

Discussion of Mortgage Defaults by Hatchondo, Martinez, and Sanchez

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Recent Developments in Consumer Credit and Payments

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- 1 Construct a macro model of equilibrium mortgage defaults.
 - Life-cycle model.
 - Individual house price and income shocks.
 - Can choose how much down payment to put.
 - Mortgage interest rates reflect default risk.
- 2 Compare two policies for foreclosure/default prevention.
 - Minimum down payment requirement.
 - Allowing mortgage lenders to garnish future income upon default.
 - Equally effective in preventing foreclosures.
 - However, different welfare implications.
- 3 Analyze the role of housing/mortgages in consumption smoothing.

Experiments 1: Comparing Foreclosure Prevention Policies

- 1 Same effect on # of defaults, but different welfare implications.
- 2 Minimum down payment requirement (0% \rightarrow 15%).
 - Defaults down by 30%.
 - Harder to buy: renters and future generations **suffer**.
 - Cheaper to borrow: current homeowners **benefit** (entitlement effect).
- 3 Allow mortgage lenders to garnish future income upon default (0% \rightarrow above 143% of \bar{c}).
 - Defaults down by 30%.
 - Cheaper to borrow: renters and future generations **benefit**.
 - Cheaper to borrow: current homeowners **benefit**.

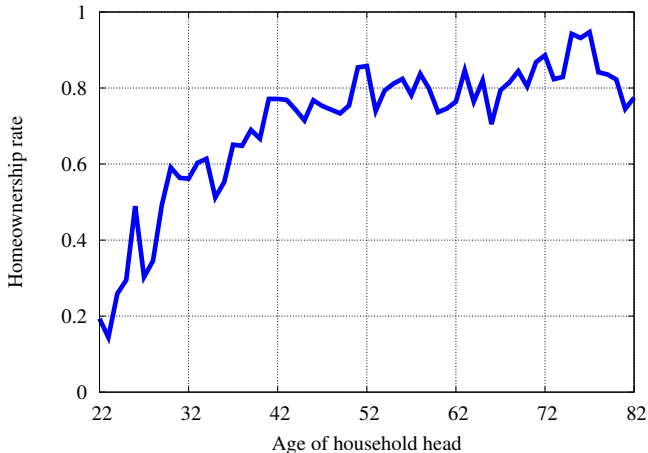
Experiments 2: Consumption Smoothing w Housing/Mortgage

- 1 BPP (Brundell-Pistaferri-Preston) insurance coefficient.
- 2 Comparing with standard Huggett model used by Kaplan-Violante.
- 3 Finding 1: Housing/mortgage doesn't improve consumption smoothing.
 - Housing/mortgage only adds moderately relaxed borrowing limit.
 - Is it a good model of housing?
 - No moving up/down.
 - No consumption of housing services.
- 4 Finding 2: House price shocks don't move consumption.
 - Because consumers cannot cash-in by assumption.
 - No moving up/down.
 - Individual house price shocks work like aggregate shocks.

Is It a Good Quantitative Model of Mortgage Defaults?

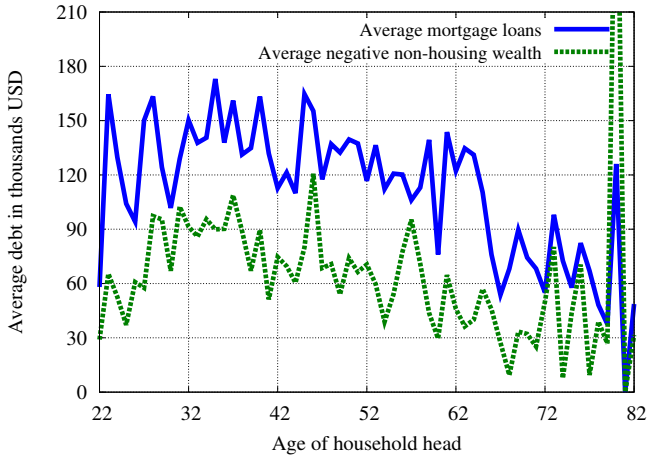
- 1 Complicated long-term contract: Why?
 - Why not a simple short-term contract like in Jeske-Krueger-Mitman?
 - Consumers refinance frequently → Not really long-term.
- 2 Homeownership in retirement.
- 3 Model-consistent definition of mortgage debt.
- 4 Debt over the life-cycle.
- 5 Defaults over the life-cycle.

Homeownership Rate



- 1 Homeownership rate does not drop after retirement.
- 2 Drops sharply in the model.
- 3 Easy fix: bequest motive.

Mortgage in Model is Different from Mortgage that You Know



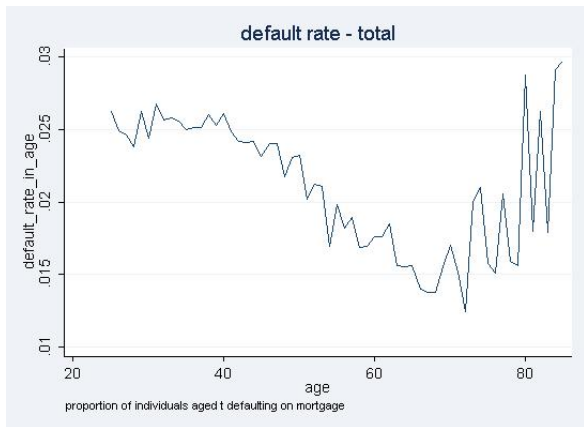
- 1 Need to be careful with the model definition of debt.
- 2 Definition of down payment as well (Figure 1).
- 3 Refinancing is more frequent. What is down payment?

Proportion with Mortgage Debt among Homeowners



1 Typical life-cycle model cannot generate the shape. Too much concentration of debt among young.

Mortgage Default Rate



- 1 Flat until age 40, steadily declining after that.
- 2 Typical life-cycle models with defaults cannot replicate this shape.
- 3 Also: who are defaulting? Income, house price, or other shock?

This Time Is Different?

- 1 Model is calibrated to the “normal” environment.
- 2 Are the findings valid in the current situation?
 - Large drop in aggregate house prices.
 - Larger income shocks.

- 1 If house price is endogenized, need to have different house sizes, and equilibrium transition analysis.
- 2 Realistic costs of foreclosure/default in the model?
 - Forced to sell the house.
 - Remain a renter for a year.
- 3 Solved with discrete state space. Quantitative results robust? (e.g. Authors' previous work)