Soon You Can Flee Your Underwater Home. But It Will Cost You

By Justin Bachman on January 29, 2013

For some homeowners, March 1 will be Liberation Day. That's when Fannie Mae (FNMA) and Freddie Mac (FMCC) will start allowing some homeowners who have been stuck in their homes—unable to move because they owe more than the property is worth—to relinquish the houses and cancel their debt.

The new rules (PDF) for deed-in-lieu transactions apply to people who are current or less than 90 days late on their mortgage payments. To the extent that the change makes it easier for people to move—to take a new job, shift locations following the death of a spouse or caregiver, or if they become ill and can no longer afford the house payment—it should help the economic recovery. The change also will benefit military personnel who are relocated.

To be eligible to turn over the house keys, homeowners must be making payments of at least 55 percent of their monthly income for the house and must be able to document a "hardship" that requires a move, such as a spouse's death. The home must be clean and not damaged. Homeowners may also have to surrender as much as 20 percent of personal assets, excluding retirement accounts, to partially meet the loan's unpaid balance, depending on the borrower's financial situation. The program does not affect second mortgages. Mortgage servicers can offer up to $6,000 for second-lien holders to release borrowers from the loans, but there's no requirement that the holders agree. This could limit participation.

The new rules are not a free pass for people who can land a better job and want to escape an underwater mortgage, said Barry Zigas, director of housing policy at the Consumer Federation of America in Washington. "Borrowers who have any kind of equity in their home and are able to pay the mortgage … never come out ahead by just walking away from the home," he said. "A deed-in lieu is a much better credit event than a foreclosure, but it's not a great conclusion to the story. But some people, they have no choice."

Thus, the new rules for mortgage services are hardly a giveaway for debtors who can afford to pay. There is no estimate as to how many borrowers will be eligible to apply for a deed-in-lieu release, although the number is expected to be small, Freddie Mac spokesman Brad German said Monday. Short sales—in which lenders allow the sale of a home for less than they are owed—have been far more popular among distressed borrowers than deed-in-lieu transactions, noted Julia Gordon, director of housing finance at the Center for American Progress, a nonpartisan research institute. In the first three quarters of 2012, the Federal Housing Finance Agency approved more than 108,000 short sales, compared with 13,000 deeds-in-lieu.

Nationally, rising home prices helped drive negative equity down to $658 billion at the end of September 2012, from $689 billion at the end of the second quarter, research firm CoreLogic (CLGX) said in a Jan. 17 report (PDF). About 22 percent of residential properties with a mortgage, or 10.7 million, were underwater at the end of the third quarter, the firm said. The worst-hit states—Nevada, Florida, Arizona, Georgia, and Michigan—accounted for more than a third of all underwater mortgages. JP Morgan (JPM) estimates that the number of properties with negative equity could fall to 4 million by 2015, Bloomberg News reported on Monday.

Why did it take so long to come up with such a restricted program to help struggling homeowners? The politics of bailing out borrowers who took on more debt than they could afford have haunted the housing market's recovery since the collapse of subprime mortgages led to the 2008 financial crisis. (It was, after all, CNBC reporter Rick Santelli's February 2009 on-air rant about not wanting to "subsidize the losers' mortgages" that has been widely credited with forming the Tea Party movement.) On the other hand, Fannie and Freddie have gotten nearly $200 billion from taxpayers since the 2008 crisis.