

What Triggers Mortgage Default?

New Evidence from Linked Administrative and Survey Data

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Discussion by

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Theories of Mortgage Default

- **Strategic:** Default \iff Negative Equity

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 - But most negative equity borrowers do not default...

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- **Consensus view** (circa 2018)
 - Negative equity is a necessary condition for default
 - Any default without a life event is strategic
 - \approx 66% of defaults are double-trigger, 33% are strategic

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 - Any default without a life event is strategic
 - \approx 66% of defaults are double-trigger, 33% are strategic
- **New view** (this paper + Ganong and Noel (2021))
 - Life events are hard to measure \rightarrow the 66/33% breakdown is wrong
 - Taxonomy above is incomplete \rightarrow negative equity need not be necessary for default

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Theories of Mortgage Default

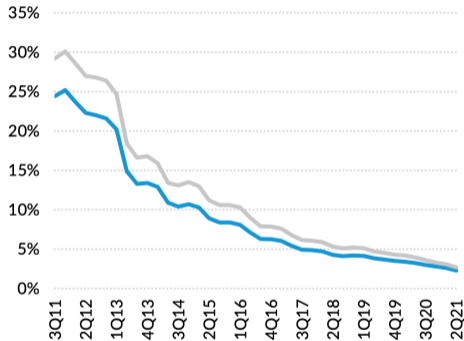
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 - New measurement: nearly *all* defaults are accompanied by a negative life event
 - Replication in new data: the *majority* of defaulters have positive equity

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 - New measurement: nearly *all* defaults are accompanied by a negative life event
 - Replication in new data: the *majority* of defaulters have positive equity
- **Emerging consensus**
 - Strategic default is exceedingly rare
 - Cash-flow defaults are a central part of the story

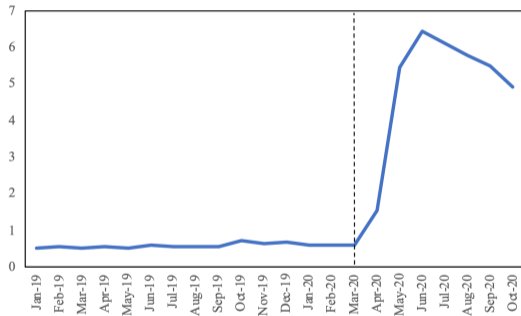
This Distinction is Important! Evidence from COVID-19

Negative Equity Share



Source: Urban Institute (2021)

Share of Mortgages in Forbearance

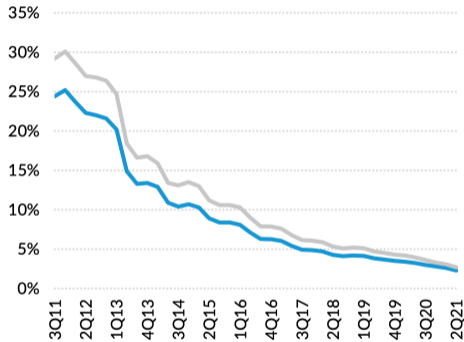


Source: Cherry, Jiang, Matvos, Piskorski & Seru (2021)

Strategic/double-trigger \Rightarrow forbearance = wealth transfer w/no change in foreclosure

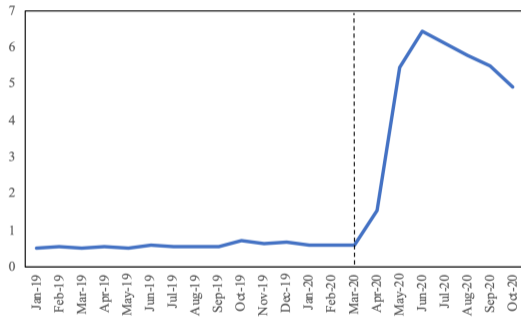
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Cash-flow \Rightarrow forbearance = wealth transfer with **large decrease** in foreclosure

My Take

This is an excellent paper!

- Addresses an extremely important question
- Brings excellent new data to the table
- Convincingly documents a striking set of new facts

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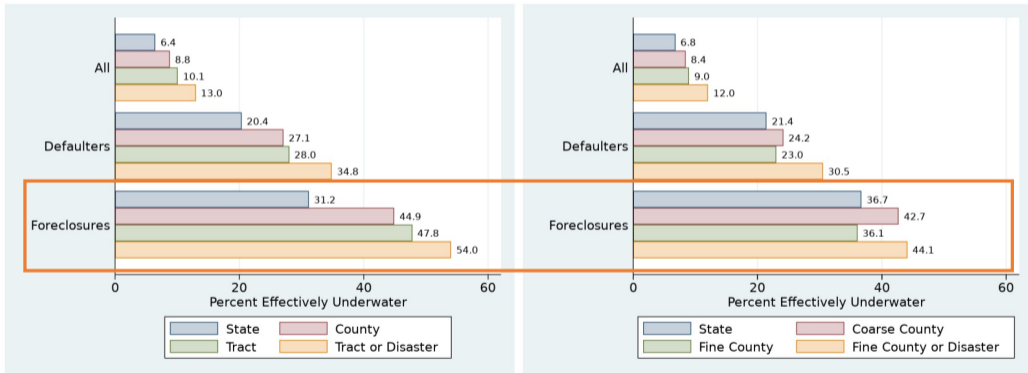
- More careful distinction between default and foreclosure
 - Many reasons why positive equity borrowers might default and later cure
 - Equity result most surprising and important for foreclosures
 - Distinguishing between foreclosure starts/completions may be similarly important

The Most Striking Result in the Paper

Figure 4: Percent Effectively Underwater

(a) FHFA

(b) Black Knight



**At least 46% of borrowers in foreclosure have positive equity!
Why can't/won't these people sell their homes?**

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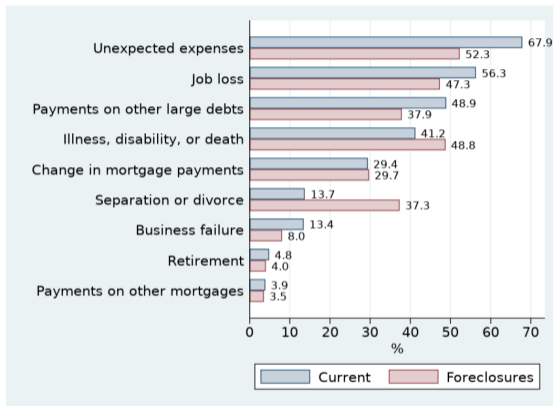
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- More careful distinction between default and foreclosure
- Investigate mechanisms driving positive-equity foreclosures
 - Search/matching frictions in the housing market?
 - Unrealistic expectations about income/shock recovery?
 - Agency conflicts with the bank (borrower can't commit to timely sale)?
 - Unfortunately the survey is of limited use here (N = 150 for foreclosures)

Shocks Triggering Foreclosure Differ from Those Triggering Default

Figure 3: Liquidity shocks triggering default, by payment status



Is there enough data to split the foreclosures by positive/negative equity?
What are the shocks that drive positive equity foreclosures in particular?

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 - **More work on this needed given huge inefficiency from lack of sale!**