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

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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);
    • 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 ?
    • Pmt shocks matter even more with negative & low equity
Defaults on Subprime 2/28’s
Interest Rate Adjustment Period
1998 to 2005 Loans

- Baseline - no big payment shock (0.5%)
- Big payment shock (>5%) at adjustment
- Big payment shock and low equity (cltv>90%) at adjustment

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