Empirical Household Finance
Online PhD-Level Class

Mortgage Borrowing and Default

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Plan For My Presentation Today

• Some observations on today’s topic:
  Mortgage Borrowing and Default

• Present a research paper:
  Asymmetric Information about Collateral Values
Mortgages: Largest Consumer Credit Category

Total Debt Balance and its Composition

Trillions of Dollars

Source: New York Fed Consumer Credit Panel/Equifax
Mortgages: Large and Important Credit Class
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Dimensions of Mortgages

- Mortgages potentially differ on many dimensions
  - FRM/ARM
  - Leverage
  - Duration
  - Teaser rate
  - Government insured?
  - Recourse/Non-recourse (US: State-level laws)
Mortgages: Interesting Questions

• What determines which mortgages individuals pick?
  • Which lender? How much leverage? ARM/FRM?
  • House price beliefs (e.g., Bailey, Davila, Kuchler, and Stroebel, 2019)?
  • Peer effects (e.g., McCartney and Shah, 2016)
  • Role of intermediaries such as mortgage brokers (e.g., Robles-Garcia, 2020)
  • Do borrowers search appropriately (e.g., Woodward and Hall, 2012)
Mortgages: Interesting Questions

- Why do individuals default on mortgages?
  - Liquidity Defaults vs. Strategic Defaults (e.g., Ganong and Noel, 2020)
  - Peer effects (e.g., Gupta, 2019; Guiso, Sapienza, Zingales, 2013)
    - Information about cost of defaulting
    - Direct effect on social stigma cost
  - Depends on legal environment (recourse/non-recourse)
Mortgages: Interesting Questions

• What determines mortgage refinancing behavior?
  • Particularly relevant for fixed rate mortgages
  • Expectations of future interest rate changes
  • Peer effects (see Jordan Nickerson's presentation from a while ago)
  • Other frictions: The need to prove income may prohibit welfare-improving refis
  • Important implications for functioning of monetary policy
  • Government programs such as HAMP/HARP
Mortgages: Interesting Questions

• Information Friction in Mortgage Markets
  • Adverse Selection vs Moral Hazard
  • Source: Borrower Types (Hansman and Gupta, 2020)
  • Source: Collateral Values (Stroebel, 2015)
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• Optimal mortgage design
  • FRM/ARM: Who is best placed to bear interest rate risk?
  • State-dependent repayment (e.g., vary with house prices to avoid strategic defaults)
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- Government intervention in the mortgage market?
  - Leverage regulation (Johnson, Mondragon, DeFusco, 2020; Benetton, 2020)
  - GSEs (Fannie Mae / Freddie Mac): Guarantee certain MBS
  - Crisis interventions: HAMP/HARP; Fed purchasing MBS