

The Impact of Repossession Risk on Mortgage Default

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This paper

- Use diff-in-diff variation to estimate treatment effect of removing repossession risk on mortgage default
 - Unexpected Irish legal ruling
- Theoretical object of interest: moral hazard effect of reduced repossession risk
 - Important for mortgage market design (Piskorski and Seru, 2018)
 - Foreclosure moratoria popular during Great Depression and Recession: what do we know about the moral hazard effects? (Mayer et al, 2014)
- 0.3 pp increase in quarterly default rates for a sample of Irish mortgages
 - 30-40% relative increase over estimated counterfactual

30 seconds on the Irish Mortgage Market

- Mostly standard contract features
- Recourse: if house sold, any residual balance is still owed
 - Bank cannot garnish salaries or assets without very specific/rare legal order
- Interest rate types more similar to UK than US
 - Fixed rates: 1-10 years, then reset
 - Variable rate: interest rate decided by bank policy (not necessarily market rate)
 - U.S-style ARMs: extinct today and don't feature in my sample because Irish banks funding costs far exceeded market interest rates during crisis

2011: The Dunne Judgment Removes Collateral Enforcement Rights

- 25th July 2011: unexpected legal ruling in Irish High Court
- Justice Dunne: Error in repossession law and it is void
 - Banks cannot use the law of the land to enforce collateral ...
- New law introduced on 1st December 2009 to update old legislation regarding transfer of property deeds
 - Failed to preserve the relevant parts of the old law
 - Repealed but did not replace it

The Natural Experiment

- Key feature of the ruling: loans originated *after* the introduction of the flawed law were still covered by repossession law
- Starting July 2011, loans issued before 1st December 2009 could not be lawfully repossessed
- How did nobody realise the new law was inadequate?
 - Inattention: banks rushing to issue foreclosure notices to combat rising defaults (Robinson, 2018)

Hundreds of home repossession cases may be struck out

High Court judge finds gap in 2009 land Act

FIONA GARTLAND

HUNDREDS OF property repossession cases could be struck out following a High Court ruling there was a "lacuna" – or gap – in legislation introduced in 2009.

On foot of the decision, counsel for one lender said his client would take a constitutional challenge of the Land and Conveyancing Law Reform Act 2009, which Ms Justice Elizabeth Dunne said yesterday may have had "unintended consequences".

The new Act was introduced on December 1st, 2009, and it only applied to mortgages created after that date, the judge found.

It repealed older conveyancing legislation and failed to save elements of the Registration of Title Act 1964 that would have allowed lenders to repossess properties with mortgages taken out before December 2009 that went into arrears after that date.

"It is not for the court to supply that which is not contained in the

tion of the Registration of Title Act 1964. In two of the cases, borrowers were sent demands for vacant possession of the property prior to December 1st, 2009, while in the other two, the demands were after that date.

Ms Justice Dunne ruled that legal proceedings started prior to the December date could continue.

Proceedings started after December 1st, but where a demand for possession had been made prior to the date, it could

He said there was an argument to be made about whether the Act could be valid, given it would deprive lenders of the remedy of repossession. He asked for time to consider notifying the Attorney General. The judge adjourned the case to November.

In a case taken by Bank of Ireland with a demand after the December date, the court was told the borrower was living in the US and had consented to an order for possession. Counsel for the lender asked the judge to consider making an order, given the consent.

"I can't do it and I'm not going to do it," Ms Justice Dunne said. "As far as I can see it, I have no jurisdiction to make an order. I will strike it out. I don't think there is anything else I can do in the matter."

Some 11 orders for possession were granted for older cases yesterday out of a list of 94.

These included an order granted to Start Mortgages



Ms Justice Elizabeth Dunne: "not for court to supply that which is not contained in 2009 Act"

also continue. But in cases where a demand had not been made until after the date, lenders had no right to apply for possession.

A further 24 cases involving

Loophole prompts surge in calls to mortgage group

Gartland, Fiona

The Irish Times (1921-Current File); Aug 5, 2011;

ProQuest Historical Newspapers: The Irish Times and The Weekly Irish Times
 pg. 4

Loophole prompts surge in calls to mortgage group

FIONA GARTLAND

A VOLUNTARY group that defends mortgage holders in danger of losing their homes has said it is receiving up to 50 inquiries a day following a court judgment that acknowledged a

2009. It repealed older conveyancing legislation, but failed to save elements of the Registration of Title Act 1964.

Ms Justice Dunne ruled that borrowers who went into arrears before December 1st, 2009, and received demand letters from

had been inundated with calls since the ruling.

He also acknowledged that it would be possible for the Dáil to simply amend the legislation to close the loophole.

"It would be possible for the Dáil to introduce such legislation

Research Design

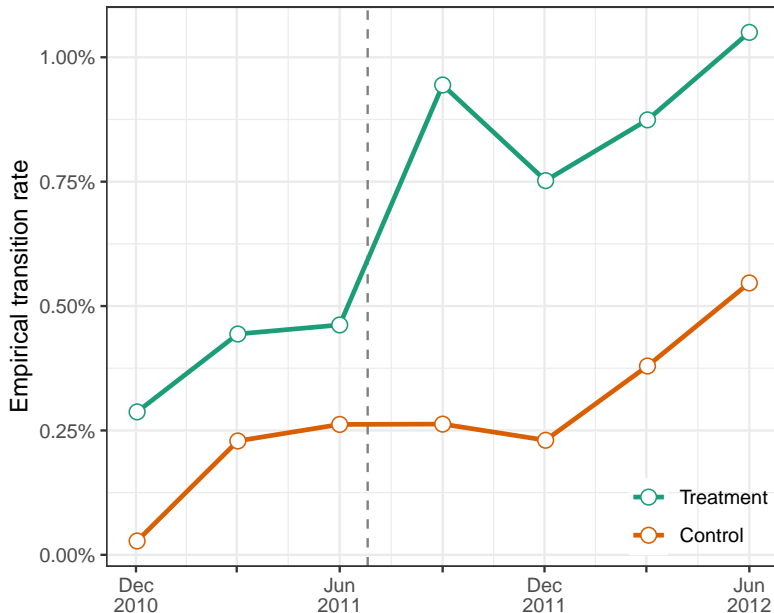
- Difference-in-difference variation created by the Dunne judgment
- Diff 1: Pre-Post July 2011
- Diff 2: Loans issued pre-post 1st December 2009

⇒ For loans in a narrow window around 1st December 2009, repossession risk is quasi-randomly removed unexpectedly on 25th July 2011

Data

- Loan-level data on Irish mortgages issued 180-days either side of the cutoff: 1st December 2009
- Quarterly panel data on default, balance, LTV, interest rate, rate type from Q3 2010- Q3 2012
 - origination information on income, age, vintage
- Loans for home purchase (no equity release)
- Treatment group: issued before 1st December 2009
- Match loans across treatment control group on first period borrower age, location, income, interest rate, LTV-at-origination
 - Drop unmatched observations
- Roughly 8000 loans, half of which receive treatment in July 2011

Default rates spiked for treated loans after Judgment



Model

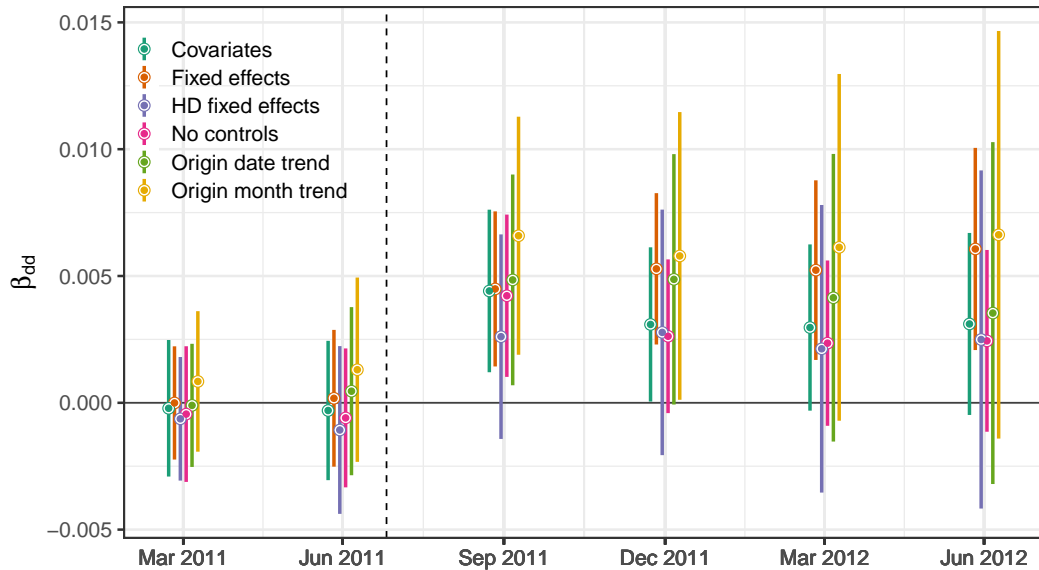
$$P(\text{default}_{ijbgrt}) = \alpha + \beta^{DD}(\text{Treatment}_j \times \text{Post}_t) + \mathbf{X}'_{it}\Psi + \phi_{rt} + \tau_{bgt} + \epsilon_{ijbgrt}$$

- Adjust for potential confounders:
 - Interest rates, interest rate types,
 - LTV and negative equity
 - Borrower region and age
 - Vintage time trends

	Default		
	(1)	(2)	(3)
Treatment	0.0021*** (0.001)	0.0001 (0.001)	
Treatment*Post	0.0034*** (0.001)	0.0040*** (0.001)	0.0048*** (0.001)
Observations	80,259	80,259	80,259
Time-varying controls	N	Y	Y
Time FE	N	Y	-
Loan FE	N	N	Y
Region*RateType*Time FE	N	N	Y
Vintage trend	N	N	Y

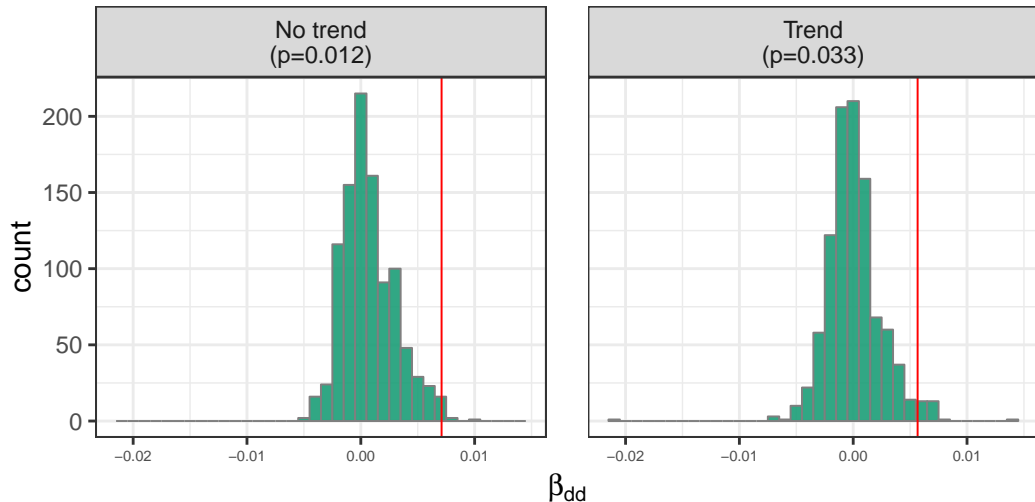
*p<0.1; **p<0.05; ***p<0.01

Event study coefficients



Permutation Inference

- Randomly choose other cut-off dates and repeat (X1000)



Mechanisms

- Liquidity or strategic default?
- Depending on which, policy implications are different
- Incomplete insurance markets or imperfect mortgage contracts, liquidity default means high marginal utility borrowers getting payment relief
- Strategic default: home no longer a good investment, can't even be repossessed so stop paying (pure moral hazard)

Mechanisms

- For a small sample (1347) loans, I can measure borrower's liquid account balance in 6-months prior to event
 - within same bank
- 2 triple-diff regressions
 1. Terciles of liquid wealth distribution
 2. Terciles of loan-to-value distribution

	(1)	(2)
Treated \times Post	-0.0046 (0.372)	0.015 (0.005)
Treated \times Post \times LTV T2	-0.0115 (0.119)	
Treated \times Post \times LTV T3	0.0198 (0.008)	
Treated \times Post \times Account Balance T2		-0.0102 (0.171)
Treated \times Post \times Account Balance T3		-0.0166 (0.026)
<i>Obs</i>	7998	7998

Conclusion

- Estimated treatment effect of removing repossession risk on default: 0.3pp increase in quarterly default rate
- Liquidity or moral hazard? Seems to be both
 - Effect driven by low liquid wealth borrowers
 - Also by highest LTV borrowers