Discussion of “The Effect of Mortgage Payment Reduction on Default: Evidence from HARP”

Paul Calem (FRB Philadelphia)

FRB Atlanta / UNC Charlotte Housing Finance Conference

12-15-2013

The opinions expressed are my own and do not represent official views of the Federal Reserve Bank of Philadelphia or Federal Reserve System

Highlights

- The paper examines relationship between payment reduction from mortgage refinancing and subsequent probability of delinquency
  - GSE fixed-rate mortgages refinanced through HARP program
    - 80 LTV and no recent delinquency at time of refinancing
    - Originated before 2009
- Main finding: 10 percent reduction in mortgage payment associated with 10-12 percent reduction in monthly default hazard
  - Control for time-varying LTV; FICO score at time of refinance; state and vintage
  - Robust to two-stage estimation addressing selection effect of program participation

Comments

- Demonstrates impact of monthly payment on mortgage performance in new, important context
  - Consistent with studies from other contexts

- This may be sufficiently important to some, but stronger motivation could be offered; for example:
  - Evaluating HARP benefits
  - Addressing "what ifs", such as what if there had been no LTV ceiling from the start?
  - How did borrowers qualifying for HUD affordable goals fare under HARP?

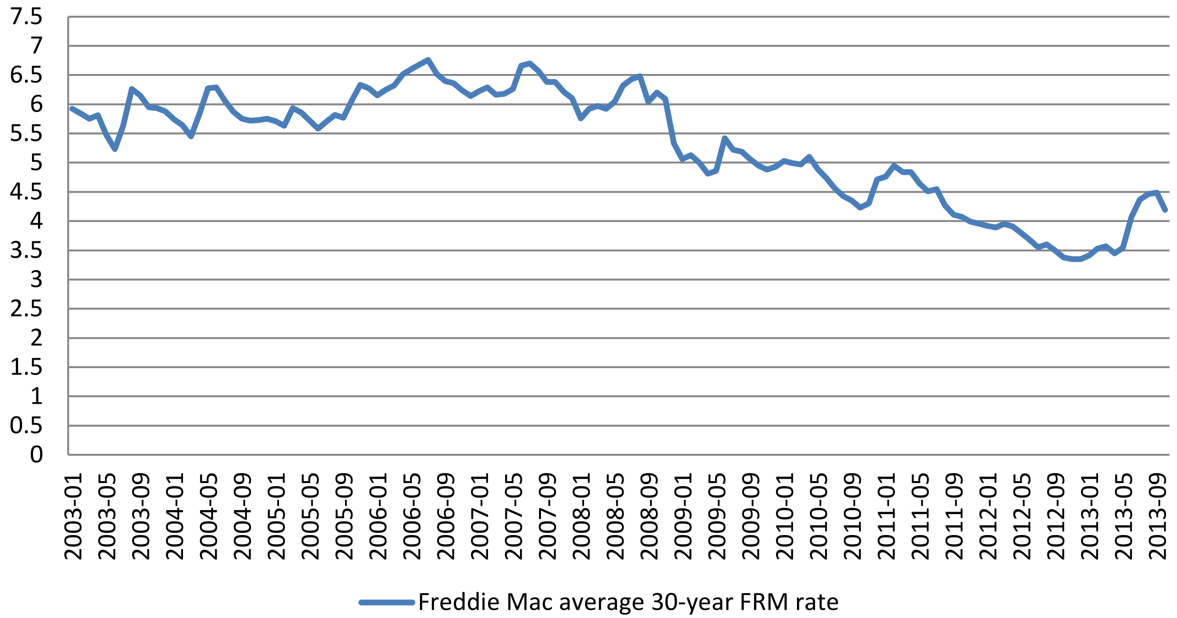
Comments

- Insufficient attention to potential confounding effects of factors correlated with size of rate change:
  - Spread at origination
  - Factors influencing timing of refinance

- Market conditions at origination are broadly controlled for by origination vintage dummies; origination spread and timing of refinance require more attention
  - For example, refinance of alt-A or other (originally) higher risk loans with higher original note rates, may introduce a survivor bias that may exaggerate the benefits of payment reduction
  - For example, borrowers who refinanced immediately on becoming eligible may have been under greater financial stress

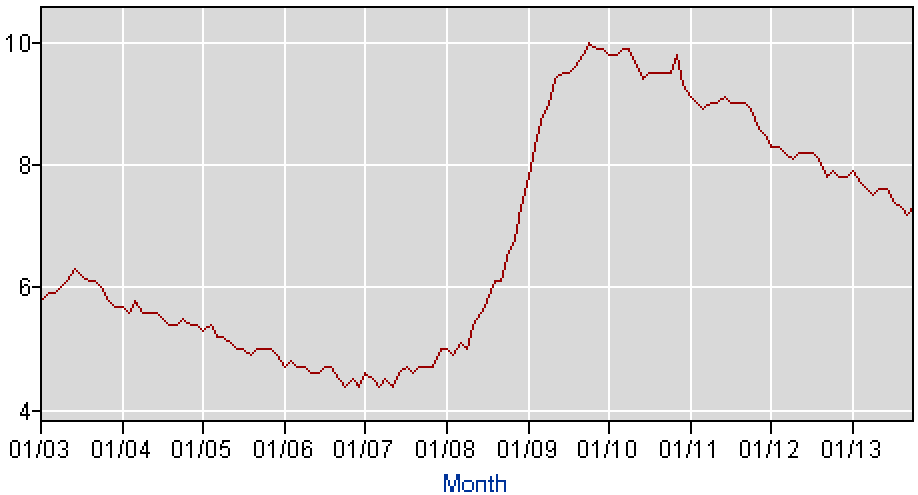
Average 30-Year Fixed-Rate Mortgage Interest Rate

Given downward trending interest rates, there may have been perceived benefit to delay (HARP did not allow more than one refinance)



U.S. Unemployment Rate

General improvement in economic conditions over the period



http://data.bls.gov/timeseries/LNS14000000

Comments

- It may prove difficult to isolate such factors, but more can be attempted
  - Control for spread at origination
  - Control directly for refinance waiting time (time between date of refinance and date of eligibility)—if there is sufficient cross-sectional variability to separate this from size of payment reduction
  - Control for change in local area unemployment rate (in place of level of unemployment)

Additional Comments

- Quantify percentage refinancing from FRM to FRM vs. other refinancing under HARP
  - Useful background information
- Size of potential payment reduction may impact program participation
  - Why not control for this directly in the two-stage estimation?
- Why two-year HPI change (e.g., why not one-year)?
- The HARP eligibility criterion requiring "clean" performance history could produce a screening effect
  - Could explain, for example, unexpected sign on LTV at refinance
  - Could explain (along with inclusion of state fixed effects) lack of explanatory power of unemployment rate
- HARP 2 borrowers with LTV < 125 may be an unusual population
  - Either newly eligible despite LTV < 125, or chose not to refinance earlier
- Why not control for original DTI ratio and examine its interaction with payment reduction?