Discussion of Foreclosures, House Prices, and the Real Economy by A. Mian, A. Sufi, and F. Trebbi

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“Sales of bank-owned homes and those in some stage of foreclosure accounted for **28 percent of all U.S. residential sales** in the first quarter of 2011”
http://www.realtytrac.com/trendcenter/
Comment #1: Mechanical price-foreclosure correlation
Mechanical correlation between price and foreclosure

- “A necessary condition for foreclosure is that a borrower have negative equity.”

- “Foreclosures and house prices will be strongly negatively correlated in the data, even if foreclosures have no independent effect on house prices.”

- “An empirical strategy seeking to estimate the effects of foreclosures on house prices must employ plausibly exogenous variation in foreclosures.”
(My understanding about)

Foreclosure process in the US

Outstanding mortgage balance < market value of a house

- Lender may have incentive to foreclose, but borrower may not.
- Distinction between state laws in terms of judicial requirement for foreclosure may play an important in identification

Outstanding mortgage balance > market value of a house

- Both lender and borrower have incentive to foreclose
- The source of mechanical correlation
- The opening bid at the auction is set at the total amount owed to the foreclosing lender.
- In most cases, no one bids above that amount. Then, the foreclosing lender will take possession of the property (Bank-owned, REO).
Pre-Foreclosure  Auction  Bank-Owned

39%  32%  29%

http://www.realtytrac.com/trendcenter/
(My understanding about)

Foreclosure process in the US

Outstanding mortgage balance < market value of a house

- Lender may have incentive to foreclose, but borrower may not.
- Distinction between state laws in terms of judicial requirement for foreclosure is important

Outstanding mortgage balance > market value of a house

- Both lender and borrower have incentive to foreclose
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- In most cases, no one bids above that amount. Then, the foreclosing lender will take possession of the property (Bank-owned, REO).

- The latter case should be excluded from the analysis.
  - This case suffers substantially from the mechanical correlation
  - Foreclosure occurs both in every state (i.e. with or without judicial requirement for foreclosure).
Comment #2: Definitions of price indexes
“When they can be identified from a deed record, non-arms-length transactions are excluded from the pairing process. The most typical types of non-arms-length transactions are property transfers between family members and repossessions of properties by mortgage lenders at the beginning of foreclosure proceedings. Subsequent sales by mortgage lenders of foreclosed properties are included in repeat sale pairs, because they are arms-length transactions.”

*S&P/Case-Shiller Home Price Indices Methodology*, page 17

“Zillow Home Value Index

**Mid-point** of Zestimate valuations for the US.
Half the Zestimates are above this number and half are below it.”

http://www.zillow.com/
Comment #3: Bubble burst in the US and Japan
Foreclosures in Japan

House Price Index for the Greater Tokyo Area

Number of foreclosure filings in Japan

AZ-Phoenix
Jan 2003-Mar 2011
Judicial Foreclosure Requirement and Actual Foreclosures
Zip Codes Near Border Sample