Forget the Mortgage, I'm Paying My Credit Card Bill

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Amid high unemployment and sliding home prices, a growing number of struggling consumers are doing what was once considered unthinkable: paying their credit card bills instead of their mortgages. A recent study developed by TransUnion found the percentage of Americans who were current on their credit cards but behind on their mortgage increased to 6.6 percent in the third quarter of 2009, up from 4.3 percent in the first quarter of 2008. Meanwhile, the share of consumers making mortgage payments on time but behind on their credit cards moved in the opposite direction, sliding from 4.1 percent to 3.6 percent over the same time period.

The data reflects a "fundamental paradigm shift" in the way consumers prioritize payment of debt obligations, says Ezra Becker, of TransUnion. "This is dramatically different," he says. "It is a clear manifestation of the dynamics that lead up to the recession and the recession itself."

Before the housing crisis, bankers typically operated under the assumption that homeowners would do whatever possible to remain current on their mortgage--even if that meant falling behind on other bills. "It used to be that the mortgage was sacrosanct," says Keith Gumbinger of HSH.com. "You paid it before anything else." But a combination of factors linked to the current economic mess--falling home prices, high unemployment, and tight consumer credit--have lead many consumers to prioritize credit card payments above mortgage bills. "This sort of thing is what keeps bankers awake at night," Gumbinger says.

The development is rooted in the housing bust. When home prices turned south--falling roughly 30 percent from their peak in the second quarter of 2006--a great deal of borrowers watched the value of their homes drop below what they owed on their mortgages. Today, roughly one in four homeowners finds himself in this position, which is also known as being "underwater." Without equity in their homes, such borrowers are more likely to default. "They don't see any value in putting money into an asset that has lost that much value and will probably never regain that value to offset the mortgages," says Celia Chen, of Moody's Economy.com.

At the same time, the breezy credit standards of the first half of the previous decade worked to reduce the psychological investments that consumers made in their properties, Becker says. "A lot of people were able to get their homes with very little down payments or no down payments," he says. "So there was no real [sense of] 'I worked really hard to achieve home ownership.'" Instead, "achieving home ownership came very easy," Becker says.

But while walking away from a mortgage--even, at times, when borrowers can afford it--has become a less radical prospect, remaining current on a credit card has grown increasingly important for many Americans. First, credit cards can be used to pay for basic necessities, like food, gas, or clothes. And with the unemployment rate remaining near double digits, purchasing such items with credit has become more and more essential. At the same time, the tighter credit environment has made credit cards more difficult to obtain, Becker says, so consumers have become increasingly concerned with hanging on to the cards that they have. "It is hard to operate in our society without a credit card today," Gumbinger says.

Still, another key factor is the disparate consequences associated with defaulting on a mortgage versus those for falling behind on a credit card. National anti-foreclosure efforts have worked to significantly extend the time period between a borrower's initial mortgage default notice and the foreclosure itself, says Edward Pinto, a former chief credit officer at Fannie Mae. "The last thing you have to worry about at this juncture is paying your mortgage because by the time they foreclose it could be six months, 12 months, or a year and a half down the road," Pinto said.

A credit card, however, can disappear much quicker, Becker says. "If you go a couple months without paying your credit card bill, they are going to close your account," he says. "You won't be able to access your credit."

A credit card's ability to finance basic necessities--and the swift consequences of default--make the trends highlighted in the TransUnion study less startling, especially in a time of high unemployment and widespread negative equity. "For a borrower who has got a significant [cash] shortfall, it is a completely rational decision [to pay off a credit card bill while defaulting on a mortgage]," Gumbinger says.

Still, Becker notes that none of these decisions are simple. "When you hear about strategic defaults, and people choosing to walk away from their mortgages, nobody is flip or carefree about that," Becker says. "Decisions about who you are going to pay and who you are not going to pay are incredibly stressful."