The Missing Housing Policy? The Impact of Mortgage Cram-down on Foreclosures

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Research Proposal

"If we can help Wall Street, folks, we sure can help Silver Springs Boulevard right here in Ocala. That's why we believe we should reform our bankruptcy laws, giving bankruptcy judges the authority to reduce the amount of principal owed, give them the authority to go out and reset the terms of the mortgage so people can stay in their homes." Joseph Biden (2008)

The U.S. experienced an unprecedented number of home foreclosures during the housing crisis. The government implemented various policies to reduce the amount of defaults, including programs that offered compensation to intermediaries for modifying underwater mortgages. However, these initiatives were mostly unsuccessful due to several frictions; among those were that securitization made the renegotiation difficult, and servicers' organizational capacity also affected the intensity of modifications (Agarwal et al., 2017).

To allow for involuntary modifications, one proposal put forth was the allowance of mortgage cram-downs by judges in Chapter 13 bankruptcy. In this case, the underwater portion of mortgage loans would be treated as unsecured loans and therefore dischargeable in bankruptcy.[1] In fact, the cram-down proposal passed the House of Representatives in 2008 but failed to achieve the requisite votes for cloture in the Senate.

In this project, we will provide the first evidence on the impact of Chapter 13 bankruptcy cram-downs on mortgage default. In particular, our study has the following objectives: 1) estimate the ex-post effects of cram-down in Chapter 13 on foreclosure, 2) study the heterogeneity in post-filing effects across filer characteristics, and 3) quantify how many foreclosures would have been prevented in

[1] Barack Obama sponsored mortgage cram-down legislation as a U.S. senator and endorsed it as a presidential candidate.

the Great Recession if the cram-down proposal had been implemented by extrapolating the estimates in a partial equilibrium analysis. In particular, it is of interest to compare the estimates from the Chapter 13 bankruptcy cram-down program with applied programs, such as the Home Affordable Modification Program (HAMP).

The research design uses the following: first, most bankruptcy courts use a blind rotation system to assign cases to judges, this allows us to exploit differences in judge discharge rates as an instrumental variable for Chapter 13 bankruptcy protection (Dobbie and Song, 2015; Dobbie et al., 2017). Second, between 1978 and 1993, a series of U.S. Court of Appeals decisions introduced the mortgage cram-down under federal bankruptcy law. However, in 1993 the Supreme Court declared the practice impermissible under the law. Using an instrumental variable design, the empirical strategy will estimate the ex-post effect of Chapter 13 bankruptcy cram-down on foreclosure in those district courts during periods in which cram-downs were allowed.

To this end, we have collected bankruptcy docket data from dozens of bankruptcy courts from the Public Access to Court Electronic Records system (PACER); the dockets contain bankruptcy cases since the 1980s. Subsequently, we will match this bankruptcy dataset with data from providers like CoreLogic or RealtyTrac to study mortgage default. In addition, we plan to match the docket data with public record information to obtain other filer characteristics (e.g., age).

This project is related to several strands of the literature. By analyzing the ex-post effect of cram-down thorough the consumer bankruptcy system, this project complements Goodman and Levitin (2014) and Li et al. (2014) who study the ex-ante effects on mortgage cram-down. The former find that when cram-down was allowed, home loans had interest rates were 16 basic points higher, and the latter find that when the Supreme Court abolished mortgage cram-down, this led to a reduction of 300 basic points in mortgage interest rates.

A main contribution of this project relative to Dobbie and Song (2015) and Dobbie et al. (2017) is that we estimate the effect of secured debt-relief (cram-down) from Chapter 13 protection on mortgage default to evaluate an important proposal from the housing crisis, while Dobbie and Song (2015) and Dobbie et al. (2017) focused on the effect of unsecured debt-relief from Chapter 13 protection. To this end, we will employ a new data set constructed for the purposes of this project to link bankruptcy docket data from the 1980s to deed and public records to estimate the reduced-form effect of mortgage cram-down on ex-post foreclosure.[2] We believe that our project is the first to provide credible estimates of the ex-post impact of cram-down from Chapter 13 on mortgage default.

This paper complements the literature that evaluates changes in debt obligations thorough modifica-

[2]Dobbie and Song (2015) and Dobbie et al. (2017) used data from 1992 and 2002, respectively.

tions, such as HAMP (e.g., Agarwal et al., 2017) and refinancing programs, such as the Home Affordable Refinancing Program (HARP) (e.g., Tracy and Wright, 2016; Agarwal et al., 2017; Abel and Fuster, 2018). Our project contributes to this literature by evaluating an alternative housing policy: secured debt relief through the consumer bankruptcy system. Besides allowing for involuntary modifications, another advantage of the mortgage cram-down proposal is that the bankruptcy system could potentially have handled a higher number of modification cases, while the servicers were capacity-constrained and unable to increase capacity (e.g., HAMP reached one-third of its targeted indebted households).

References

Abel, Joshua and Andreas Fuster, "How do mortgage refinances affect debt, default, and spending? Evidence from HARP," *Evidence from HARP (February, 2018). FRB of New York Staff Report*, 2018, (841).

Agarwal, Sumit, Gene Amromin, Itzhak Ben-David, Souphala Chomsisengphet, Tomasz Piskorski, and Amit Seru, "Policy intervention in debt renegotiation: Evidence from the home affordable modification program," *Journal of Political Economy*, 2017, *125* (3), 654–712.

Dobbie, Will and Jae Song, "Debt relief and debtor outcomes: Measuring the effects of consumer bankruptcy protection," *American Economic Review*, 2015, *105* (3), 1272–1311.

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Goodman, Joshua and Adam Levitin, "Bankruptcy law and the cost of credit: The impact of cramdown on mortgage interest rates," *The Journal of Law and Economics*, 2014, *57* (1), 139–158.

Li, Wenli, Ishani Tewari, and Michelle J White, "Using Bankruptcy to Reduce Foreclosures: Does Strip-down of Mortgages Affect the Supply of Mortgage Credit?," Technical Report, National Bureau of Economic Research 2014.

Tracy, Joseph and Joshua Wright, "Payment changes and default risk: The impact of refinancing on expected credit losses," *Journal of urban Economics*, 2016, *93*, 60–70.

Itemized Budget

- Total $ 12,000
- Travel $ 3,000
- Data acquisition $ 9,000
  - Deed records from Realtytrac or Corelogic: $7,000. We estimate that the cost per match from Realtytrac or Corelogic is going to be between $0.1 to $0.2, and we expect to have around 35,000 Chapter 13 filers in district courts and periods in which cram-downs were allowed and in areas with geographical coverage by the data providers.
  - Public Records Data: $2,000. The annual subscrition to a service such as Lexis Nexis is around $2,000

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ACADEMIC EMPLOYMENT

University of Minnesota - Carlson School of Management. *Minneapolis, MN*
Assistant Professor of Finance, July 2018-Present

EDUCATION

The University of Texas at Austin - McCombs School of Business. *Austin, TX*
Ph.D. in Finance, 2018

The University of Texas at Austin - McCombs School of Business. *Austin, TX*
M.S. in Finance, 2014

Instituto de Estudios Superiores de Administracion (IESA). *Caracas, Venezuela*
M.B.A, 2007 (Highest Honors)

Universidad de Carabobo. *Valencia, Venezuela*
B.A. in Economics, 2005 (Valedictorian)

RESEARCH INTERESTS

Corporate Finance, Household Finance, Financial Intermediation, FinTech

WORKING PAPERS

Heterogeneous Sensitivities to Interest Rate Changes: Evidence from Consumer Loans

The "Jackpot" Question: How Do Cash Windfalls Affect Small Business Growth? with Xing Huang and Carlos Parra

Almost Famous: How Wealth Shocks Impact Career Choices with Zack Liu and Carlos Parra

Peer Effects Across Firms: Evidence from Security Analysts with Carlos Parra

PRESENTATIONS

2020: Harvard Business School (scheduled), London Business School (scheduled), MFA (scheduled), FIRS (scheduled), Showcasing Women in Finance (scheduled), UConn Finance Conference (scheduled), IZA Junior/Senior Symposium (scheduled), EALE/SOLE/AASLE World Conference (scheduled), UAB Personal Finance Symposium (scheduled)

2019: NBER SI (Entrepreneurship), Conference on Household Finance at NYU, FIRS, Northeastern Finance Conference, NFA*, ECWFC meeting at the WFA, 16th Finance UC Conference*, Showcasing Women in Finance (EU)*, Minnesota Junior Conference, UT Dallas Finance Conference*, PUC-Chile, Universidad Adolfo Ibanez

2018: Baruch College, BI Norwegian Business School, Bocconi University, CICF**, College of William & Mary, FED Board, FMA, ITAM, McGill University, MFA*, Nova SBE, PUC-Chile, Purdue University, Showcasing Women in Finance, SMU, Universidad de los Andes-Chile, University of Georgia, University of Houston, University of Minnesota

2017: EFA, Colorado Finance Summit (Ph.D. Session), Corporate Finance Conference at Washington University in St. Louis (Ph.D. Poster Session), SOLE*, FMA Ph.D. Paper Presentation Session and Doctoral Student Consortium, Trans-Atlantic Doctoral Conference at London Business School, Whitebox Advisors Graduate Student Conference, AFA Ph.D. Poster Session

2016: Trans-Atlantic Doctoral Conference at London Business School

2015: Annual IZA European Summer School in Labor Economics

(*presented by co-author) (**discussant)

HONORS AND AWARDS

WFA-CFAR Award in Honor of Prof. Stuart I. Greenbaum, Washington University in St. Louis 2017

DSG Tuition Scholarship, University of Texas, 2016

Professional Development Award, University of Texas, 2016

Bonham Eugene & Dora Mem Fund, University of Texas, 2015

Ph.D. Fellowship Scholarship, University of Texas, 2012-2017

Heinz Award, IESA, 2007

Dean's Award, Universidad de Carabobo, 2005

TEACHING

Instructor: Finance Fundamentals, Spring 2019

Overall Evaluation: 5.6/6.0

Investment Management, Summer 2015

Overall Evaluation: 4.2/5.0

ADDITIONAL INFORMATION

Languages: Spanish (native), English (fluent)

Computing Skills: Stata, MATLAB, Python

January 2020

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ACADEMIC EMPLOYMENT

Catholic University of Chile (PUC), Business School.
Assistant Professor of Finance (2019 - present)

Instituto Tecnológico Autónomo de México (ITAM), Business School.
Assistant Professor of Finance (2016 - 2018)

EDUCATION

The University of Texas at Austin, McCombs School of Business. Austin, TX.
Ph.D. in Finance, 2016

Instituto de Estudios Superiores de Administración (IESA). Caracas, Venezuela.
M.S. in Finance, 2007 (Highest Honors)
M.B.A., 2006 (Highest Honors)

Universidad de Carabobo. Valencia, Venezuela.
B.A. in Economics, 2004

RESEARCH INTERESTS

Corporate Finance, Household Finance, Financial Intermediation.

WORKING PAPERS

Capital Mobility and Regulation Frictions: Evidence from U.S. Lottery Winners

How Does Consumer Bankruptcy Protection Impact Household Outcomes?

The 'Jackpot' Question: How Do Cash Windfalls Affect Small Business Growth? (with Jacelly Cespedes and Xing Huang)

Almost Famous: How Wealth Shocks Impact Career Choices (with Jacelly Cespedes and Zack Liu)

Peer Effects across Firms: Evidence from Security Analysts (with Jacelly Cespedes)

HONORS AND AWARDS

PhD Paper Award in Honor of Stuart Greenbaum, Olin Business School, Washington University in St. Louis, 2015.

Finance Department Nomination for Fred Moore Assistant Instructor Award, 2015.

Travel Grant, European Economic Association, 2015.

Ph.D. Fellowship Scholarship, University of Texas at Austin, 2010-2015.

PricewaterhouseCoopers Award, IESA, 2007.

Heinz Award, IESA, 2006.

Dean's Award, Universidad de Carabobo, 2004.

Graduate Fellowship, Gran Mariscal Ayacucho, 2003.

CONFERENCE PRESENTATIONS

2020: Financial Intermediation Research Society Conference (scheduled), Midwest Finance Association (scheduled), IZA Junior/Senior Symposium (scheduled), EALE/SOLE/AASLE World Conference (scheduled), UAB Personal Finance Symposium (scheduled), Showcasing Women in Finance (scheduled).

2019: NBER Summer Institute (Entrepreneurship)*, Northeastern Finance Conference*, NYU Conference on Household Finance*, UTD Finance Conference*, Northern Finance Association*, Community Banking in the 21st Century Research Conference, PUC International Conference, University of Minnesota Junior Conference*, Showcasing Women in Finance*.

2018: Western Finance Association, Midwest Finance Association, FMA Annual Meeting*.

2017: ASSA-AREUEA, Society of Labor Economics Annual Meeting, FMA Latin American Conference.

2016: Finance Research Association Annual Meeting, Financial Intermediation Research Society Conference, Indian School of Business CAF Summer Research Conference, Boulder Summer Conference on Consumer Financial Decision Making, American Law and Economics Association Meeting, Annual Conference on Empirical Legal Studies.

2015: European Economic Association, IZA European Summer School in Labor Economics*, LBS Transatlantic Doctoral Conference, Olin Corporate Finance Conference (poster session).

* Presentation by co-author.

DISCUSSIONS

PUC International Conference, 2019

China International Conference in Finance (CICF), 2018

FMA Latin American Conference, 2017

American Law and Economics Association Meeting (2x), 2016

Annual Conference on Empirical Legal Studies, 2016

LBS Transatlantic Doctoral Conference, 2015

TEACHING EXPERIENCE

Instructor, Corporate Finance, PUC Chile.

Instructor, Corporate Finance, ITAM.

Instructor, Business Finance (Summer 2013), University of Texas at Austin.

Teaching Assistant (2010-2016), University of Texas at Austin.

Corporate Finance Theory (PhD), Advance Corporate Finance (MBA), Investment Management (Undergraduate)

NON ACADEMIC POSITION

Corporate Finance Associate, Mercantil Servicios Financieros (Financial Holding). Caracas, Venezuela (2007-2010).

ADDITIONAL INFORMATION

Languages: English (fluent), Spanish (native).
Computing Skills: MATLAB, Python, Stata.
Citizenship: Venezuela (U.S. Permanent Resident).

MEDIA COVERAGE

Capital Mobility and Regulation Frictions: Evidence from U.S. Lottery Winners

Fox Business, National Affairs, Dawn, Gestion.

REFERENCES

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