Strategic Default Attitudes and Behavior among Low-Income Homeowners

Sarah Riley • October 17, 2013
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MORTGAGE DEFAULT TYPES

- Negative Equity
- Strategic
- Dual Trigger
- Insolvency
PRIOR ESTIMATES OF STRATEGIC DEFAULT

- **Credit bureau data** (Experian, etc.)
  - 12-19%
  - Measure:
    - Negative equity and
    - “straight roll” with no subsequent payments
  - Likelihood increases with credit score, loan balance, and income
PRIOR ESTIMATES OF STRATEGIC DEFAULT

- **Credit bureau data** *(Experian, etc.)*
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- **Survey data** *(Guiso et al. – FTIS)*
  - 35%
  - Measures:
    - Know any defaulters?
    - Know any strategic defaulters?
    - Strategic default morally wrong?
    - Strategic default at [$50k/$100k] negative equity?
  - Likelihood decreases with income
QUESTION: What are the implications for...

- Strategic default measurement methods?
- Low-income lending?
FINDING 1: Low-income homeowners ...

- Are less likely to default strategically.
- Have similar beliefs about strategic default.
- Are more likely to say that they would default strategically.
FINDING 2: Identify strategic defaulters via ...

- Higher income and credit score
- Higher note rate
- Location in Sand States and/or LMI census tract
FINDING 3:

Survey measures overestimate strategic default.
DATA:
THE COMMUNITY ADVANTAGE PROGRAM (CAP)

20,000
originated 1999 or later

1,000
originated 1999-2003
completed 2011 survey
SERIOUS DELINQUENCY OVER TIME (% OF ACTIVE)

Jan-05 Jan-07 Jan-09 Jan-11 Jan-13

PRIME FRM
PRIME ARM
SUBPRIME FRM
SUBPRIME ARM
CAP
ACTIVITY STATUS

- Active: 37% (Portfolio 20k) 35% (Seriously Delinquent 4k)
- Prepaid: 53% (Portfolio 20k) 8% (Seriously Delinquent 4k)
- Foreclosure Sale: 40% (Portfolio 20k) 7% (Seriously Delinquent 4k)
EQUITY STATUS

- Negative Equity: 35%
- Negative Equity >= 10%: 24%
- Negative Equity >= 20%: 17%

- Portfolio (20k): 18%
- Seriously Delinquent (4k): 11%

- Portfolio (20k): 8%
- Seriously Delinquent (4k): 17%
STRATEGIC DEFAULT INCIDENCE

Percent of Seriously Delinquent Loans

- **Straight Roll**: 29%
- **Straight Roll + Negative Equity**: 13%
- **Straight Roll + Negative Equity >= 10%**: 9%
- **Straight Roll + Negative Equity >= 20%**: 7%
STRATEGIC DEFAULT BELIEFS

Strategic Default Morally Wrong

- 82% (CAP Survey)
- 81% (FTIS)

Perceived Strategic Default Rate

- 32% (CAP Survey)
- 35% (FTIS)
WILLINGNESS TO DEFAULT STRATEGICALLY

13%  31%  54%

$20k  $50k  $100k

CAP Survey  FTIS
MULTIVARIATE ANALYSES – DEPENDENT VARIABLES

1. Straight roll + Negative equity $\geq 20\%$ \((\text{StratDef20})\)

2. Strategic default morally wrong

3. Strategic default threshold: $\leq 20\%$ or $\leq 60\%$
AVERAGE MARGINAL EFFECTS PREDICTING STRATDEF20 (OBSERVED STRATEGIC DEFAULT)

- Income: 6
- Credit Score: 2
- Note Rate: 2
- Sand States: 13
- LMI Tract: 3
AVERAGE MARGINAL EFFECTS PREDICTING STRATEGIC DEFAULT MORALLY WRONG

- Income: 5
- Credit Score: 11
- DTI Ratio: 3
- Note Rate: 4
- Single Family: 4
AVERAGE MARGINAL EFFECTS PREDICTING STRATEGIC DEFAULT MORALLY WRONG

Knows Defaulters: -0.5

Knows Strategic Defaulters: -1.0
AVERAGE MARGINAL EFFECTS PREDICTING STRATEGIC DEFAULT MORALLY WRONG

- LMI Tracts in Sand States
- LMI Tracts in Other States
- Minority Tracts in Sand States
- Minority Tracts in Other States

11
-5
-42
6
AVERAGE MARGINAL EFFECTS PREDICTING HYPOTHETICAL STRATEGIC DEFAULT THRESHOLD

<= 20%  <= 60%

-20 -15 -10 -5 0 5

- Morally Wrong  - Knows Strategic Defaulters
AVERAGE MARGINAL EFFECTS PREDICTING HYPOTHETICAL STRATEGIC DEFAULT THRESHOLD
AVERAGE MARGINAL EFFECTS PREDICTING HYPOTHETICAL STRATEGIC DEFAULT THRESHOLD
CONCLUSIONS

- Most low-income defaults not strategic

- Beliefs ≠ Behavior
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