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Cover Story

Owners find themselves trapped underwater

When homes aren't worth what you owe, you're stuck

By Stephanie Armour
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Michael and Cynthia Russell wanted to move to New York City, where they both work. Jobs are more plentiful there than in their town of Poughkeepsie, N.Y. But like millions of Americans today, the couple are stuck. They owe about $80,000 more on the home they bought in 2004 than it is now worth.

So instead of selling their home, Cynthia is going to school to become a registered nurse and Michael is working from home.

"We have had to find opportunities closer to home," Michael Russell says. "We actually began trying to refinance in June 2007, but absolutely no one would take us."

It's a problem that's only expected to get worse for legions of homeowners across the USA. Nearly one in seven homeowners is underwater, owing more on their mortgages than their homes are worth. That's about 12 million homeowners, nearly double the number underwater at the end of 2007, according to Moody's Economy.com. Most are homeowners who bought between late 2003 and 2007.

Home prices are projected to drop on average another 10%, bringing to about 14.6 million the number of homeowners who will be underwater on their mortgages by fall 2009, says Mark Zandi, chief economist at Moody's Economy.com. By contrast, about 2.5 million homeowners had negative equity in their homes in 2006.

Increasingly, job seekers find that their homes are albatrosses imperiling their ability to relocate for higher incomes or more secure job opportunities. In fact, the greatest drop in home prices, in many cases, is in areas with the sharpest rise in unemployment.

"It's a pretty alarming trend," says Alan Steel, general manager of AOL Real Estate.

In California, about 18% of homeowners owe more on their first mortgages than their homes are worth. In Florida, it's nearly one in four. Half of homeowners in Louisiana are underwater on their first mortgages.

Paying on 'a lost cause'

Ken Schimpf, 61, a retired carpenter in Lancaster, Calif., briefly toyed with the idea of moving to Wyoming so he could be closer to his oldest son and live in an area where he could find work more easily. But he's trapped by his house.

In August 2005, Ken and his wife, Juli, bought their home in Lancaster for $330,000. It seemed ideal at the time. The 1,900-square-foot, three-bedroom house includes an expansive master suite with a Jacuzzi, a pool, and 2.5-car garage where he keeps a 1923 T-Bucket hot rod that he and his wife worked on.

They got an interest-only loan at 5.25%, with the rate locked in for five years.

But in January 2006, Juli was diagnosed with leukemia. She spent months in and out of the hospital. Ken eventually took a leave of absence from work to help care for her. She died last March. Now Ken is trying to make his mortgage payment of $2,600 a month by relying on his retirement pension of $1,900 a month and savings. He doesn't want to lose the house because it's also home to two adult children: a son who was laid off and a daughter who is working temporary jobs. In September, his mortgage payments will increase by almost $500 a month when the interest-only teaser runs out.

He's selling his hot rod collection, looking for work and fast depleting his savings to make ends meet. Plans to sell the house were thwarted when he discovered the property is worth about $90,000 less than he paid for it. He doesn't want to just walk away from the home because he fears that would devastate his credit.

"I really hate putting the money out each month into what appears to be a lost cause," Schimpf says. "I just hope the economy turns around before too long so people can once again realize that owning a home is the American dream and not the American nightmare."

The inability to relocate because of negative home equity isn't just hurting workers who want to move for better jobs. It's also straining employers. Employees and new hires are increasingly turning down relocation opportunities because of the housing market. A 2008 corporate relocation survey by Atlas Van Lines found that "family ties" was the top reason (62%) cited by companies for workers declining relocations. That was a sharp drop from 84% last year. By contrast, 50% of companies said employees cited "housing and mortgages concerns" as the reason for turning down relocation offers, vs. 30% in 2007.

The dramatic shift is forcing businesses to offer more generous relocation assistance at the same time they're facing significant pressures to curtail costs because of the lackluster economy. In fact, the number of firms offering lump sum payments to transferees and new hires is at the highest in six years.

Some homeowners are so certain that their homes won't appreciate anytime soon that they have pondered simply walking away. Accountant Jason Khan, 33, owes about $80,000 more on his Phoenix home than it's worth in today's market.

"I am not in danger of losing my house. I have no problem paying my mortgage payments," he says in an e-mail. "However, I have considered walking away from my house and buying another … or making late payments to see if my mortgage company will renegotiate my principal with me."

For the most part, lenders will only ease loan terms for homeowners who are at risk of default or foreclosure.

Home prices keep on falling

Economists say a rebound in the housing market is still months away. The drop in home prices has shown no signs of letting up. And at least $500 billion worth of option-ARM loans are expected to reset from mid-2009 through 2012, driving up monthly mortgage payments for homeowners.

That could lead to a wave of new foreclosures that "could drive down home prices and leave more people underwater," Zandi says.

Jim Fawcett of Houston says the 6% decline in his home's value is just enough of a drop to keep him from retiring and moving inland from the coast.

"There's probably no way I could even sell my house in this market — short of giving it away," says Fawcett, 70. "Homes in my area, a newer development, sit on the market for six months, don't sell, then are taken off."

Mara Stefan's house is an unwanted reminder of her life before divorce. "As part of the settlement, I'm stuck in a house I don't want to live in," says Stefan, 42, who works in consumer technology and whose suburban Boston home is $60,000 underwater. She would love to move with her sons, Eric, 15, and Ethan, 6. "But it looks like I'll have to be here awhile."