

Foreclosure's Wake

The Credit Experiences of Individuals Following Foreclosure

Kenneth P. Brevoort
Federal Reserve Board

Cheryl R. Cooper
The Urban Institute

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The views expressed are those of the authors and do not necessarily represent those of the Federal Reserve Board or its staff.

- Foreclosures lower credit scores and consequently reduce future access to credit
- Very little is known about the size of these declines or how long they last
- We examine the impact that foreclosure has on credit scores and how long it takes individuals to recover
 - Also examine how individuals perform on their credit obligations before and after foreclosure

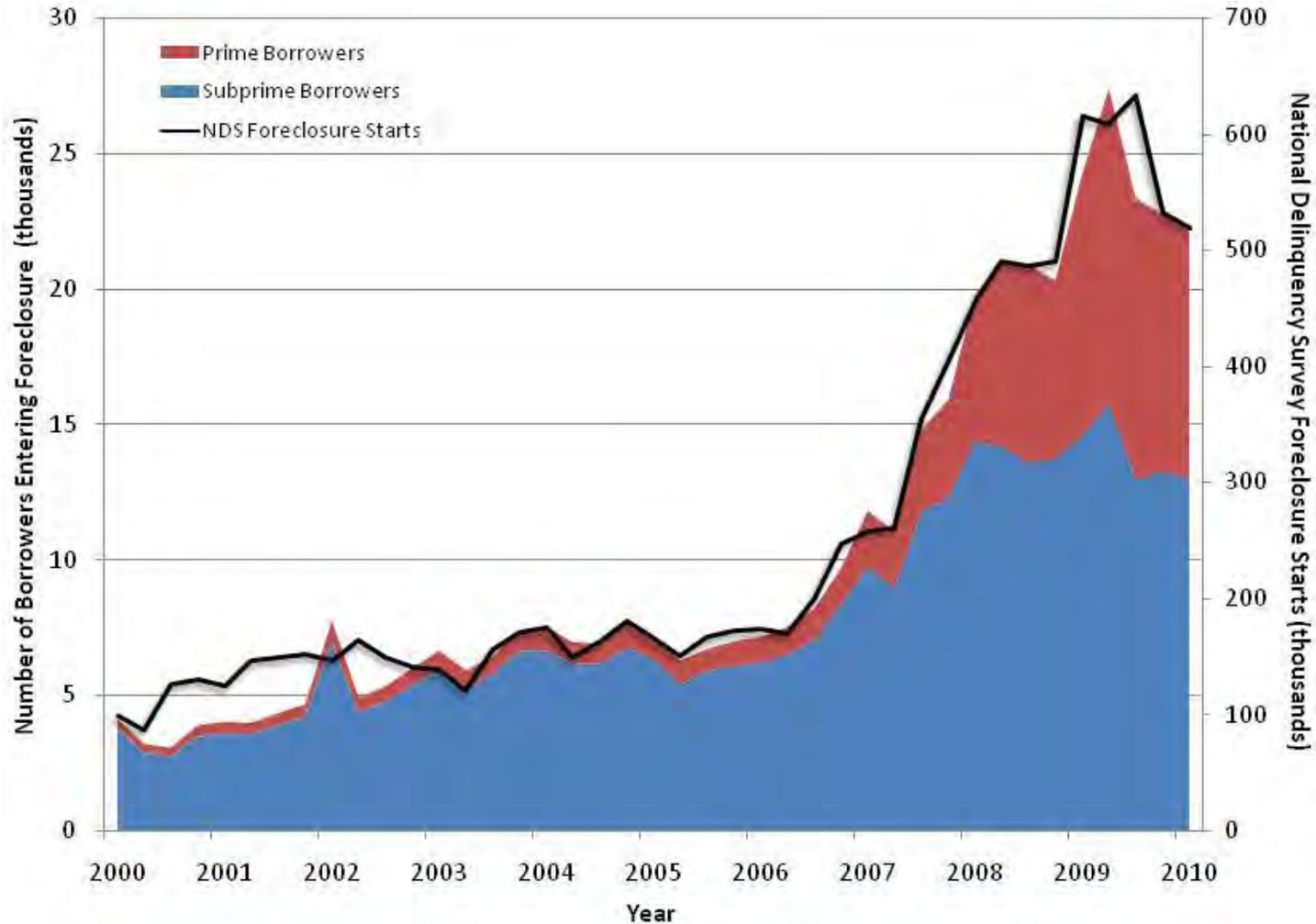
- Lower neighborhood property values
 - Harding, Rosenblatt, & Yao (2009); Immergluck & Smith (2006b); Lin, Rosenblatt, & Yao (2009); Leonard & Murdoch (2009); Mikelbank (2008); Schuetz, Been, & Ellen (2008); Rogers & Winter (2009)
- Increase violent crime rates
 - Immergluck & Smith (2006a)
- Impose substantial costs on local governments
 - Apgar, Duda, and Gorey (2005)

Data – Foreclosure Sample



- Anonymous credit records from Equifax
 - Observed quarterly from 1999Q1 – 2010Q1
- 345,360 individuals whose mortgage entered foreclosure during 2000-2009
- Definitions:
 - “Foreclosure Period” – quarter in which mortgage enters foreclosure
 - “Pre-delinquency Period” – quarter before foreclosure when record last free of mortgage delinquency

Foreclosure Starts by Quarter

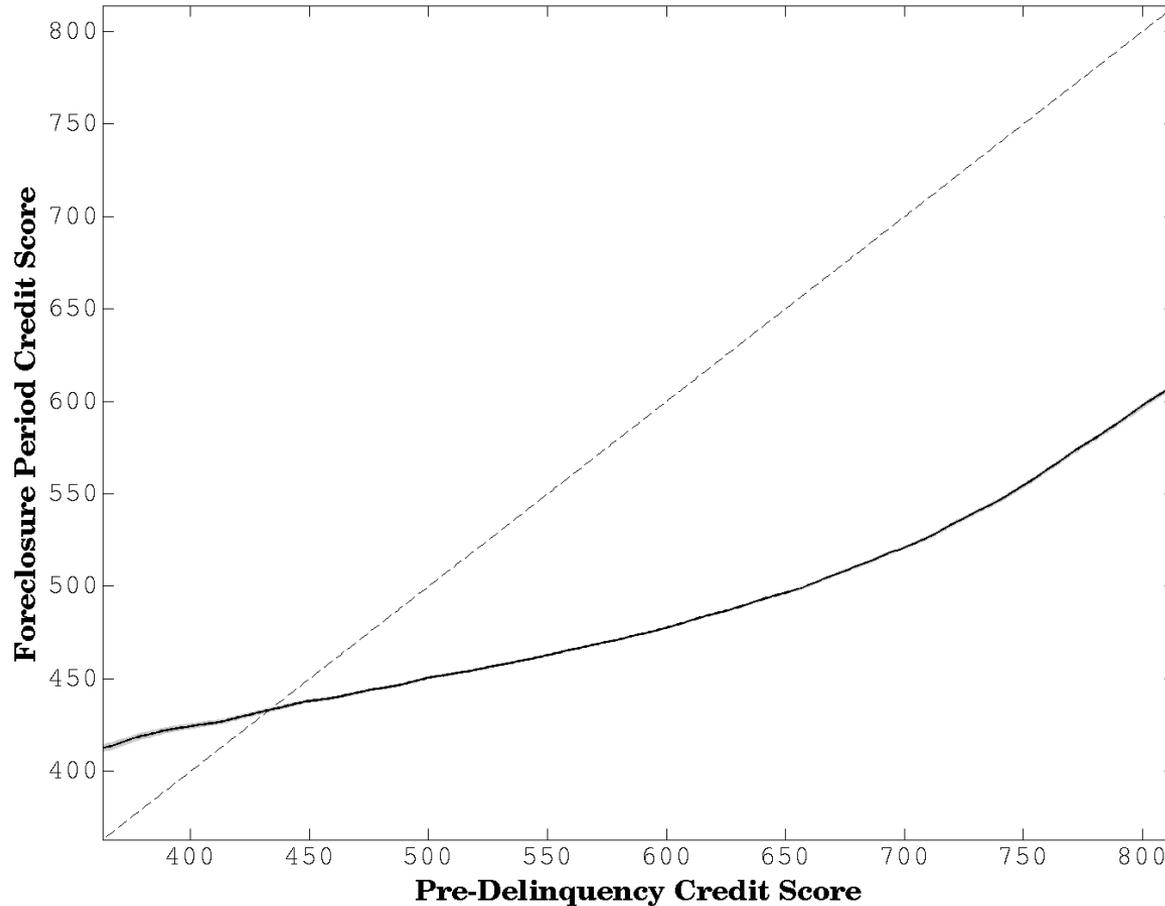


Credit Score Declines Accompanying Foreclosure

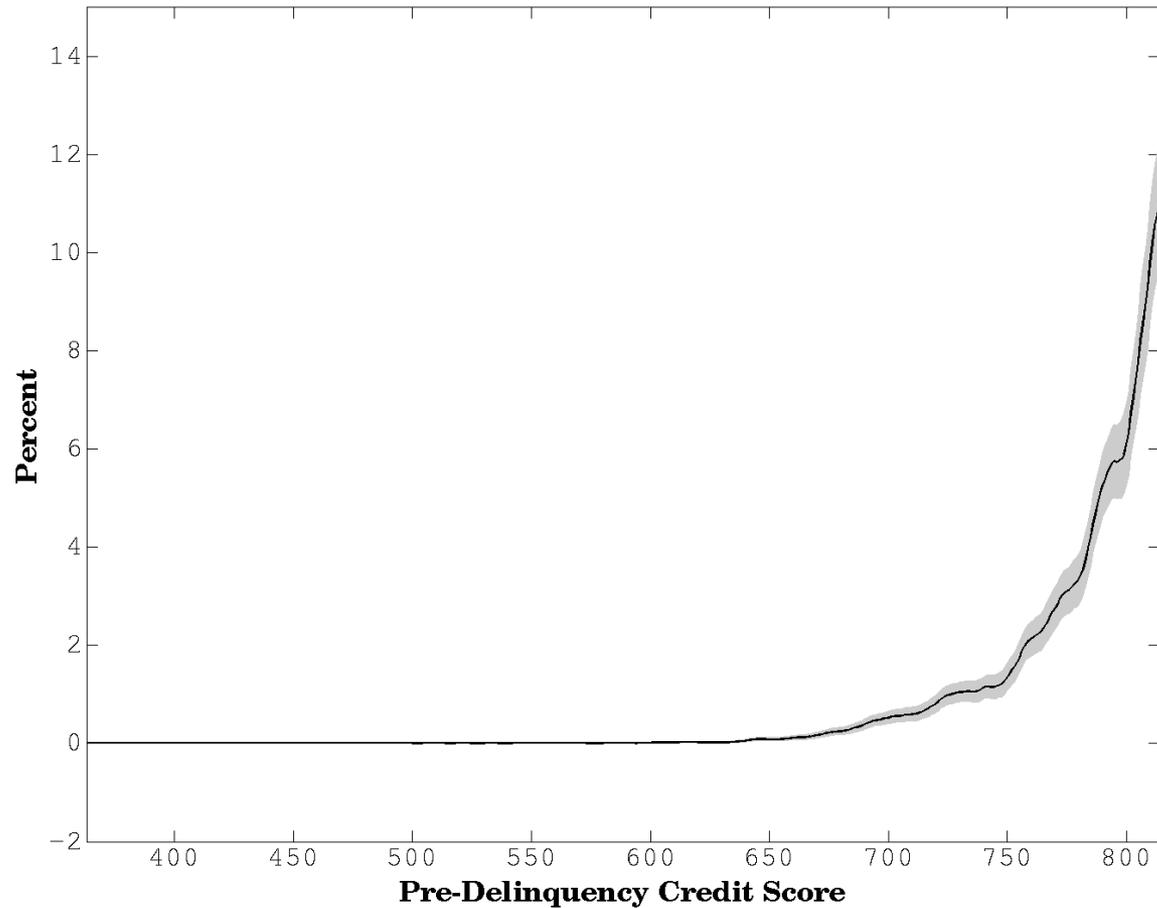


- Little is known about the size of declines
 - Models are proprietary
- FICO information suggests scores fall
 - 85 points for borrower with score of 680
 - 160 points for borrower with score of 780
- Simulated score changes based on adding foreclosure in isolation

Score Changes Around Foreclosure

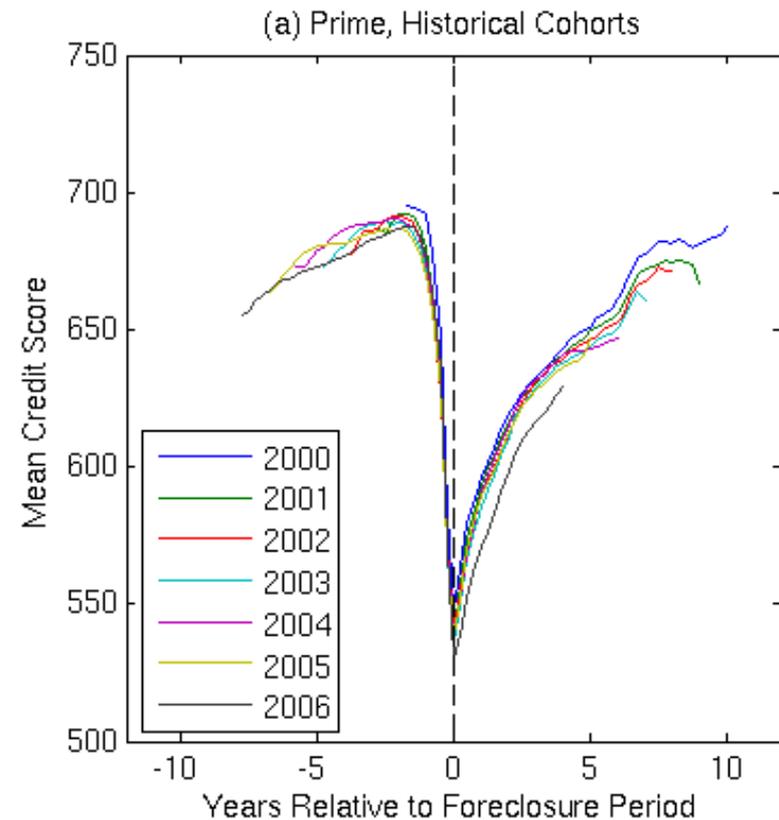
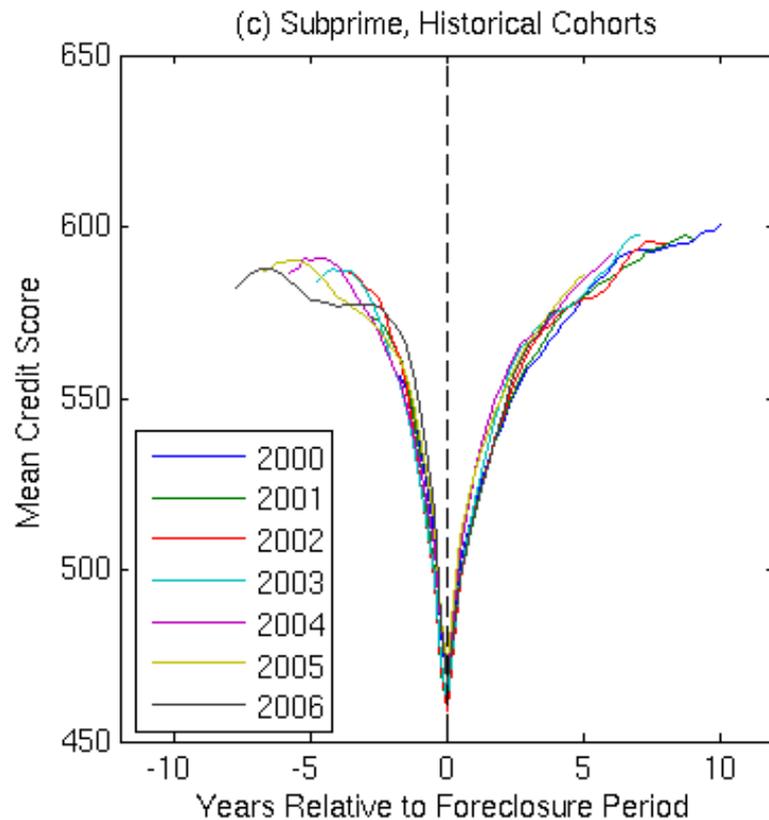


Share With Prime Credit Scores in Foreclosure Period

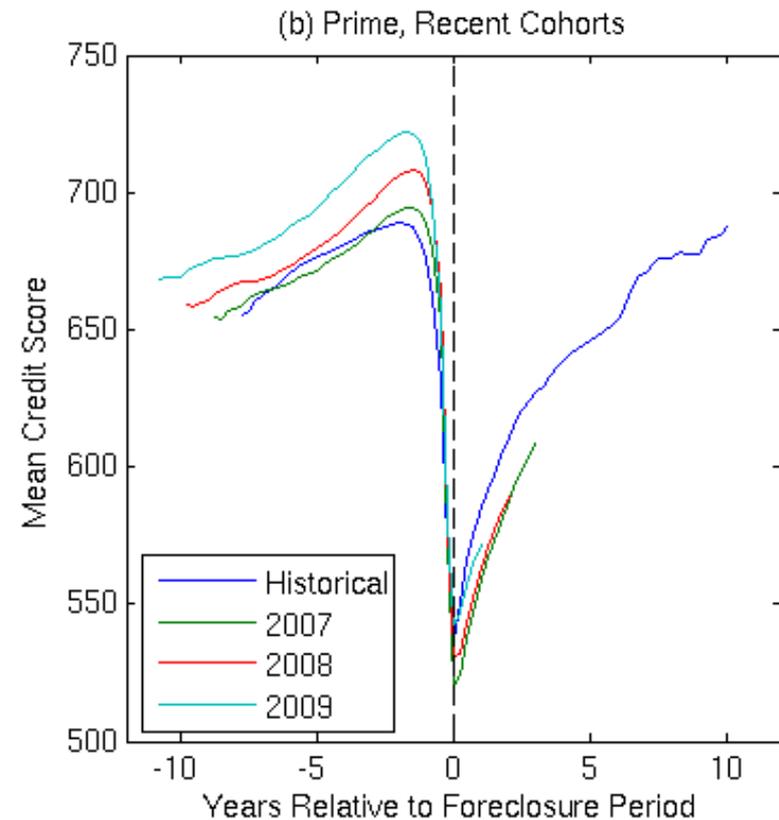
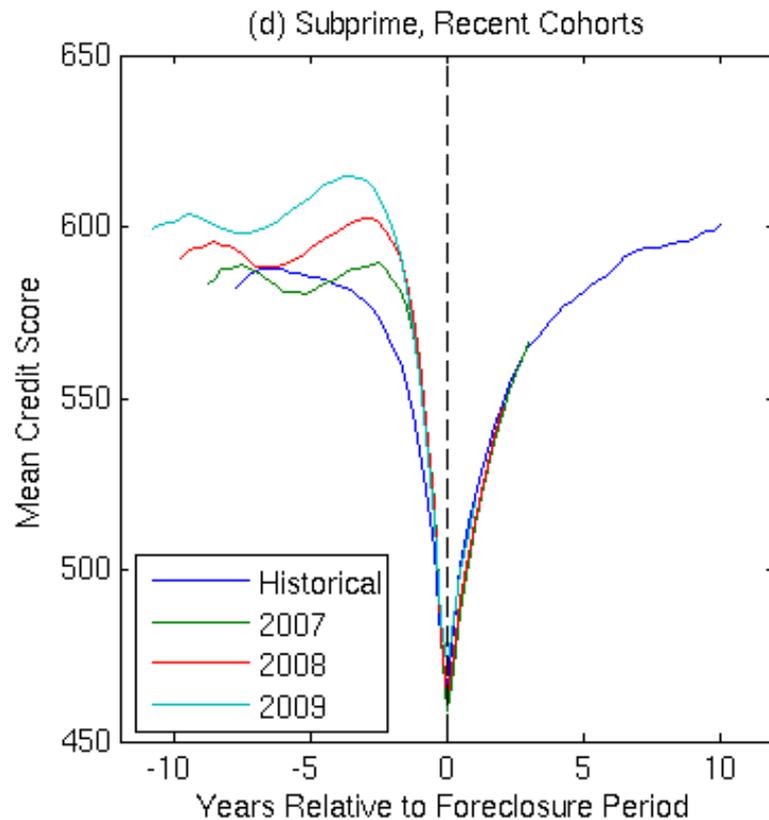


- Lower credit scores accompanying foreclosure will reduce access to credit
- How long do these reductions last? Possibly not long:
 - FICO suggests scores may recover after 2 years
 - VantageScore simulations indicate recovery may take as few as 9 months
 - Information about foreclosure removed from credit record after 7 years

Mean Credit Scores, Historical Cohorts



Mean Credit Scores, Recent Cohorts

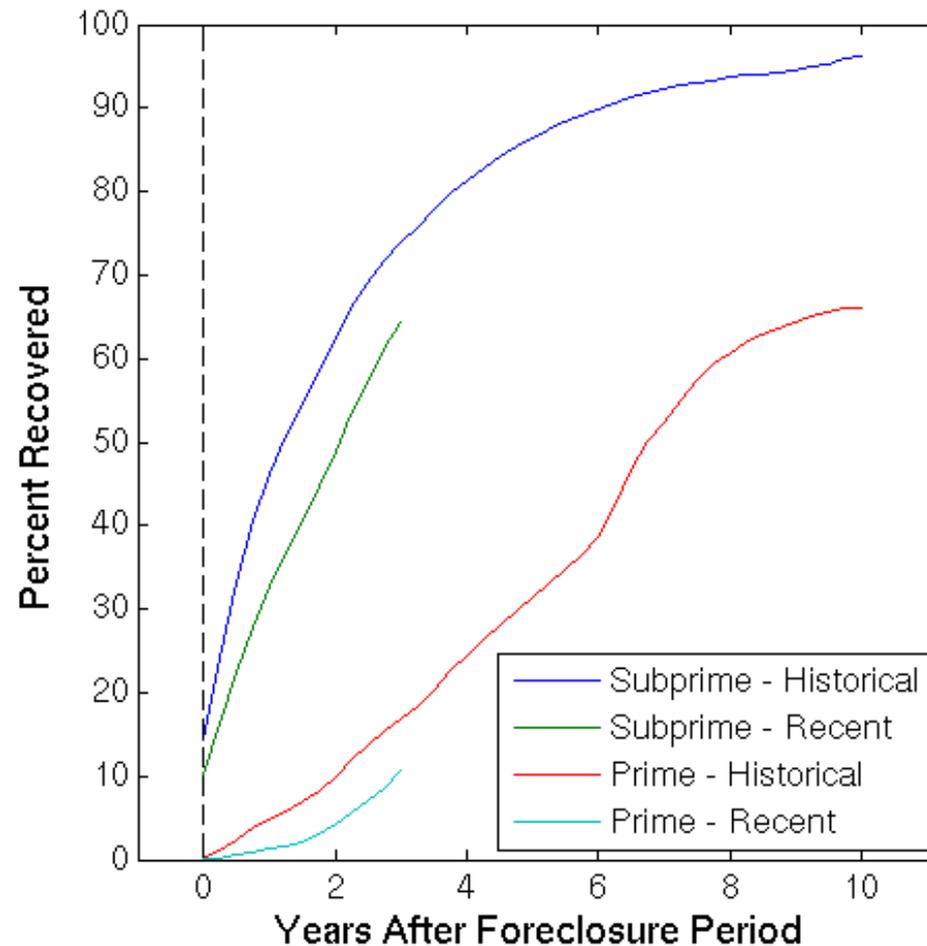


A More Focused Definition



- A credit score “recovers” when it returns to its pre-delinquency level
- Once a credit score returns to its pre-delinquency level, it is assumed to remain recovered in all subsequent periods

Share with Recovered Credit Score

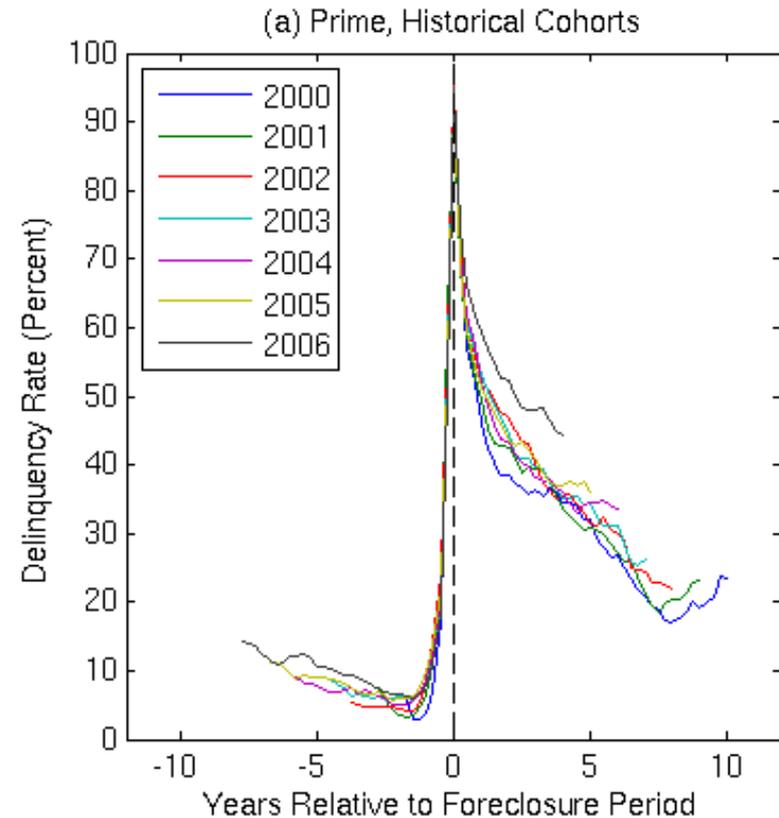
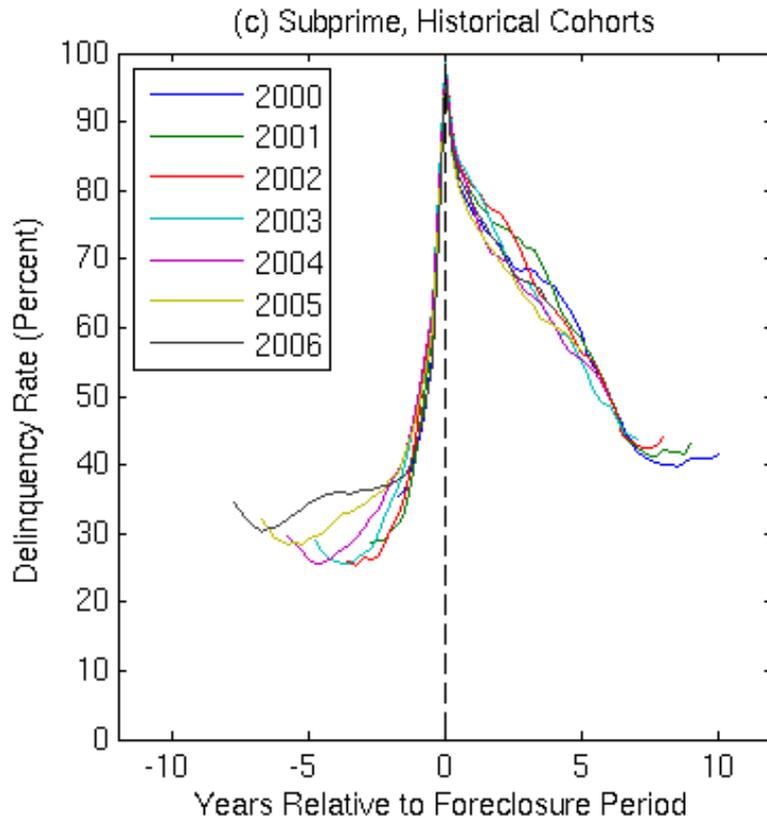


Why Are Scores Persistently Low?

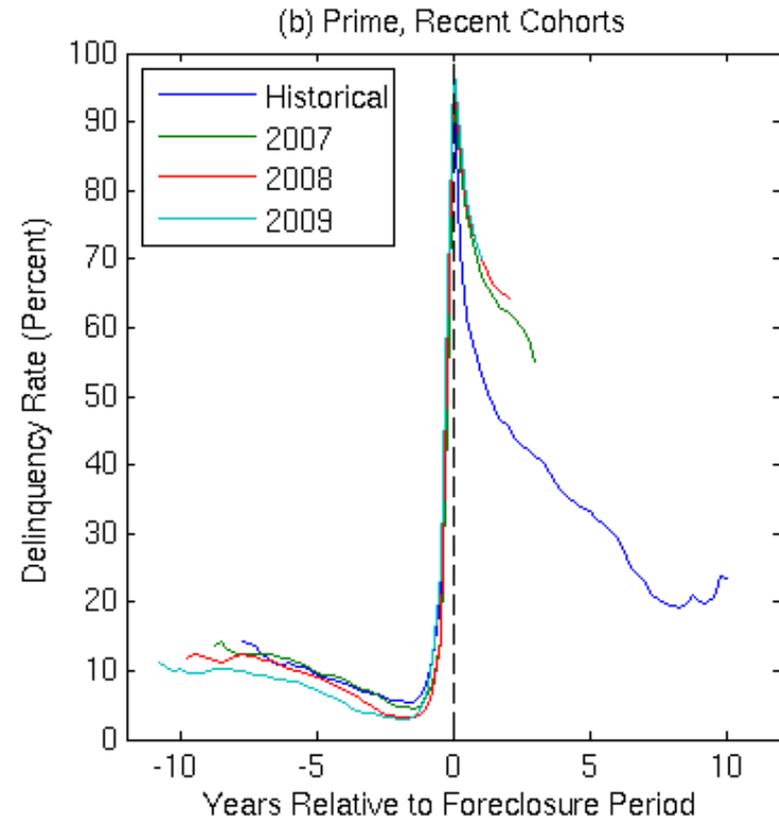
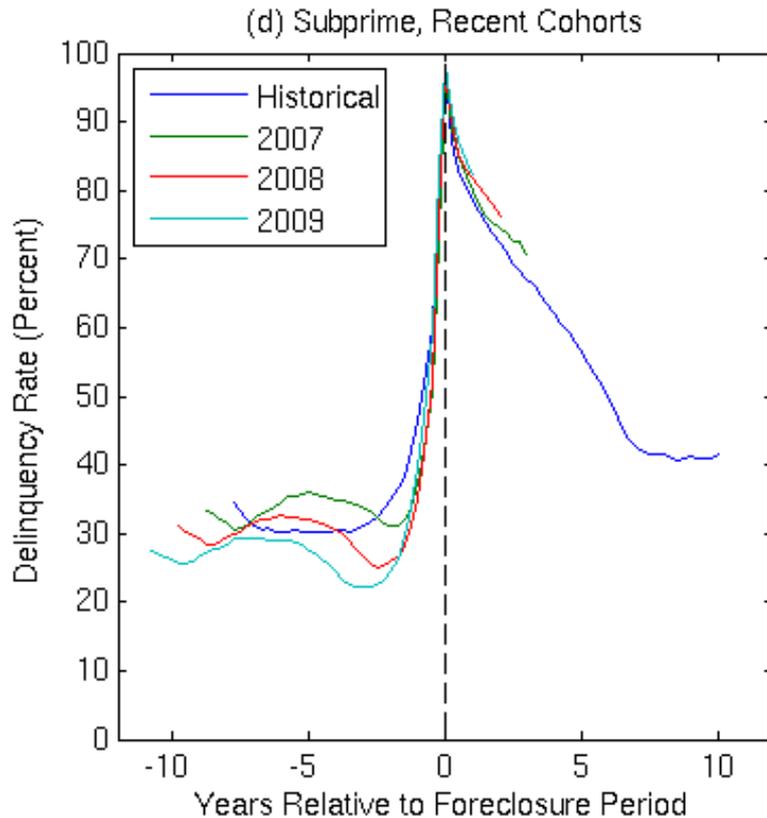


- Reason is unknown
- Cannot be directly attributed to foreclosure after 7 years
- Most likely candidate explanation is payment delinquency
 - Generally most important explanatory variables in credit bureau based models
- Look at share of borrowers who are 90 days past due or worse

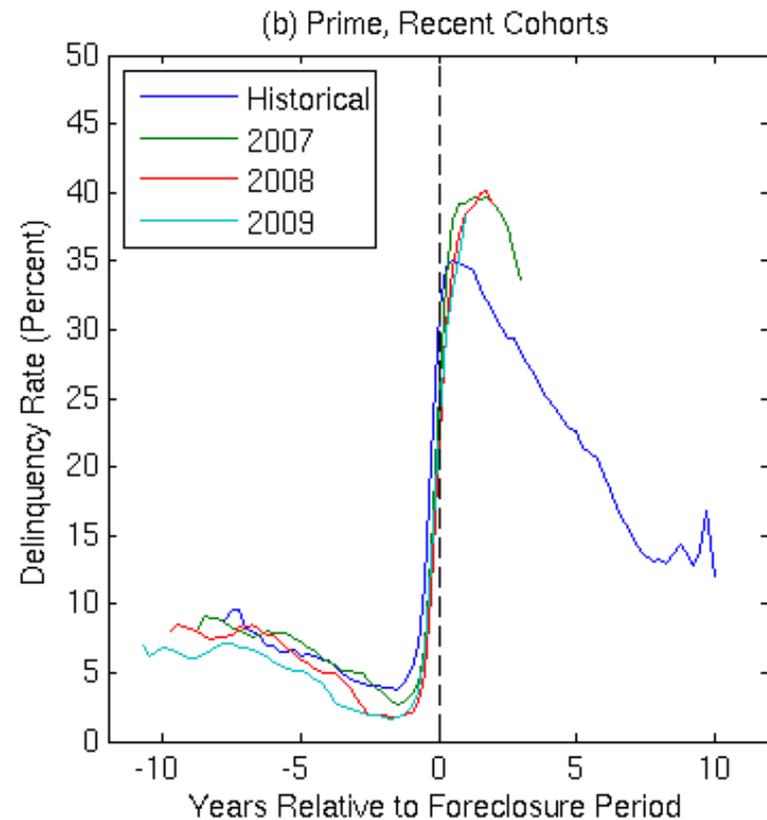
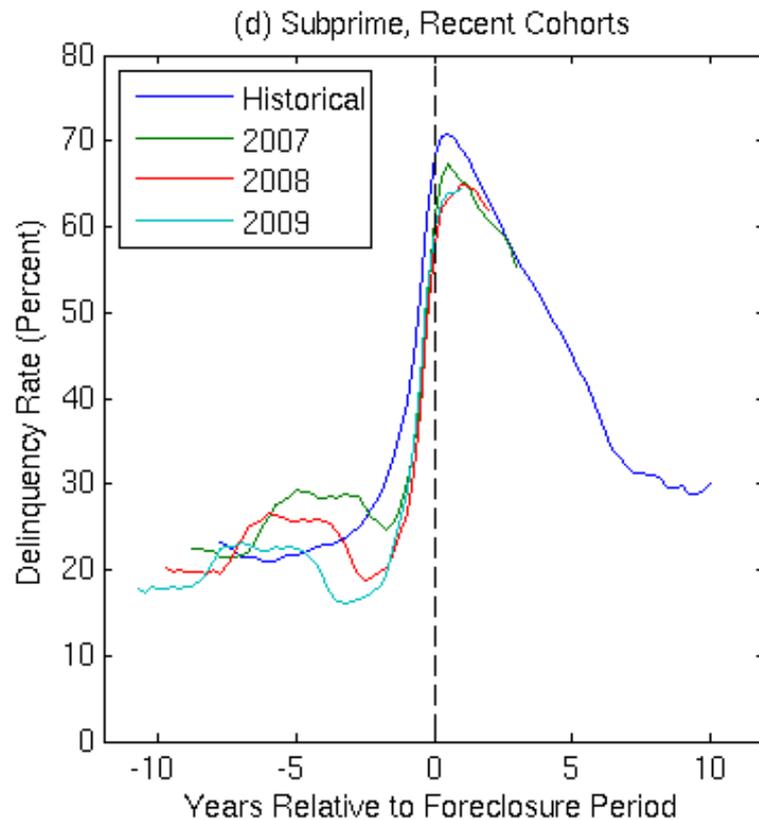
Delinquency Rate on All Credit, Historical Cohorts



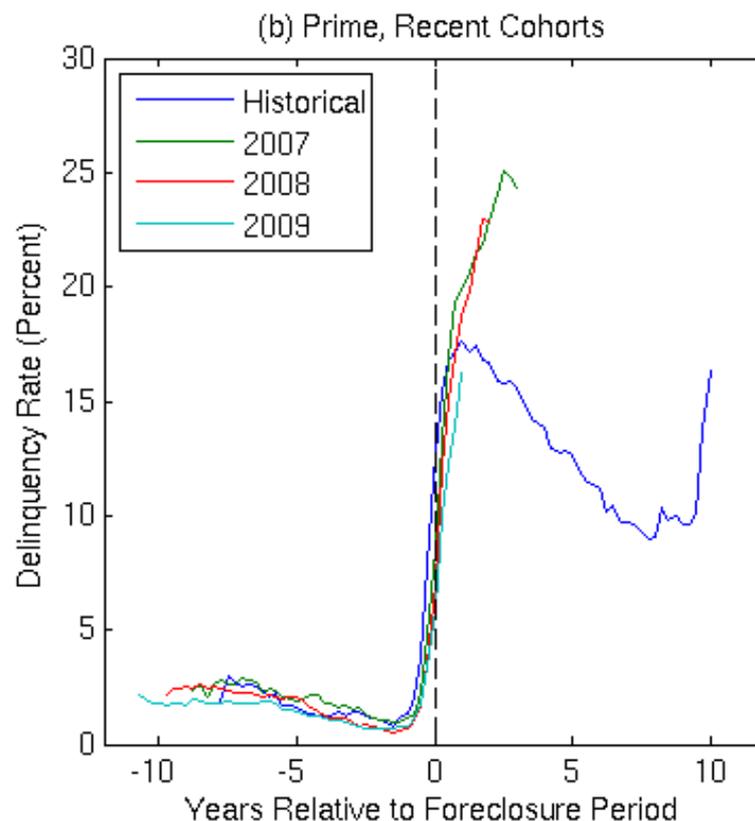
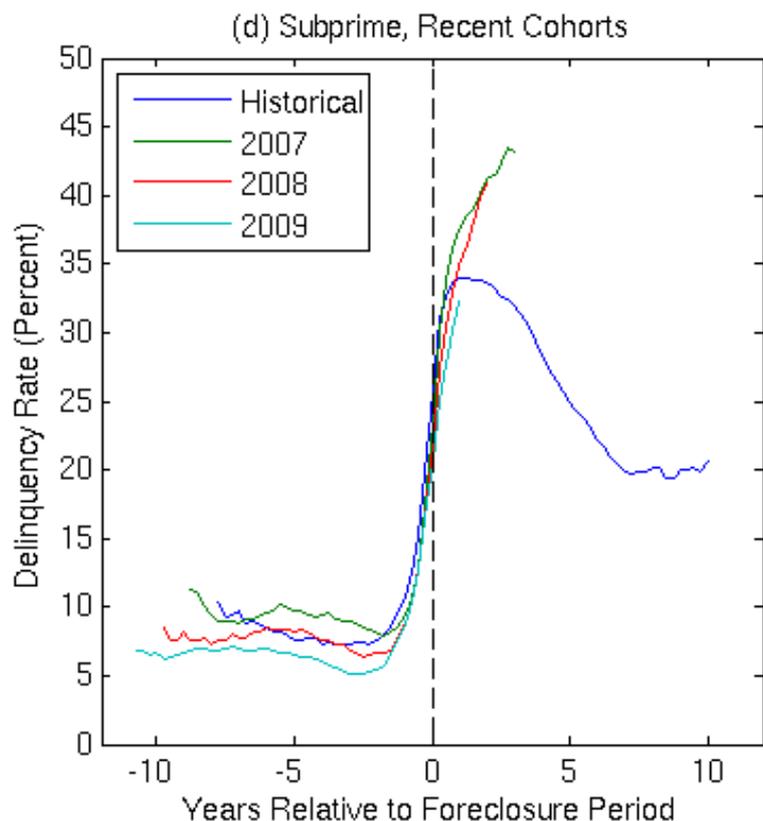
Delinquency Rate on All Credit, Recent Cohorts



Credit Card Delinquency Rates



Auto Loan Delinquency Rates

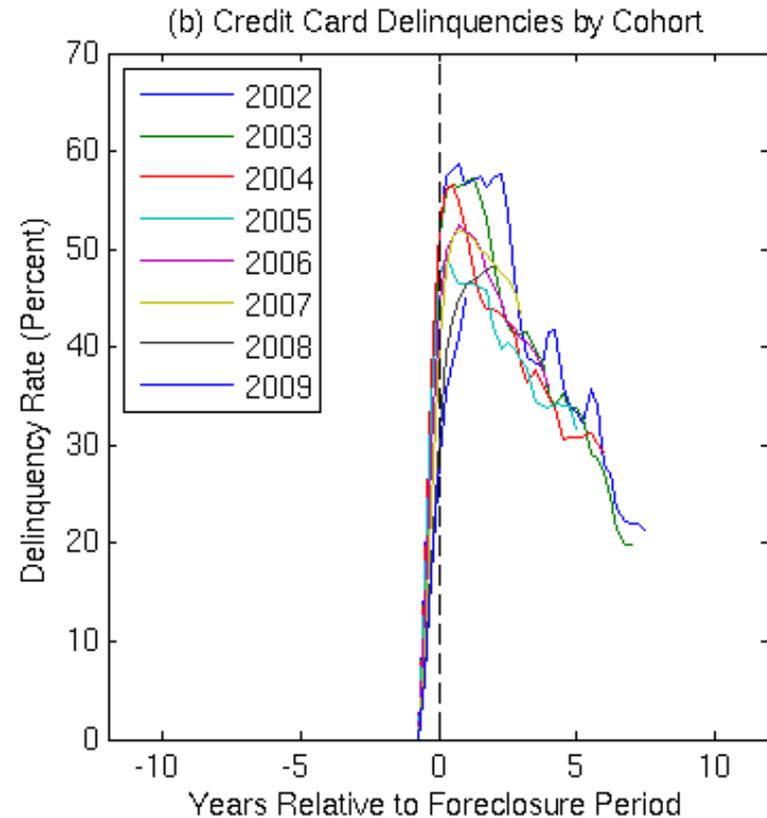
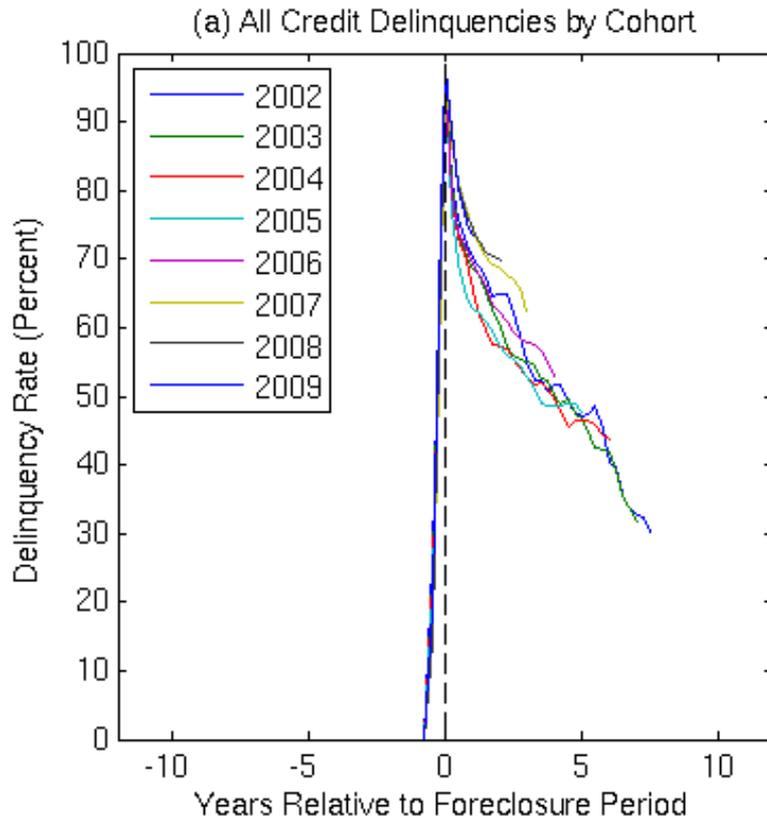


Flawless Payment Sample



- Increase in delinquency may reflect gradual change where borrowers just becoming delinquent more frequently
- Identify subset of the populations with a flawless payment history before foreclosure
 - No evidence of missed payments more than 6 months before foreclosure period
 - At least 3 years (12 quarters) of payments made

Delinquency for Flawless Payment Sample



Recent Cohorts and Strategic Default



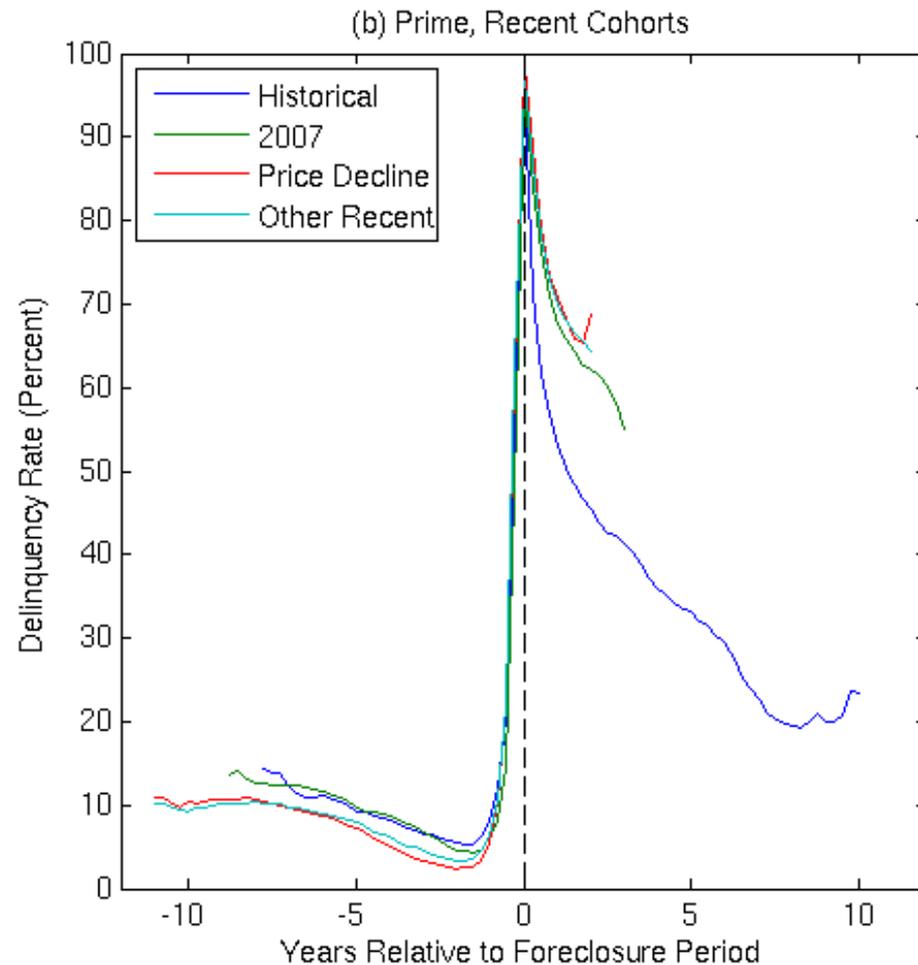
- Recent cohorts following similar pattern to historical cohorts, though post-foreclosure experience somewhat worse
 - Robust to controlling for credit score and economic conditions (unemployment)
- Somewhat surprising given the attention given to strategic default in recent foreclosures

Strategic Defaulters



- Difficult to identify strategic defaulters in credit bureau data
 - No information about LTVs
- Instead, we isolate subset of population that is more likely to contain strategic defaulters
 - Calculate decline in FHFA HPI between quarter in which mortgage opened and foreclosure period
 - “Price decline” cohort – individuals for whom HPI decline was at least 20 percent

Price Decline Cohort



Conclusions



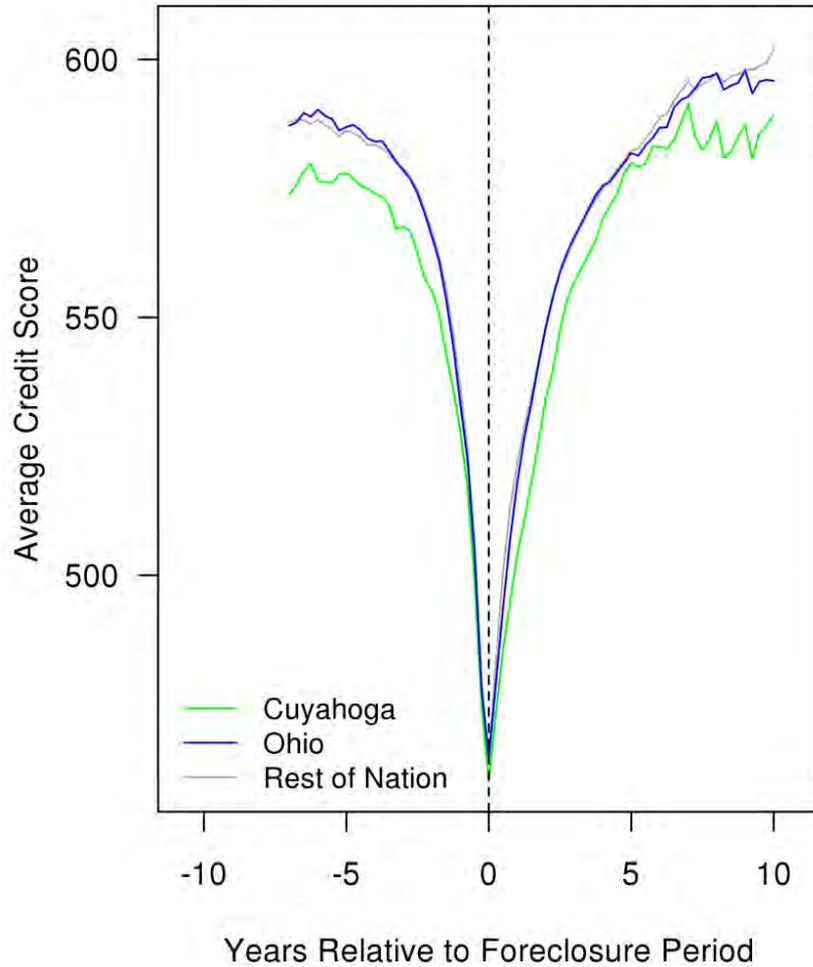
- Credit scores decline into subprime ranges as mortgage enters foreclosure
- Credit score recovery takes many years, if it comes at all
- Lack of recovery appears to reflect changes in borrower behavior in the form of higher delinquency

- Cannot identify the reasons for this change in behavior
- Three candidate sources
 - Foreclosure may alter borrowers' financial circumstances in manner that makes future delinquencies more likely
 - Lower credit scores or destroyed wealth
 - Event that triggered foreclosure may have persistent effects that alter borrowers' financial circumstances
 - Borrower preferences may change after foreclosure
 - Lower stigma associated with delinquency

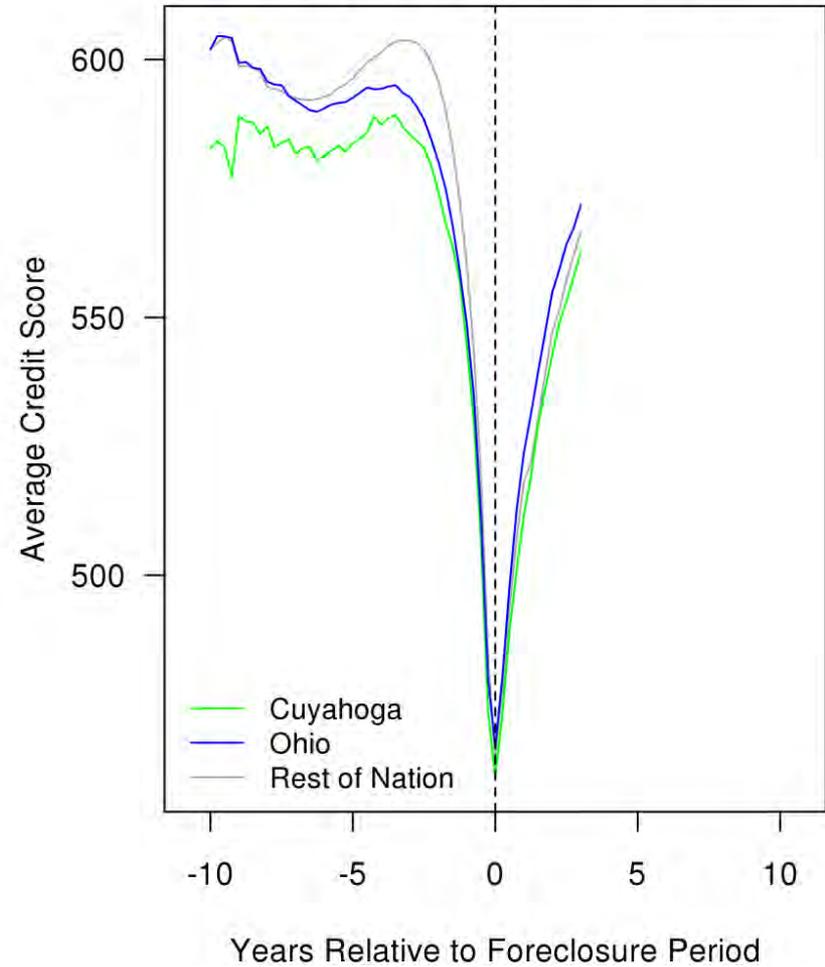
Ohio Score Changes - Subprime



Subprime Historical, Ohio

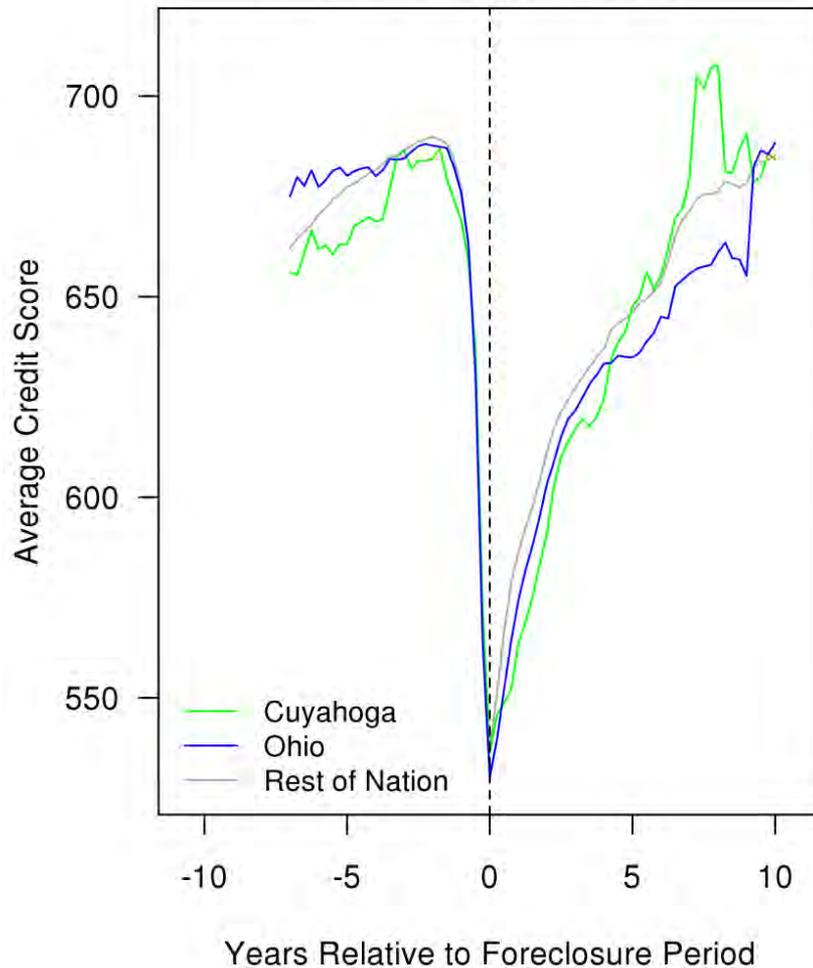


Subprime Recent, Ohio

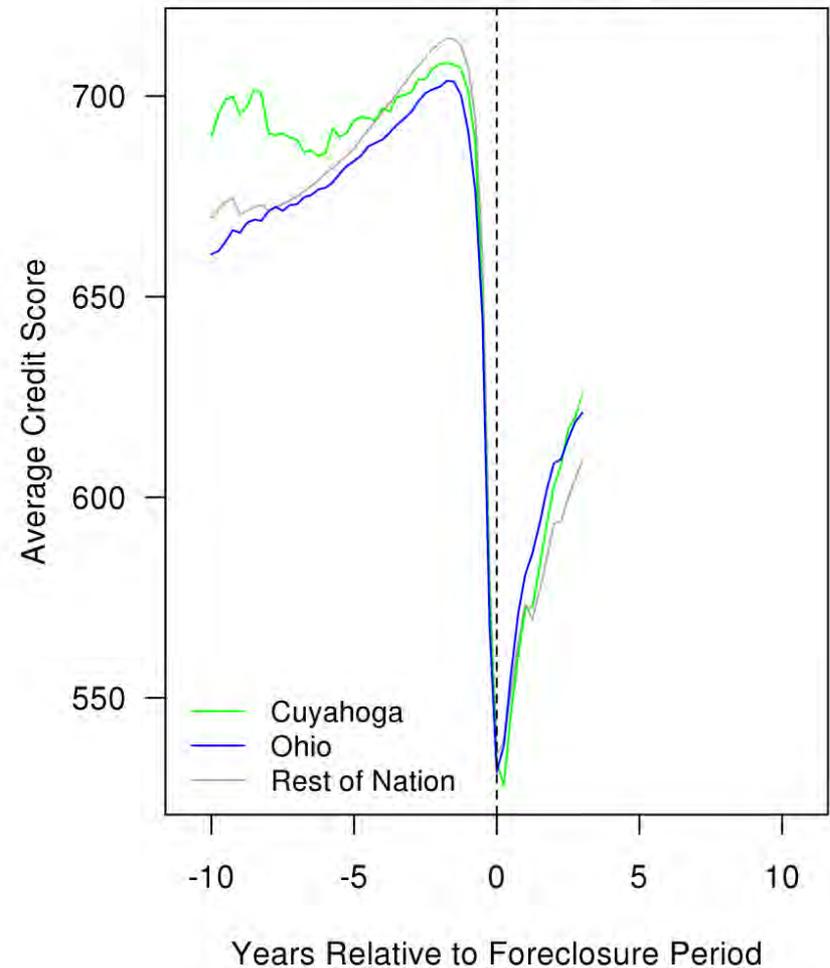


Ohio Score Changes - Prime

Prime Historical, Ohio



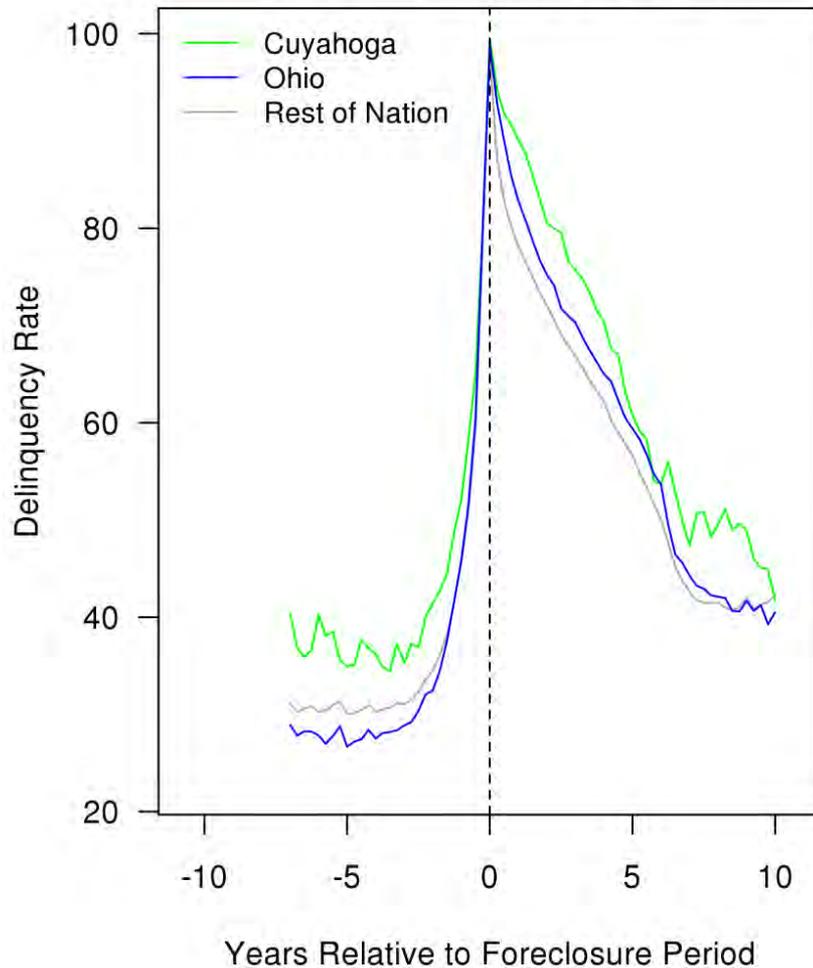
Prime Recent, Ohio



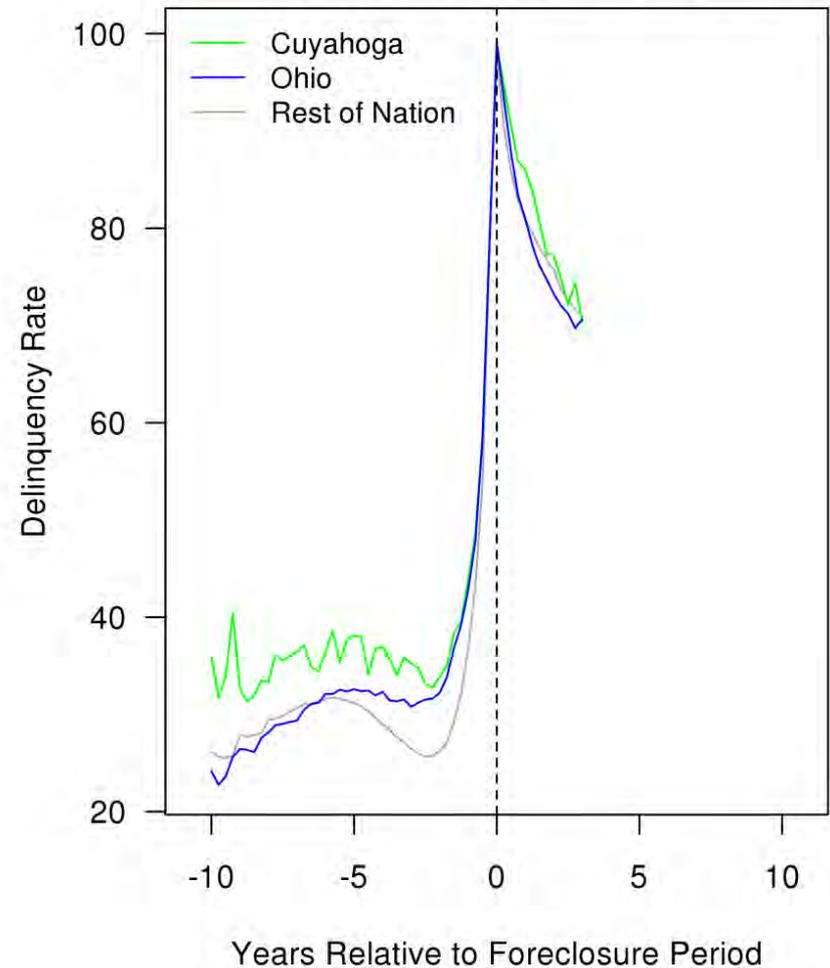
Ohio Delinquency – All Credit, Subprime



Subprime Historical, Ohio



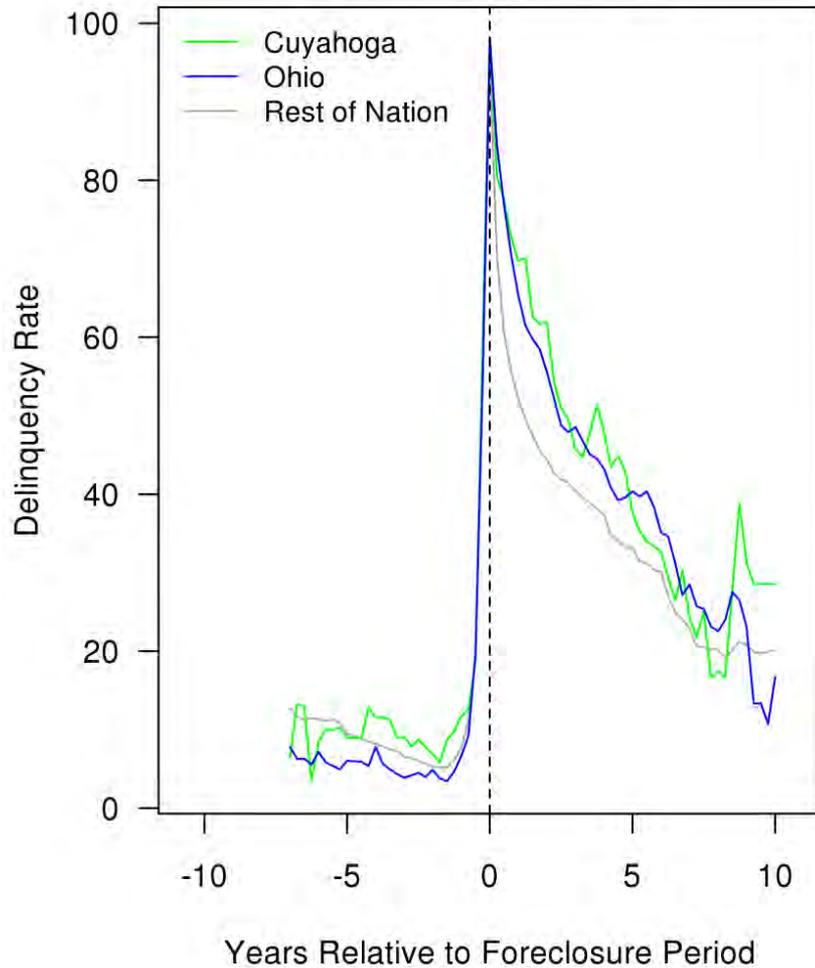
Subprime Recent, Ohio



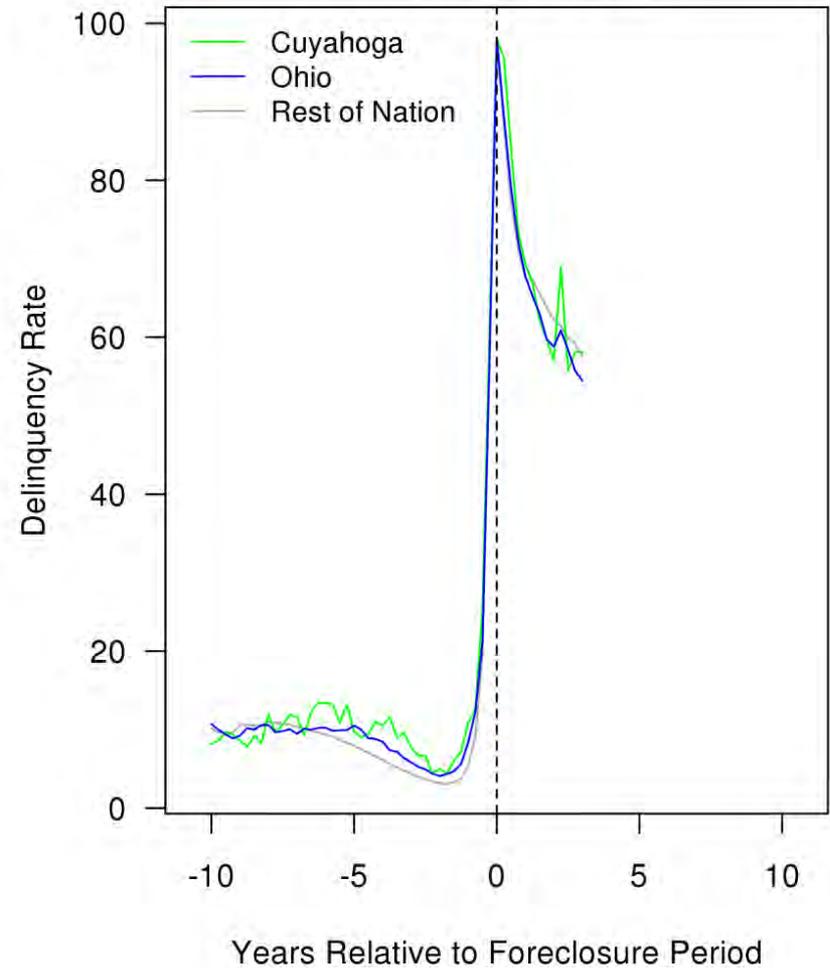
Ohio Delinquency – All Credit, Prime



Prime Historical, Ohio



Prime Recent, Ohio



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