Up 5 San Francisco Towers Bought at Peak*, BLOOMBERG, Dec. 17, 2009, http://www.bloomberg.com/apps/news?pid=20601206&sid=aLYZhnfoXOSk. Describing what would be considered a strategic default for homeowners, Morgan Stanley officials stated, "[t]his isn't a default or foreclosure situation. We are going to give them the properties to get out of the loan obligation." *Id.*

40. Roger Lowenstein, *Just Walk Away: Why Should Underwater Homeowners Behave Any Different From Banks?*, N.Y. TIMES MAG., Jan. 10, 2010, at 15.

41. *See, e.g.*, Zingales, *supra* note 6.

42. *See, e.g.*, *id.*

frequently negotiate more favorable terms than the average homeowner, including provisions that sometimes more strictly limit the lender's recourse in the event of default.[43] But this is not a moral difference, and it does not change the fact that both types of contracts contain agreed-upon remedies in the event of default. Indeed, if anything, the difference between commercial and residential mortgage contracts cuts in the other direction—and we should be more forgiving of less sophisticated residential borrowers. It just can't be the case that it's morally acceptable for financial institutions and large corporations to default on their mortgages, as long as they are willing to bear the contractually agreed-upon penalty in their contract, but it's not okay for average Americans to do exactly the same thing. There shouldn't be two sets of rules.

I would favor a world in which all actors—both corporate and individual—acted or were required to act in socially responsible ways. Institutional lenders, which bear a much greater share of the blame for the housing crisis than the average underwater homeowner, would then take responsibility for their actions by writing down at least part of the principal on underwater mortgages.[44]

It would be naïve, however, to wait for this to happen. There's no indication that financial institutions are going to start voluntarily writing down mortgages for underwater homeowners,[45] nor is there any indication that Congress will ever pass a law requiring them to do so. As long as Congress is unwilling to force lenders to write down underwater mortgages, many homeowners will conclude that strategic default is not only morally acceptable, but also the most rational course of action.[46]

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43. Brett Dockwell Kravitz, Note, *Which Price Is Right? Valuing Real Estate Purchased in Bulk With Nonrecourse Promissory Notes:* Epic Associates v. Commissioner, 56 TAX LAW. 301, 301 (2002) ("Nonrecourse loans are prevalent in the financing of income-producing commercial properties.").

44. Along these lines, some scholars have proposed requiring lenders to write down homeowners' negative equity. *See, e.g.*, Eric Posner & Luigi Zingales, *The Better, Cheaper Mortgage Fix*, SLATE (Mar. 2, 2009), http://www.slate.com/id/2212649 (proposing that lenders give underwater homeowners the option of resetting their mortgages to the current value of their houses in exchange for giving the lender 50 percent of the house's future appreciation).

45. *See* David Streitfeld, *Banks Resist Plans to Cut Mortgages*, N.Y. TIMES, Apr. 14, 2010, at B1 (reporting that major banks testified before Congress opposing the Obama Administration's plan that financial institutions simply *consider* principal reductions for underwater homeowners); *see also* Adam Zibel, *Banking Execs Skeptical on Mortgage Reductions*, ASSOCIATED PRESS, Apr. 13, 2010, http://finance.yahoo.com/news/Banking-execs-skeptical-on-apf-3551790565.html?x=0&.v=3.

46. *See* Streitfeld, *supra* note 5 (reporting on the increase in homeowners walking away). According to one mortgage broker: "Everyone has lost hope. They don't qualify for modifications, and being on the hamster wheel of paying for a property that is not worth it gets so old." *Id.*