

Homeowners with Jumbos Pose Greatest Risk of Strategic Default

A new national telephone interview study indicates who mortgage lenders need to worry about the most: Prime jumbo borrowers with good FICO scores are now the most likely to opt for a strategic default and walk away from their homes.



Background

- Moody's and FICO reported in the Wall Street Journal that mortgage lenders need to worry the most about: Prime jumbo borrowers with good FICO scores, who are underwater and can afford to pay their mortgage are now the most likely to opt for a strategic default and walk away from their homes.
- FICO went further to say that the risk of strategic default among these upside down prime borrowers is a growing problem and even a greater risk than that of subprime borrowers.
- FICO also reported that there are now more than 12 million mortgages that are now underwater and 30% of all defaults are strategic.
 - A strategic default is the decision by a borrower to stop making payments (i.e., to default) on a debt despite having the financial ability to make the payments.
 - This is particularly associated with residential mortgages, in which case it usually occurs after a substantial drop in the house's price such that the debt owed is (considerably) greater than the value of the property — the property has negative equity or is "underwater" — and is expected to remain so for the foreseeable future, such as following the bursting of a real estate bubble. Such borrowers are called "walk-a-ways." A strategic default is the decision by a borrower to stop making payments (i.e., to default) on a debt despite having the financial ability to make the payments.



The Strategic Default Challenge

- At MEG we have studied the Moody's and FICO projections about underwater "prime" borrowers and have decided to subject it to a national empirical research study.
- The study includes 800 telephone interviews conducted nationally among underwater mortgage borrowers who had to meet the following criteria:
 - Have a jumbo (non-conforming) mortgage.
 - Report that they had a FICO score of 700 or higher.
 - Purchased their home in the past six years.
- The 800 telephone interviews (sampling error +/- 3.5%) were divided into two groups:
 - 400 surveys in non-recourse states (sampling error +/- 5.0%)
 - 400 surveys in recourse states (sampling error +/- 5.0%)
- Survey respondents were read the definition of strategic default (see previous slide).



Issues Addressed in the Research

- Whether they lived in a recourse (38) or non-recourse state (12).
 - Distinguishing whether it is recourse debt or non-recourse debt, meaning whether the mortgage lender can pursue claims against the defaulted debtor beyond their home.
- Whether they are:
 - Current on their mortgage
 - Current on non-mortgage debt
 - Executing a strategic default
 - Planning a strategic default
 - Have or plan to get professional advice about a strategic default
 - Believe they can afford their current mortgage



Anti-Deficiency / Non-Recourse States

- **The 12 Anti-Deficiency / Non-Recourse States are:**
 1. Alaska
 2. Arizona
 3. California
 4. Connecticut
 5. Florida
 6. Idaho
 7. Minnesota
 8. North Carolina
 9. North Dakota
 10. Texas
 11. Utah
 12. Washington
- **The top 10 states based on percentage of foreclosures are:**
 10. Colorado
 9. Oregon
 8. Idaho
 7. Illinois
 6. Georgia
 5. Michigan
 4. Florida
 3. Arizona
 2. California
 1. Nevada

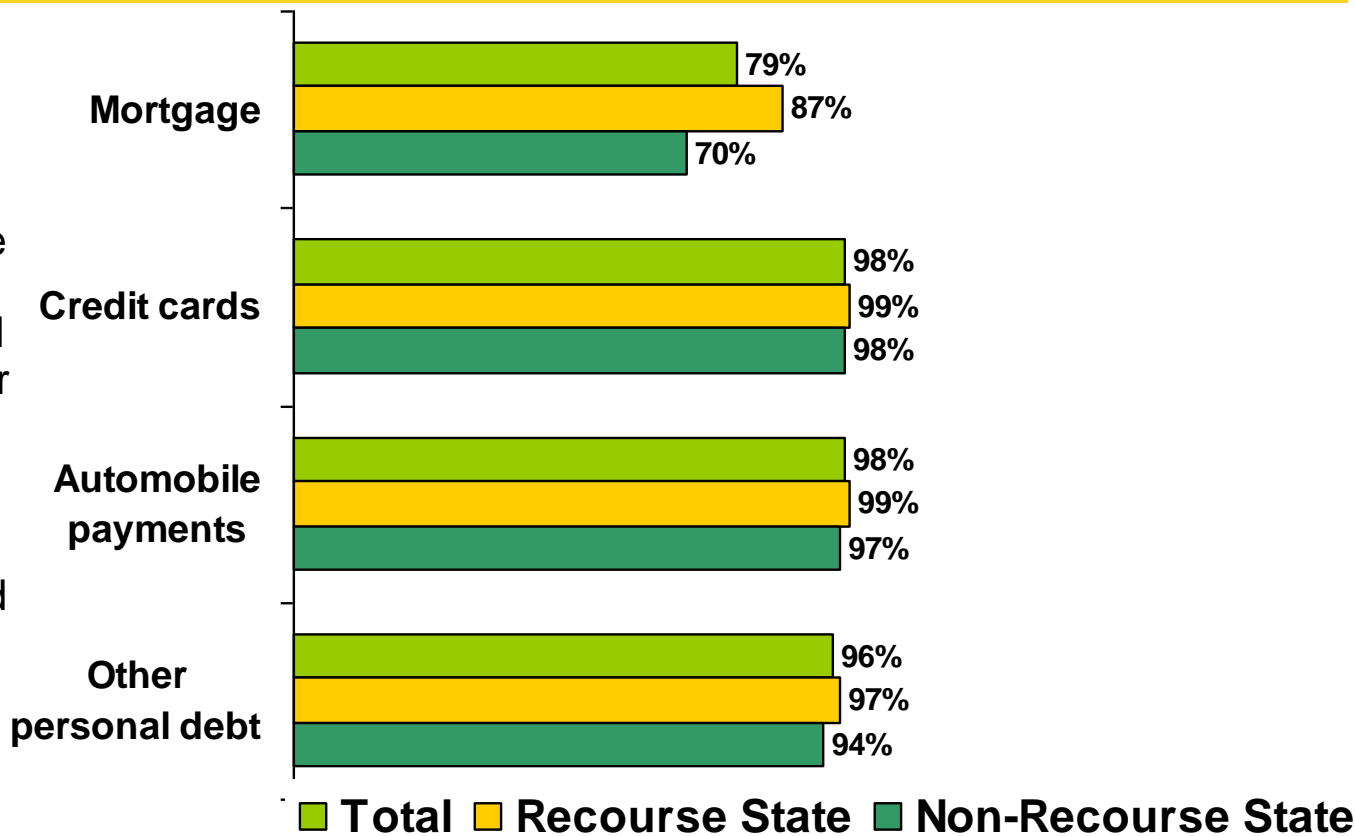


Status on Current Mortgage and Other Consumer Debt



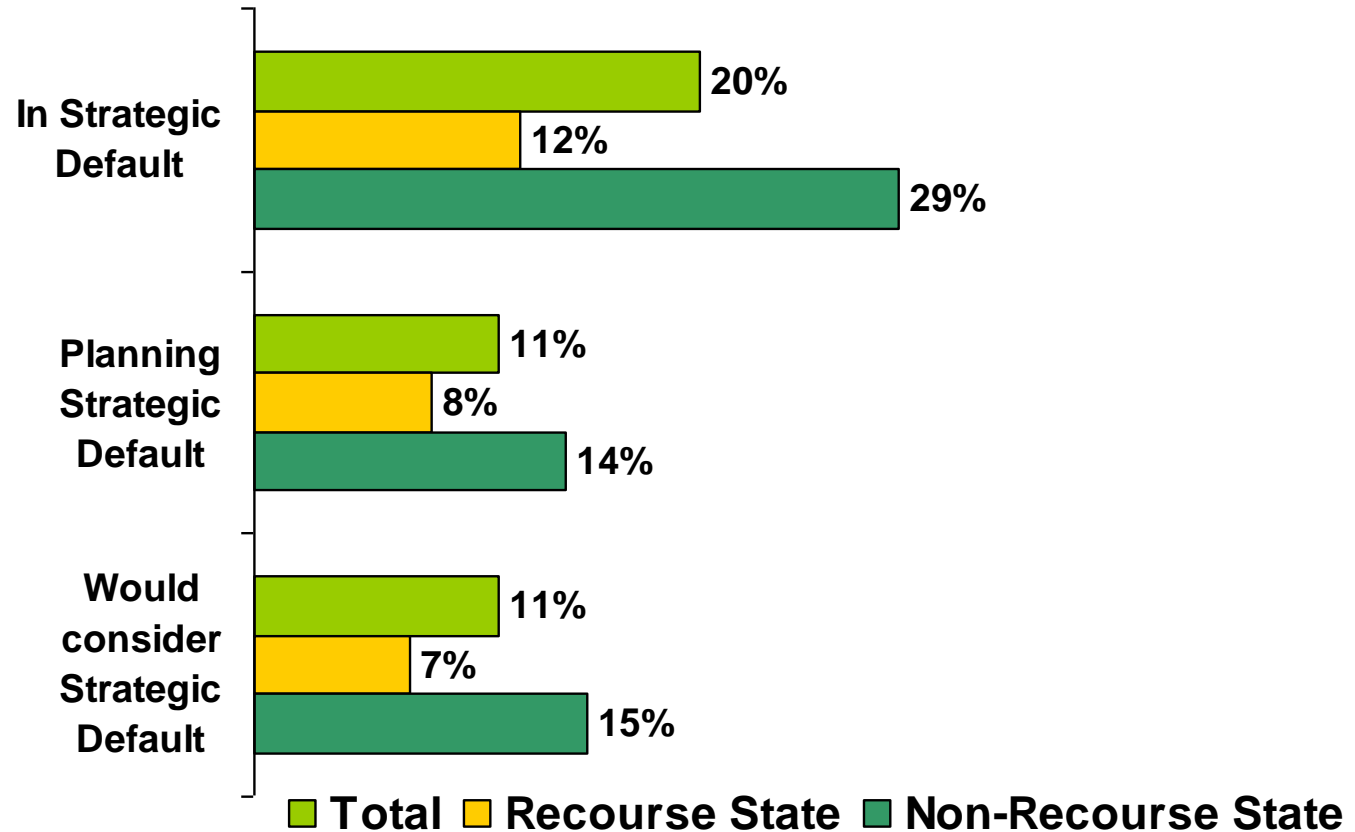
Status on Current Mortgage and Other Consumer Debt

- “Yes” responses only.
- These underwater prime borrowers are almost universally current on all non-mortgage consumer debt.
- Mortgage delinquencies by an over two to one margin are concentrated in the 12 non-recourse states.

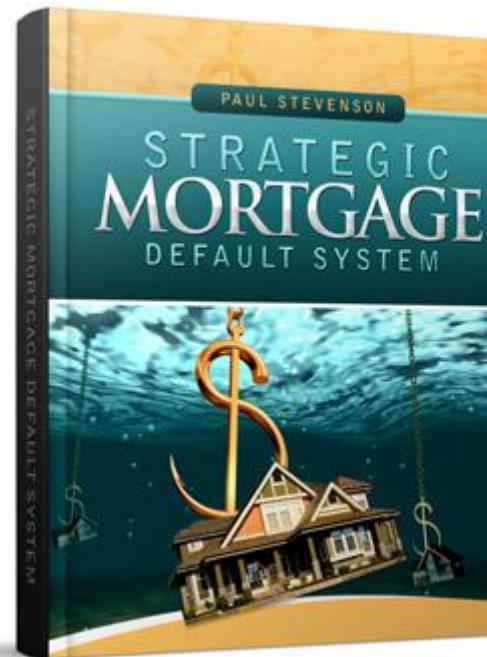


Strategic Default Status

- One in five of underwater homeowners are in a strategic default.
- Strategic defaults, those planning one, and those willing to consider one are concentrated in non-recourse states.
- The near-term threat of strategic defaults comes from those already in and those already planning for one (31%).



Strategic Default Behavior and Attitudes



Strategic Default Behavior

	In Strategic Default	Planning Strategic Default	Would consider Strategic Default
Yes responses only			
Have or plan to get professional about a strategic default	72%	78%	16%
Have tried to refinance their mortgage to make it more affordable	61%	42%	33%
How many months do you think it will be before you are or would be foreclosed on (mean)	20	18	12
Plan to buy or rent another residence before defaulting or being foreclosed on	93%	94%	99%
Can afford your current mortgage	82%	84%	98%



Strategic Default Attitudes and Behaviors

	In Strategic Default	Planning Strategic Default	Would consider Strategic Default
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Strategic Default Attitudes

	In Strategic Default	Planning Strategic Default	Would consider Strategic Default
Yes responses only			
Believe there is anything that is morally wrong with defaulting on a mortgage	2%	3%	5%
Believe you have been treated fairly by your mortgage lender	51%	43%	76%
Have contacted a REALTOR® to get a market evaluation of the price of your home	79%	82%	31%
Have checked out the value of your home on Zillow or another online source	83%	91%	52%
Feel you have a pretty good idea about what your home is worth	87%	91%	83%



Reasons for Considering or Doing a Strategic Default

Multiple unaided responses. <u>Selected listing of most frequent responses.</u>	In Strategic Default	Planning Strategic Default	Would consider Strategic Default
Home is not worth the size of the mortgage	87%	91%	62%
Home will not regain its lost value in the foreseeable future	71%	69%	57%
Can buy basically the same home for a fraction of the cost	52%	55%	41%
Lender rejected short sale terms	52%	51%	23%
Save money before being foreclosed on	36%	39%	23%



Background on Strategic Default Homeowners



Annual Household Income

	In Strategic Default	Planning Strategic Default	Would consider Strategic Default
Under \$50K	0%	3%	9%
\$50K to \$74.9K	23%	24%	31%
\$75K to \$99.9K	32%	31%	35%
\$100K or more	45%	42%	25%



Education

	In Strategic Default	Planning Strategic Default	Would consider Strategic Default
High school or less	0%	0%	0%
Some college or trade school	12%	10%	15%
Bachelor's degree	52%	56%	51%
Advanced degree	36%	34%	34%

Key Conclusions



Fortunately, debtors no longer face prison time, as they did in nineteenth-century London, but shouldn't they pay when they can afford to?

Key Conclusions

- Strategic defaults and the risk of same are heavily concentrated in the Anti-Deficiency / Non-Recourse States .
- Under water strategic defaulters are:
 - Higher income
 - Very well educated
 - Largely current on all consumer credit except their mortgage

Key Conclusions

- These prime jumbo borrowers with good FICO scores are now most likely to opt for a strategic default and walk away from their homes because:
 - They have made a well thought out calculated decision, “not” because of need – they can almost all afford their mortgage.
 - Most have sought out professional advice.
 - They believe they can basically live for free for upwards of 20 months and pocket the savings.
 - They know their house is not worth anywhere near their mortgage.
 - They have gone online and/or consulted a REALTOR® and believe they know what their home is worth and that it will not recover for the foreseeable future, if ever.
 - They believe there is nothing morally wrong with a strategic default – it is basically a straight financial calculation.

