Strategic Mortgage Default and the Impact on Surrounding Homes and Homeowners

Dr. Michael J. Seiler, The College of William & Mary
K. Dane Brooksher Endowed Chair of Real Estate
Some Past Studies

- **Harvard, MIT, JHU, USC, NUS, OCC, etc…**


What is Behavioral and Experimental Real Estate?

- **Behavioral RE**: Recognizing that people care about more than money.

- **Experimental RE**: A (primary) data collection method required when other data does not exist.
What is Strategic Mortgage Default?

• **Economic Default**: When a homeowner defaults on his mortgage due to an inability to make monthly payments.

• **Strategic Default**: When a homeowner makes the conscious choice to default on his mortgage even though he is fully capable of making his monthly payments.
25% of all homes are underwater (regional)
- Yet far fewer loans are in default

Strategic Defaults (SD) are on the rise
- Estimated to be from 10%~26%
  - Guiso, Sapienza, and Zingales (2013), FICO (2011), and Wyman (2010)

Viewed as a major reason for the slow economic recovery
Informational Uncertainty

Financial life after mortgage breach is currently extremely uncertain

- And varies greatly by state
  - strategicdefault.org & youwalkaway.com

- Cost of time, legal expenses, and even health concerns (anxiety, marital problems, etc.)
Why is SMD potentially attractive?

- Live rent-free (in the meantime – for years)
- Low Probability of Lender Recourse
  - Even in states that allow for lender recourse
- Lenders are overwhelmed with cases
- Legal pursuit is expensive
- Many borrowers do not have the money
  - Winning is not the same as collecting
- May reach a settlement below UPB (BR threat)
SMD is widely viewed as being immoral – even by people who do it
- 80%~90% of people view SMD as immoral

Many mitigating circumstances
- Lender Characteristics (egregious lender; distant versus local lender; common vs. uncommon default)
- Borrower Characteristics (age, gender, blame game, previous default, malleability)
NeuroScience (fMRI)
Game Theory: It almost NEVER Makes Sense to Modify a Loan!!

Above the line means that Borrower will pay off mortgage

Beneath the line means Borrower will strategically default and be foreclosed on

- Interface between player paying off mortgage and strategically defaulting
- Modification offered by Bank
- Results when banks are not allowed to modify mortgage
Epidemiology: Social Network Study

- **Red:** Foreclosed House
- **Green:** Indicates on market
- **Gray:** Normal House
- **Yellow:** marginally underwater
- **Orange:** significantly underwater
Social Network Study
Social Network Study
Humans are social, and look to their peers and Mavens (consciously or subconsciously) when forming their opinions, habits, and behaviors.

Easier to bring a market down than up.

Media efforts affect Fear, Shame, and Guilt associated with Strategic Mortgage Default.

Outcome uncertainty causes unpredictable behavior.

A need for understanding all sides of the issue.
Thank You for inviting me!