

Comments on
“Payment Size, Negative Equity, and Mortgage Default,”
by Andreas Fuster and Paul Willen
&
“Strategic Default Behavior and Attitudes among Low-Income
Homeowners”
by Sarah Riley

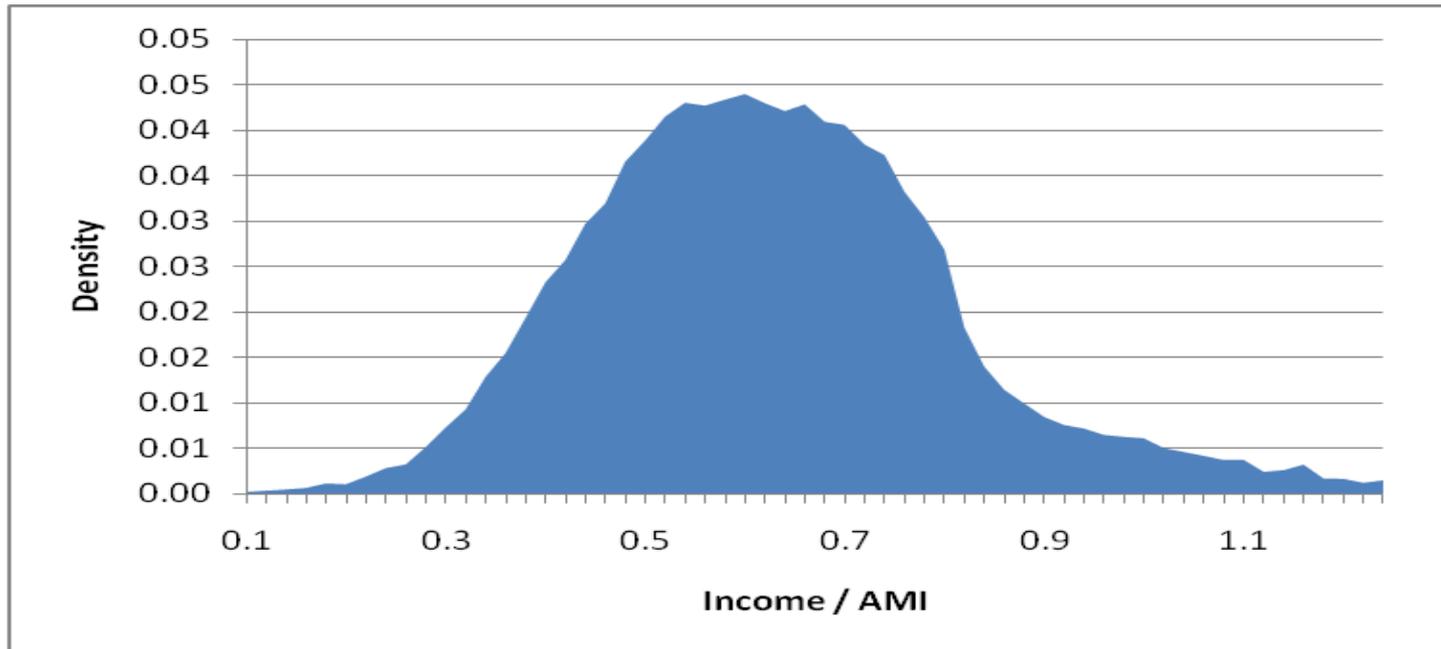
FDIC 3rd Annual Consumer Research Symposium
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Panel 4: Mortgage Performance

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Riley – Low Income & Strategic Default

- **Low income less likely to be strategic, despite claiming to be**
- **What do we know about lending to low income households?**
- **Low income homeowners**
 - Higher rates of default and prepayment (McArdle 2009, Bhutta 2009);
 - Sometimes about the same & Sometimes less risky (Mills and Lubuele 1994, Calem and Wachter 1999, Van Order and Zorn 2000 & 2002, Firestone, Van Order, and Zorn 2007, Deng and Gabriel 2006, Quercia, Pennington-Cross, & Tian, 2012).
 - **Lower prepayment & higher default risks**
 - Standard drivers of termination matter – but differing amounts depending on income
 - Credit scores, LTV, interest rates, labor market conditions, DTI sometimes

How low is low income?



Source: Quercia, Pennington-Cross, & Tian, 2012

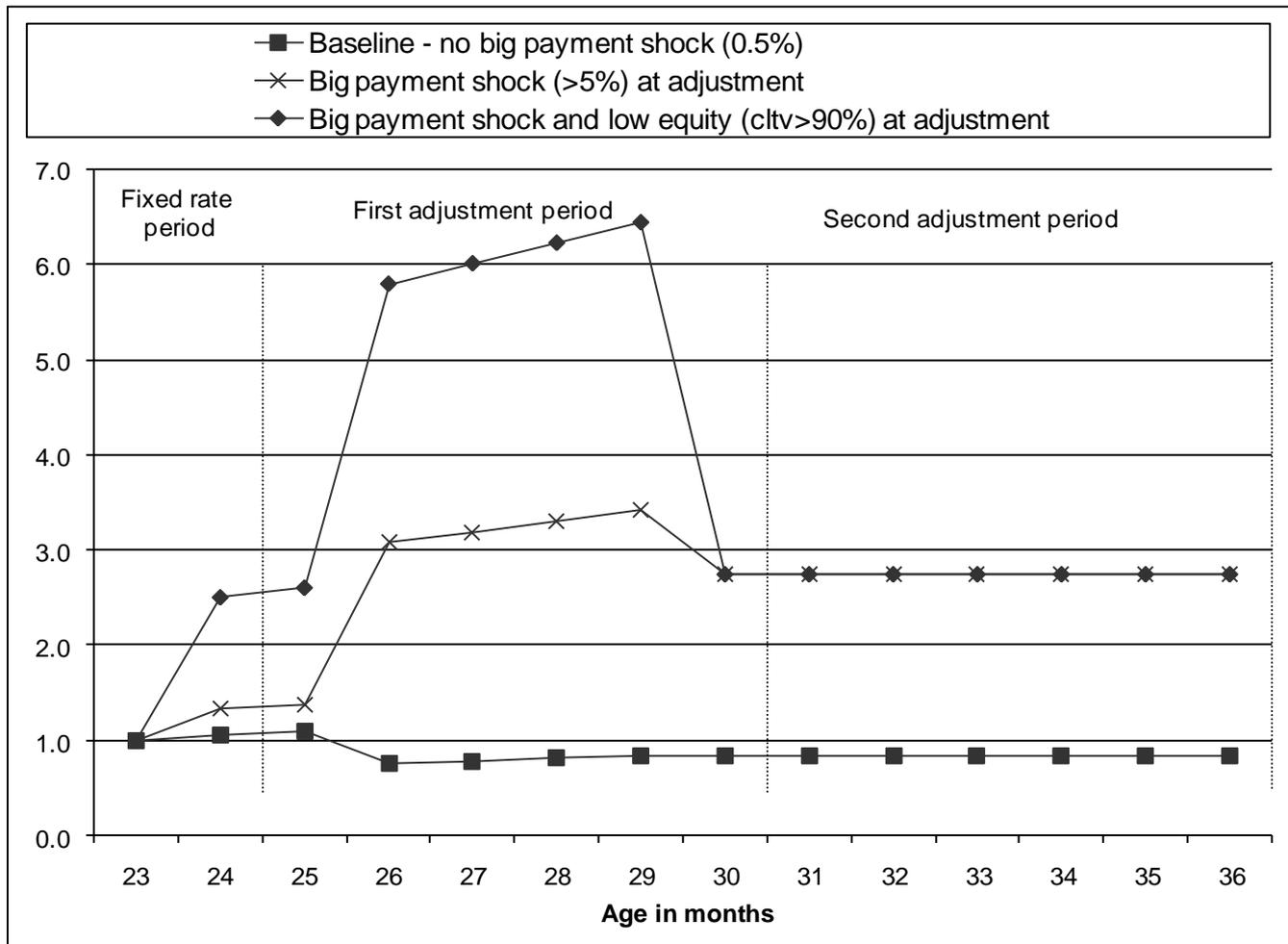
How can you use the survey?

- **Do attitudes about strategic default affect**
 - Default or prepayment probabilities
 - Strategic default probabilities
- **Need to impute strategic default attitudes**
 - Have everything you need to do this
 - Demographics
 - Location
 - Mortgage Information
 - Borrower financial info

Fuster and Willen - Payment Size

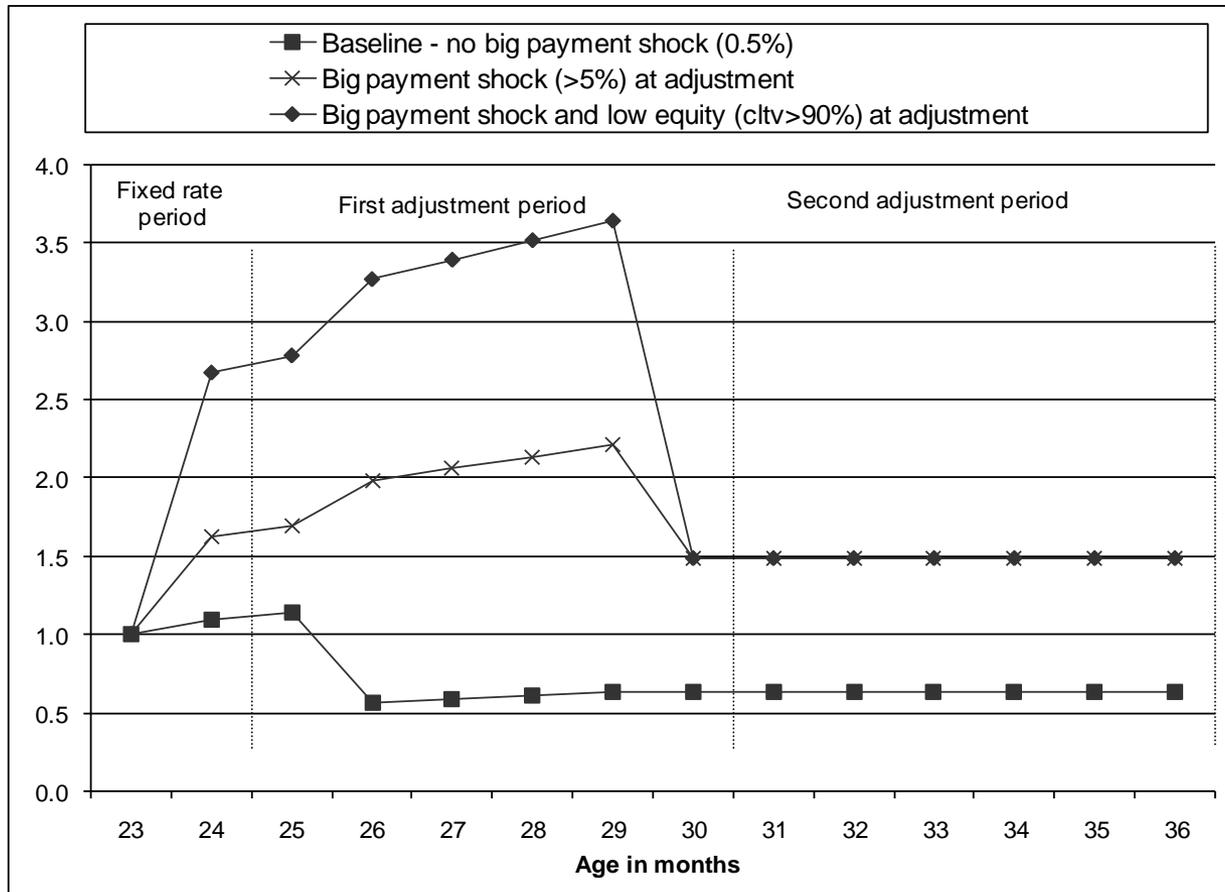
- Can't believe I just read this paper!
 - Major findings
 - Payment shocks matter a lot
 - PMT shocks matter even more negative equity
 - Foote, Gerardi and Willen (2012) working paper – payment shocks don't matter much
 - Motivation for contribution
 - Issue with the approach -- “In other words, the increase in the default hazard after the reset that is typically observed in the data confounds the treatment effect of higher payments with the **selection of higher-quality borrowers into prepayment**”
 - “quality of the pool is lower after the reset as a consequence” – predicted impacts are biased upward
 - ? Observed or unobserved?
 - ? Distressed prepayments ?
 - Pennington-Cross & Ho (2010) REE – payment shocks matter a lot.
 - Pmt shocks matter even more with negative & low equity

Defaults on Subprime 2/28's Interest Rate Adjustment Period 1998 to 2005 Loans



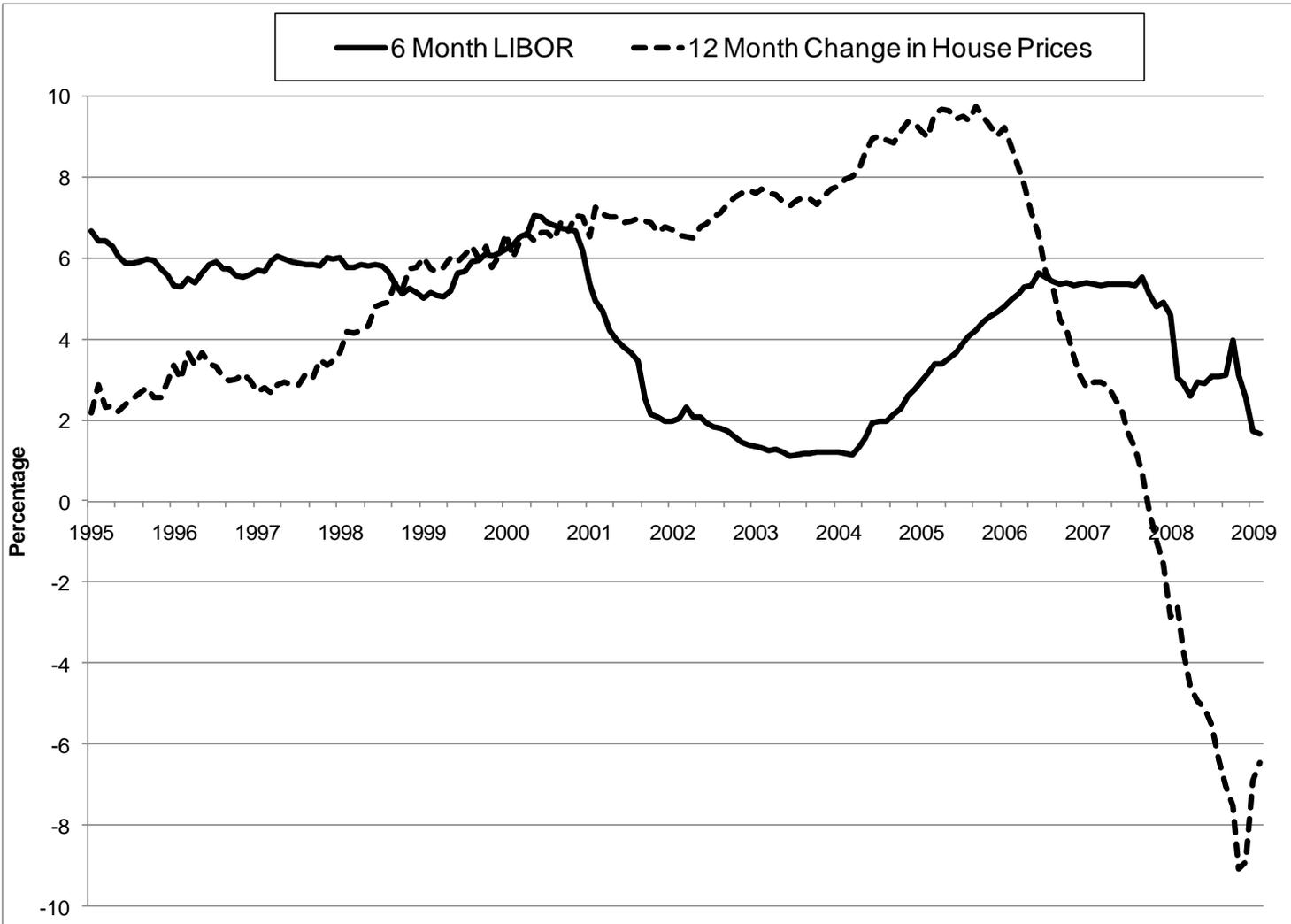
Source: Pennington-Cross & Ho, *Real Estate Economics*, 2010

Prepayments of Subprime 2/28's Interest Rate Adjustment Period 1998 to 2005 Loans



Source: Pennington-Cross & Ho, *Real Estate Economics*, 2010

The index – 6 month LIBOR



Source: Pennington-Cross & Ho, *Real Estate Economics*, 2010

Fuster and Willen - Payment Size

- How can you convince me? Its easy!
 - Impact of + payment shocks
 - Impact of – payment shocks
 - Expectations of future short run rates
 - Yield curve
- Some other things
 - Control group
 - Why not use the same product type? – likely selection problems
 - Is this jointly estimated?
 - Coefficients biased?
 - Default vs delinquency
 - Motivations differ – pmt shock may cause delinquency but not default
 - Paper really about delinquency