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When mortgage default becomes a strategy

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Who is more likely to walk away from a house and a mortgage -- a person with super-prime credit scores or someone with lower scores?

Hint: It's probably not who you think. New research using a massive sample of 24 million individual credit files has found that homeowners with high scores when they apply for a loan are 50 percent more likely to ``strategically default'' -- abruptly and intentionally pull the plug and abandon the mortgage -- compared with lower-scoring mortgage borrowers.

Experian, one of the three national credit bureaus, teamed with consulting company Oliver Wyman to identify the characteristics and debt management behavior of the growing numbers of homeowners who bail out of their mortgages with none of the expected early warning signs, such as nonpayments or late payments on other personal debts.

With foreclosures, delinquencies and loan losses at record levels, strategic defaults and walkaways are among the hottest subjects in residential real estate finance. Unlike earlier academic studies, Experian and Wyman had the ability to tap into credit files over extended periods of years to identify patterns associated with strategic defaults.

Among researchers' findings are these eye-openers:

• The number of strategic defaults is far beyond most industry estimates -- 588,000 nationwide during 2008, more than double the total in 2007. They represented 18 percent of all serious delinquencies that extended for more than 60 days during the fourth quarter of last year.

• In contrast with most types of mortgage delinquencies, strategic defaulters often go straight from perfect payment histories to no mortgage payments at all. They just suddenly stop. This is in stark contrast with most financially distressed borrowers, who try to keep paying on their mortgage even after they've fallen behind on other accounts. They want to save their houses, not dump them.

• Strategic defaults are heavily concentrated in negative-equity markets where home values zoomed during the boom and have cratered since 2006. In California last year, the total number of strategic defaults was 68 times higher than it was in 2005. In Florida it was 46 times higher. In most other parts of the country, defaults were about nine times higher in 2008 than in 2005. Loans originated across the country in the pivotal market-turn year of

2006 have produced seven times more walkaways than loans originated during 2004, when property values were still rising.

• Two-thirds of strategic defaulters have only one mortgage -- the one they're walking away from on their primary homes. Individuals who have mortgages on multiple houses also have a higher likelihood of strategic default, but researchers believe that many of these walkaways are from investment properties or second homes.

• Homeowners with large mortgage balances generally are more likely to pull the plug than those with lower balances. Similarly, people with credit ratings in the two highest categories measured by VantageScore -- a joint scoring venture created by Experian and the two other national credit bureaus, Equifax and TransUnion -- are far more likely to default strategically than people in lower score categories.

• People who default strategically and lose their houses appear to understand the consequences of what they're doing. According to Piyush Tantia, an Oliver Wyman partner and a principal researcher on the study, strategic defaulters ``are clearly sophisticated,'' based on the patterns of selective payments observable in their credit files. For example, they tend not to default on home equity lines until after they bail out on their main mortgages, sometimes in order to draw down more cash on the equity line.

While high scorers have lower overall default rates on all their credit activities than people with lower scores, it's much more likely that when they stop payments on mortgages, the default is intentional and calculated.

Strategic defaulters may know that their credit scores will be severely depressed by their mortgage abandonment, Tantia said in an interview, but they appear to look at it as a business decision: ``Well, I'm $200,000 in the hole on my house, and yes, I'll damage my credit,'' he said of defaulters. But they see it as the most practical solution under the circumstances, and they won't have to deal with their negative equity albatross any further.

The Experian-Wyman study does not attempt to explore the ethical or legal aspects of mortgage walkaways. But it does suggest that lenders and loan servicers take steps to screen and identify strategic defaulters in advance and possibly avoid offering them loan modifications, since they'll probably just re-default on them anyway.

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