Government and Private Household Debt Relief during COVID-19

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Lessons from Great Recession

- Household debt distress during crises spills over to real economy
- Importance of temporary household financial relief and recovery
- Implementation of relief—frictions which lower and slow down take-up

Motivation and Objective

- Policy measures taken during COVID-19
  - PPP, stimulus checks, extra unemployment support, **consumer debt relief**

- This paper: debt relief during the pandemic using data that covers the entire US
  - *Focus:* Debt forbearance = postponing loan repayments
  - Distribution, effectiveness, implementation, broader policy implications

Main Findings: Debt Forbearance during the COVID-19 Crisis

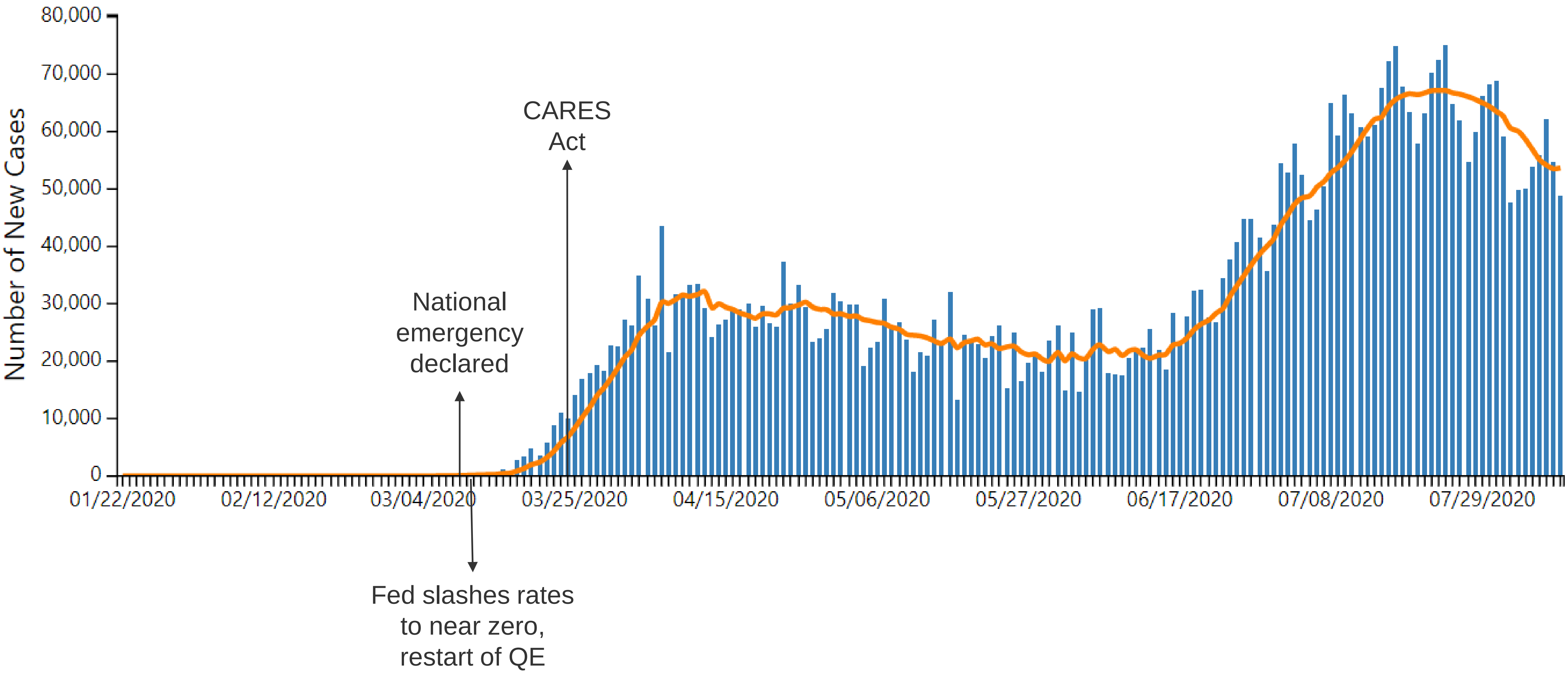
- Massive forbearance actions and absence of household debt distress
  - $ 2.3 trillion debt, +70 million US consumers, $86 billion missing payments
  - Can account for absence of household distress: level, patterns, cross section, RD identification

- Central role of borrower self-selection (who obtained forbearance – well targeted)
  - Self-selection -> better targeted debt relief policy
    - Credit constrained borrowers received more forbearance
    - Rates higher in regions with the highest COVID-19 rates and greatest economic decline
  - Complemented other income-based programs: 55% relief went to above-median income borrowers
  - Much less “costly” than other programs: forbearance is a loan and not a transfer
  - But subject to intermediary frictions

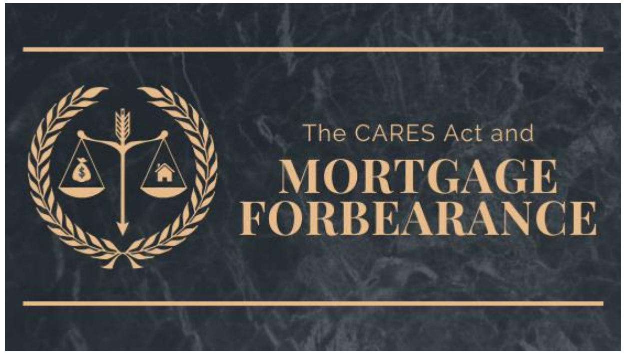
- 20% forbearance provided outside government mandates
  - Implicit forbearance subsidy: DID, RD

- Unwinding: ~ 40% still in forbearance
  - Forbearance debt overhang = $60 billion, $3,900 per individual, $14,200 for mortgage borrowers
  - Clustered in regions with lower income, higher unemployment, more minorities

US COVID-19 Cases and Policy Response



CARES Act and Debt Forbearance Mandates



- Government backed mortgages (about 2/3 total)
  - Borrowers need to request forbearance
  - Prohibits servicers from starting foreclosure proceeding
  - Extended several times until the end of September 2021

- Federal student loans (almost all student loans)
  - Borrowers automatically placed in forbearance
  - Extended several times until the end of January 2022

- No mandates for auto, revolving debt, non-government backed mortgages

- Loans in forbearance not reported as delinquent to credit bureaus

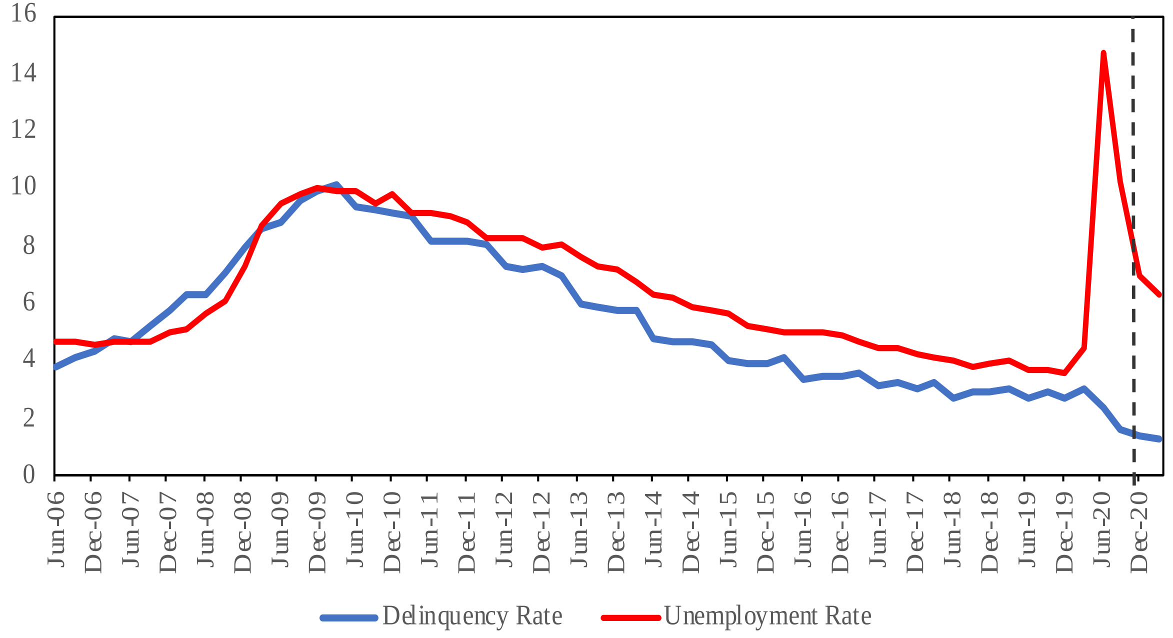
Empirical Setting and Data

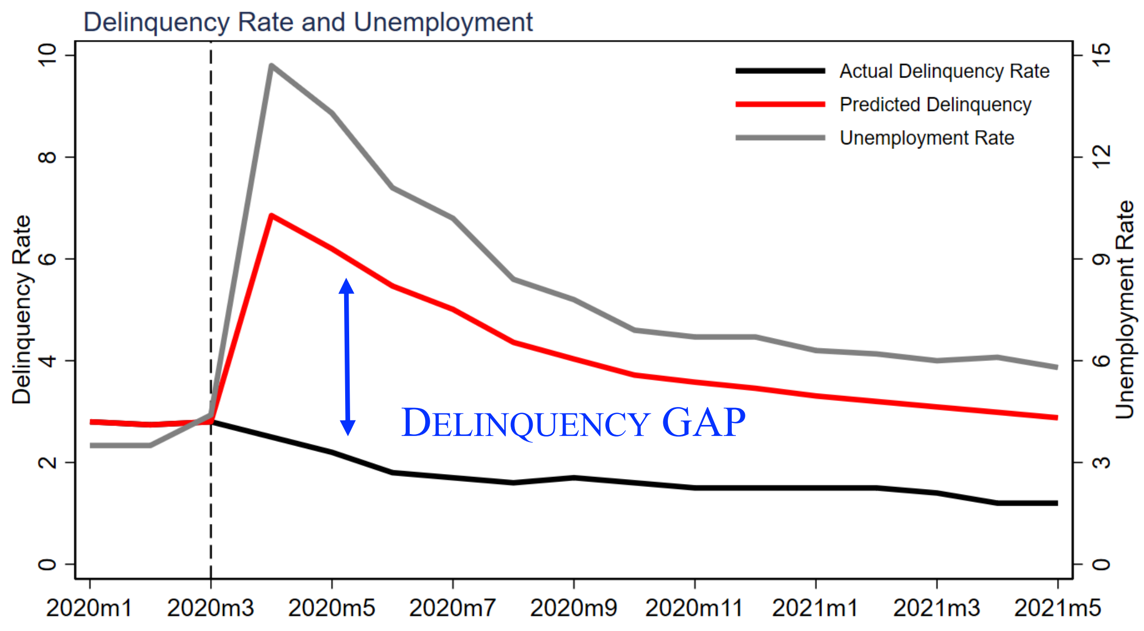
- COVID-19 Crisis and Cares Act of 2020

- Debt forbearance actions in the $14 trillion US consumer credit market
  - Mortgages, student, auto, revolving loans

- Data
  - Equifax representative random sample panel of US consumer population (10%)
    - ~ 20 million consumers
    - Randomized based on SSN → Aggregation
    - Identify and track forbearance actions on each loan
  - Rich data covering various regional economic conditions
    - Zillow, BLS, Census, Economic Tracker…
  - Shadow bank Call reports (Jiang et al 2020)
  - GSE mortgage data w/ servicer identifiers

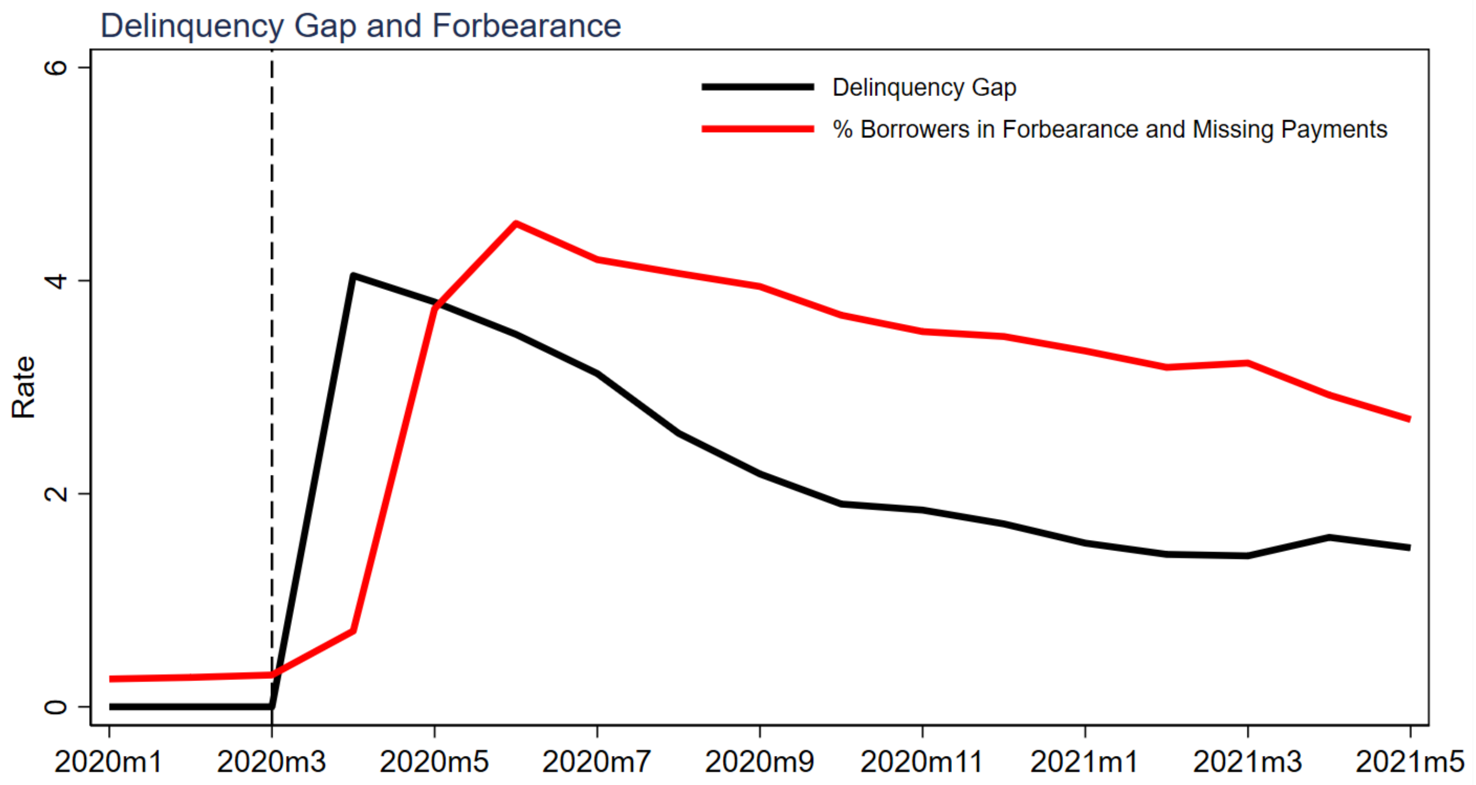
Absence of Household Debt Distress





- ❑ Counterfactual default rate: Large increase along with unemployment
- ❑ Instead, delinquencies declined: absence of household distress channel
- ❑ 1.5-2.5 million missing mortgage defaults

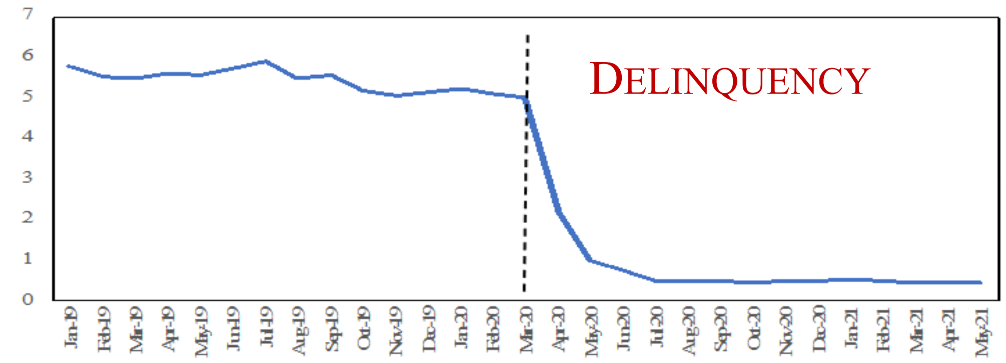
Forbearance and Pent-Up Delinquencies

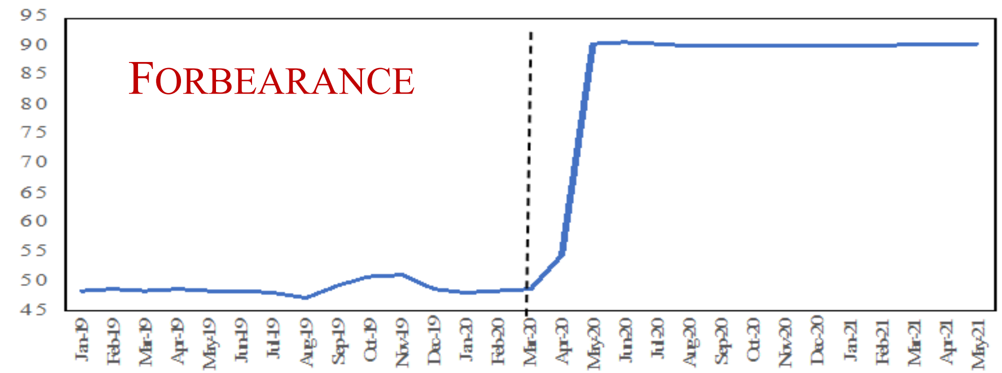


- Large increase in debt forbearance rate, also relative to Great Recession
- Can account for very low delinquency during the pandemic despite record unemployment
- For two forbearances we have one missing default

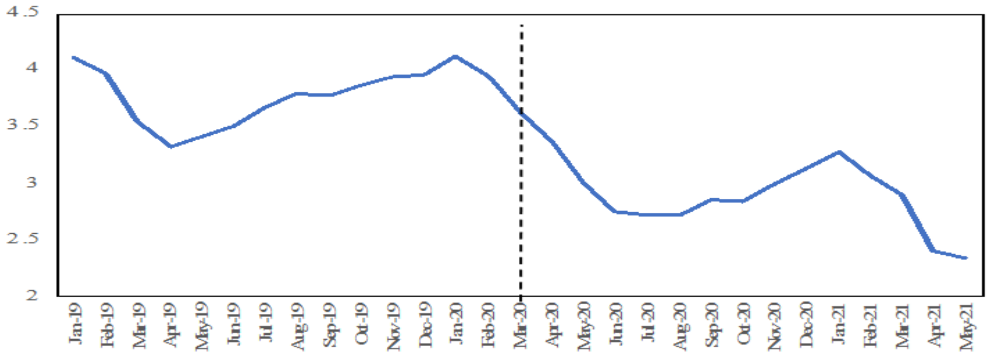
Delinquency and Forbearance on Other Debt Types

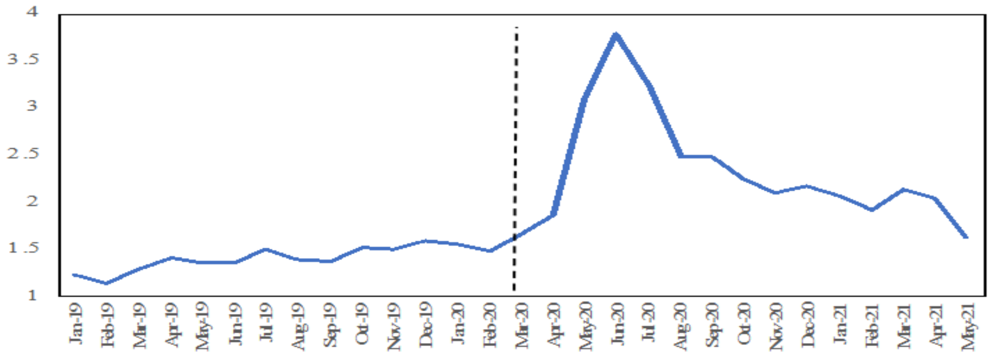
STUDENT DEBT



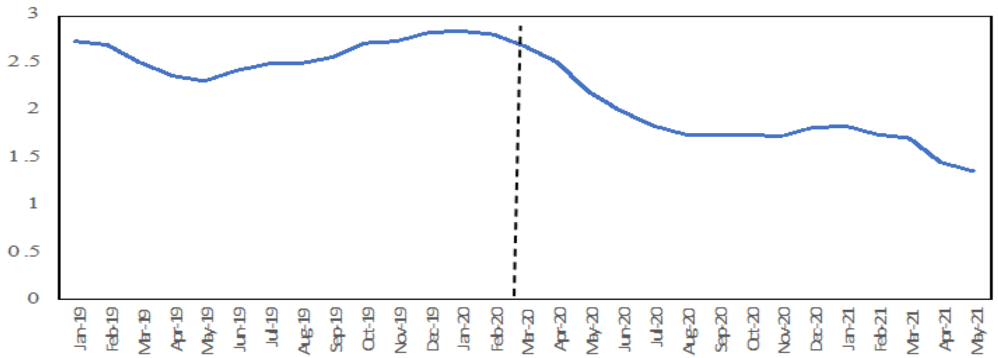


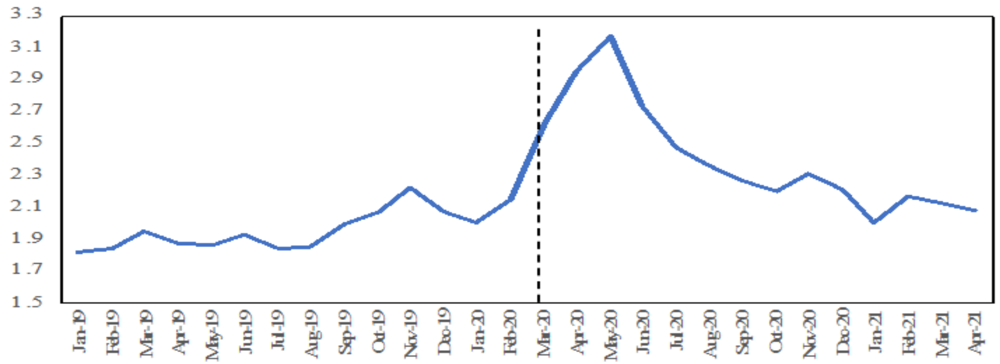
AUTO DEBT



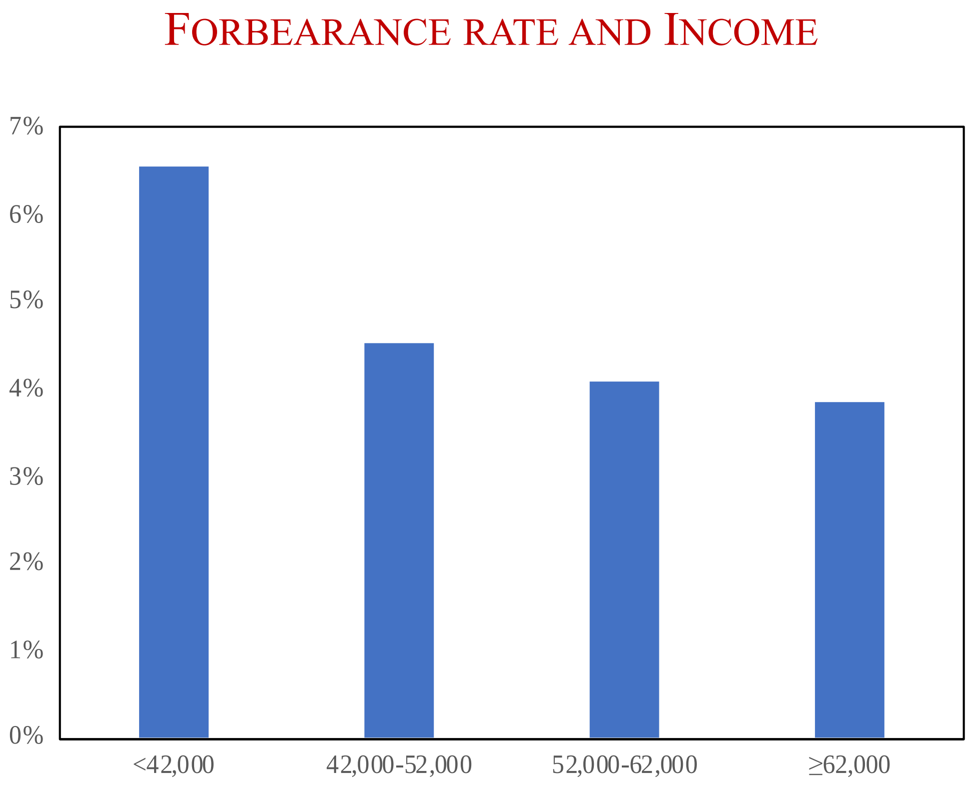


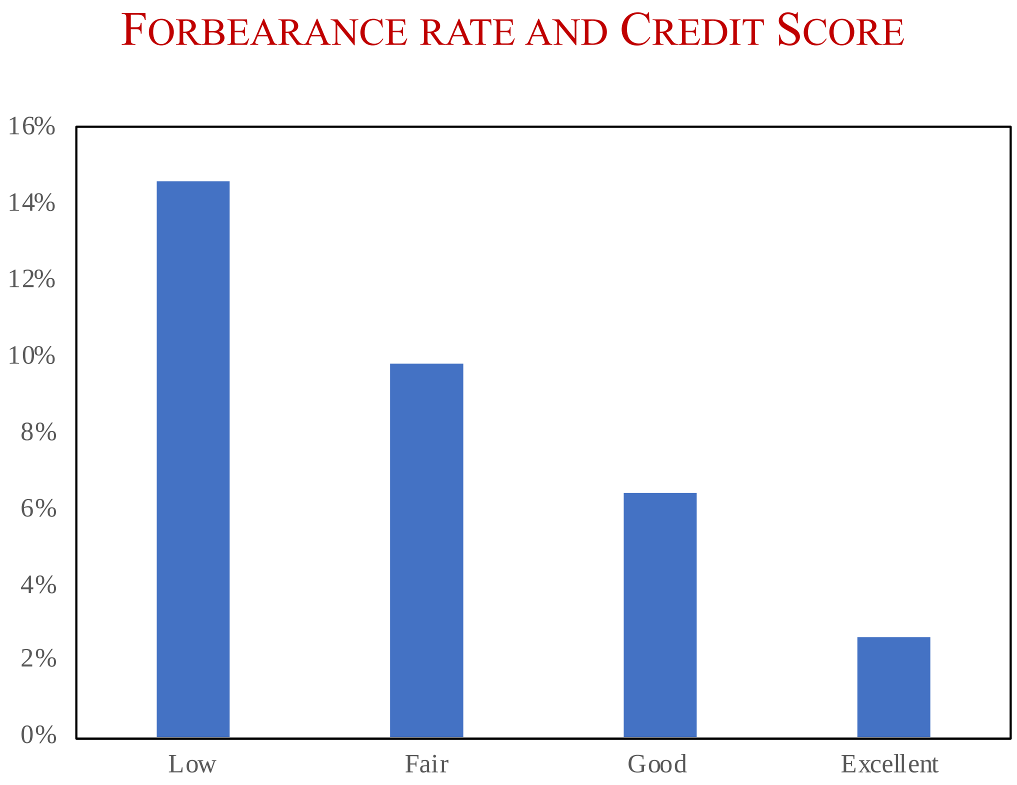
REVOLVING DEBT





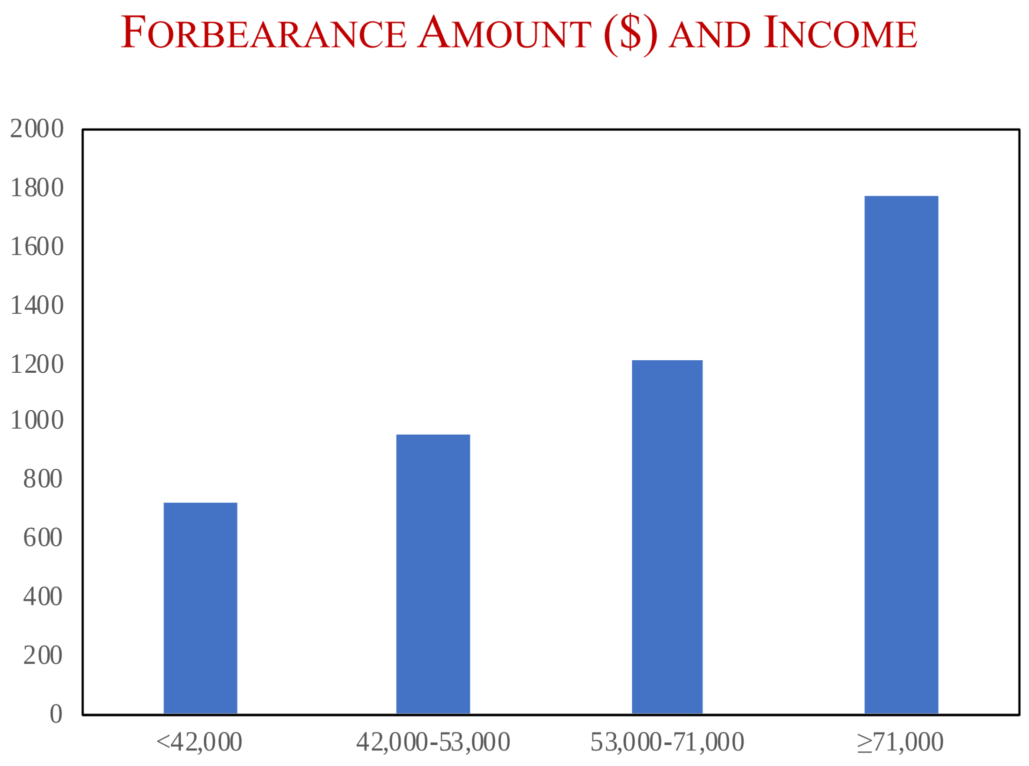
Mortgage Forbearance Rate across Income & Creditworthiness

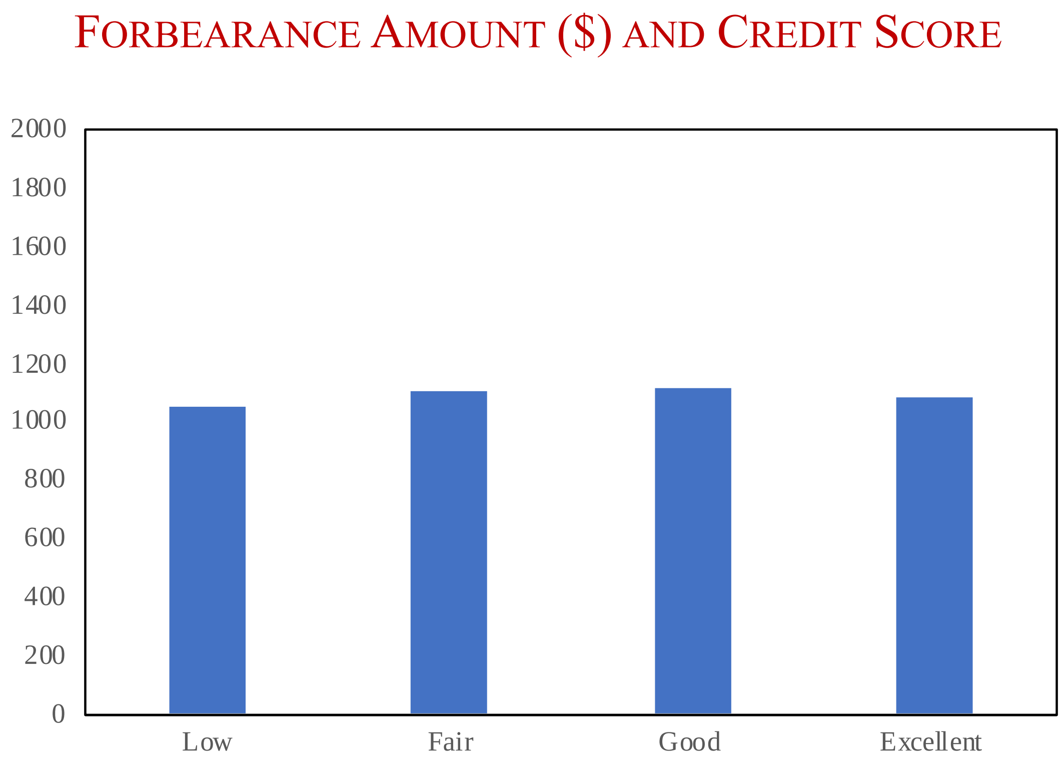




- ❑ Less creditworthy and lower income get forbearance at higher rates
- ❑ Broadly similar patterns for other debt types
  - ❍ Much less variation for student debt (automatic mandate)

Mortgage Forbearance Amount across Income & Creditworthiness

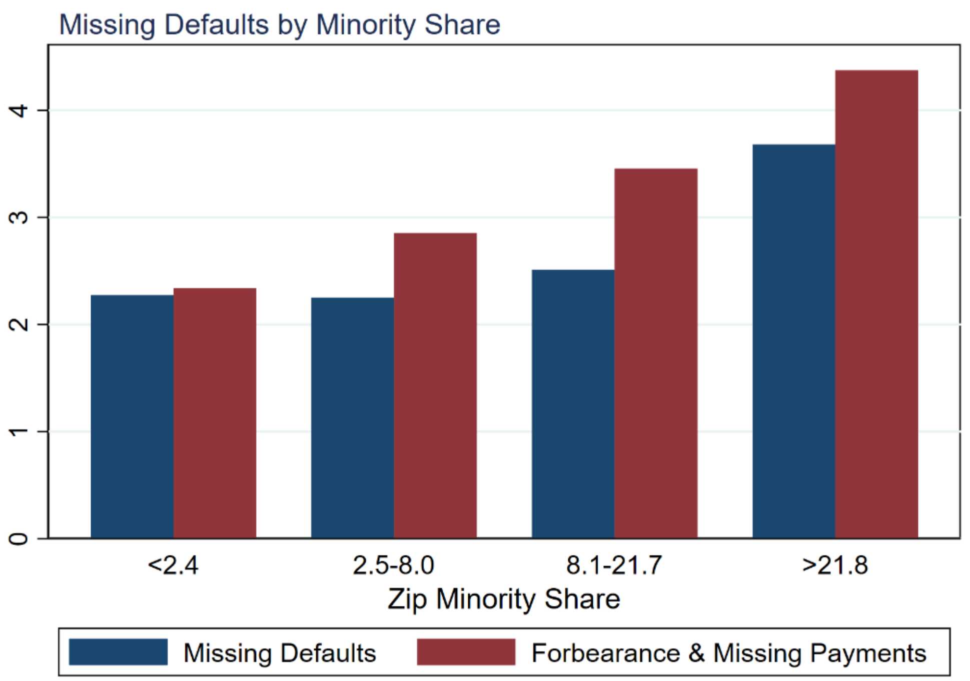




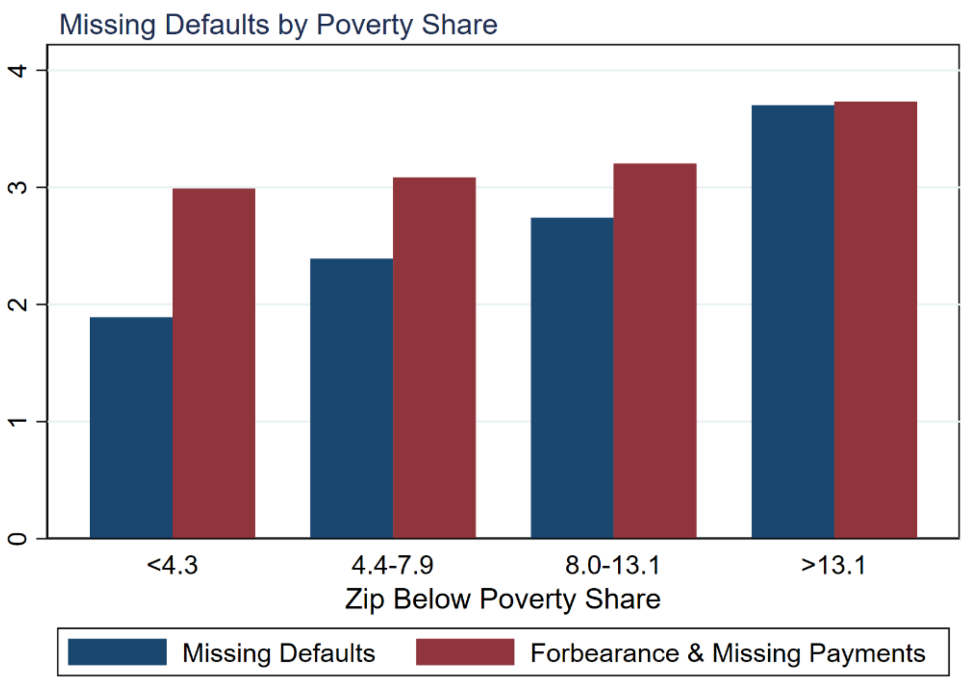
- Higher income borrowers get much larger $ amount of forbearance per individual
  - Largely reflects their higher loan balances
- About 55% of financial relief due to forbearance went to higher income borrowers

Default Gap Across Race and Poverty

MINORITY



POVERTY SHARE

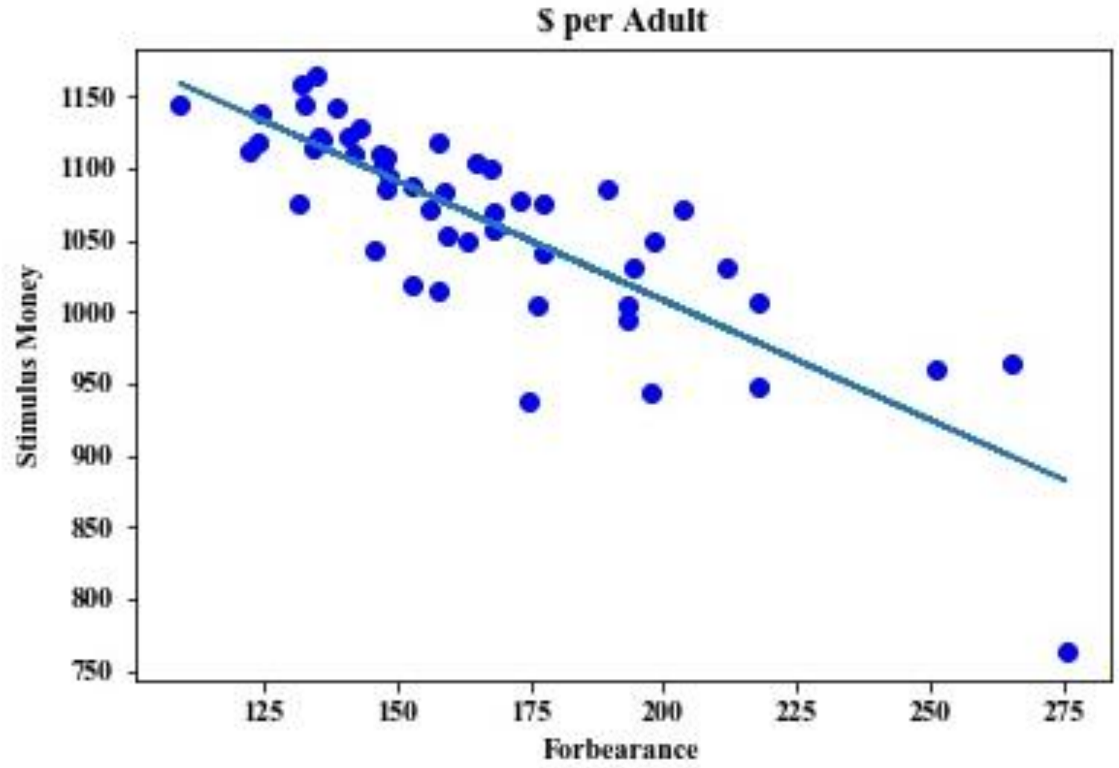


- More missing defaults and higher debt forbearance rates
  - Regions with a larger share of minorities
  - Regions with higher poverty rates

Debt Forbearance Target

- ❑ Target
  - ❍ Borrowers based on their financial vulnerability / creditworthiness
  - ❍ Borrowers with higher pre-pandemic income receive a significant relief

- ❑ Different from other programs like stimulus checks that just target based on income



Debt Forbearance and Government Mandates

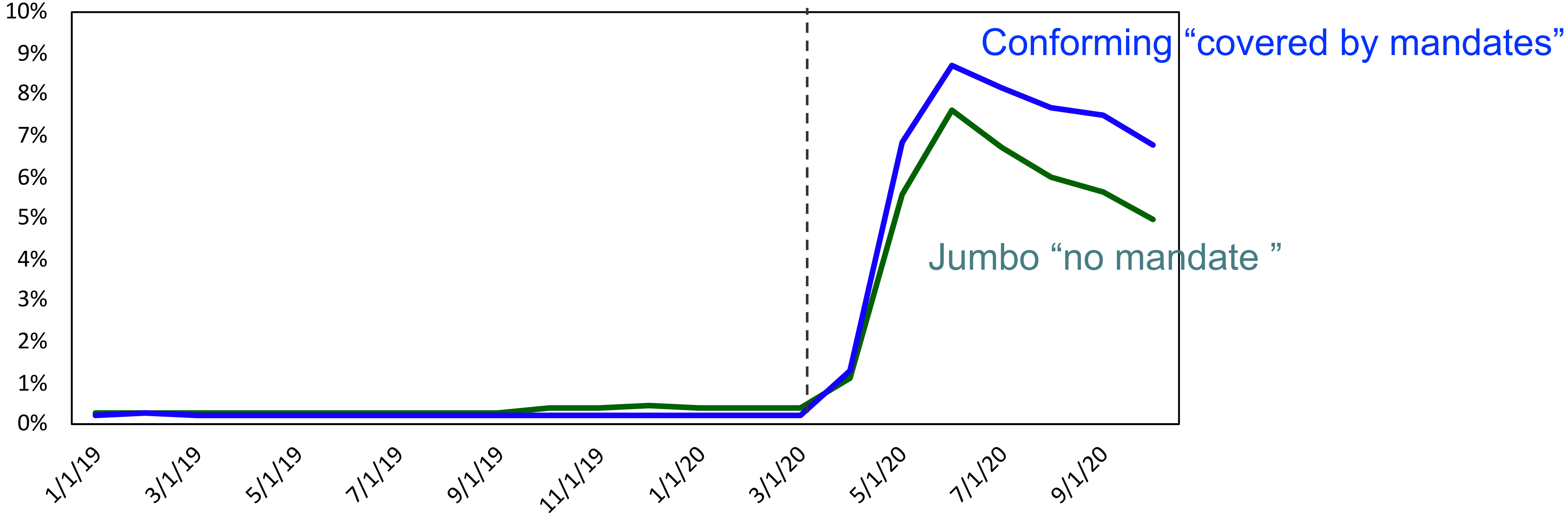
- 20% of total debt relief was provided outside of the government mandates

- Government vs. private debt relief
  - Private: mutually beneficial
  - Government mandate: beneficial to borrower
    - If not beneficial to lender → transfer (*implicit subsidy*)

- Across debt types
  - mortgages & student loans (covered) had higher forbearance rates than auto & revolving (not covered)

- Exploit variation *within the debt type* (mortgages)

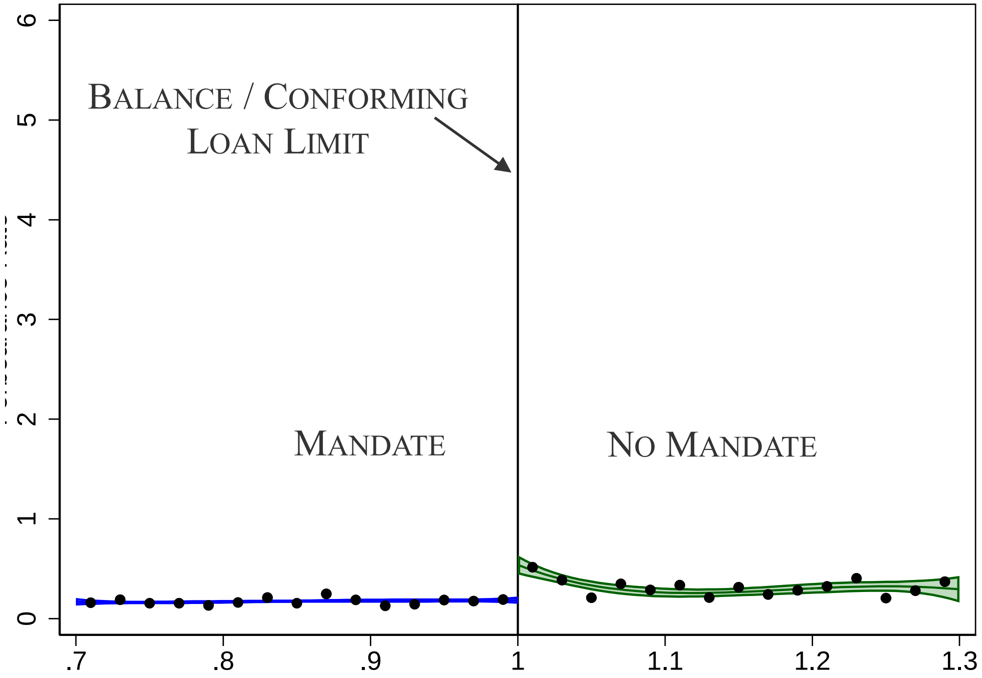
Mortgage Forbearance Rate Across Mandates



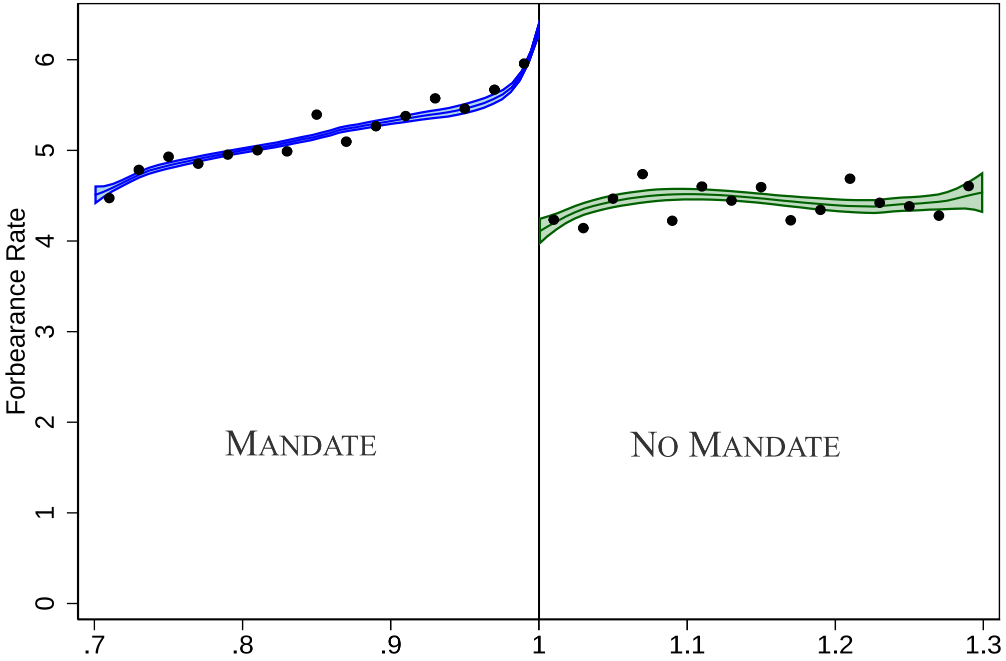
- ❑ Prior to pandemic, forbearance rates nearly identical for conventional and jumbo loans
- ❑ Dramatic increase for both groups in April and May but larger increase for government loans
- ❑ Suggests government forbearance mandates resulted in increased debt relief

Mortgage Forbearance Rate Across Mandates

PRE-COVID



COVID



- ❑ 1.6pp higher forbearance rate on loans subject to government mandates
  - ❍ About third higher in relative terms → implicit subsidy
  - ❍ Possibly lower bound if a positive impact of mandates on private forbearance

Delinquency Gap Across Mandates

	Window -/+ 10%			
	Forbearance Rate		Missing Defaults	
Conforming	1.667***	1.639***	0.676***	0.604***
	(0.115)	(0.136)	(0.0755)	(0.0919)
Mean of Dependent Variable	5.358	5.173	2.556	2.385
Zip Code Controls	No	Yes	No	Yes
Zip Code FE	Yes	No	Yes	No
Observations	1,4665,53	896,192	945,697	577,945
Adjusted R-squared	0.089	0.034	0.34	0.30

- Larger delinquency gap on loans subject to government mandates
  - 1.6% higher forbearance is associated with about 0.7% higher rate of missing defaults
  - Two forbearances associated with about one missing default (same as in the aggregate data)
- Forbearance accounts for substantial portion of prevented defaults

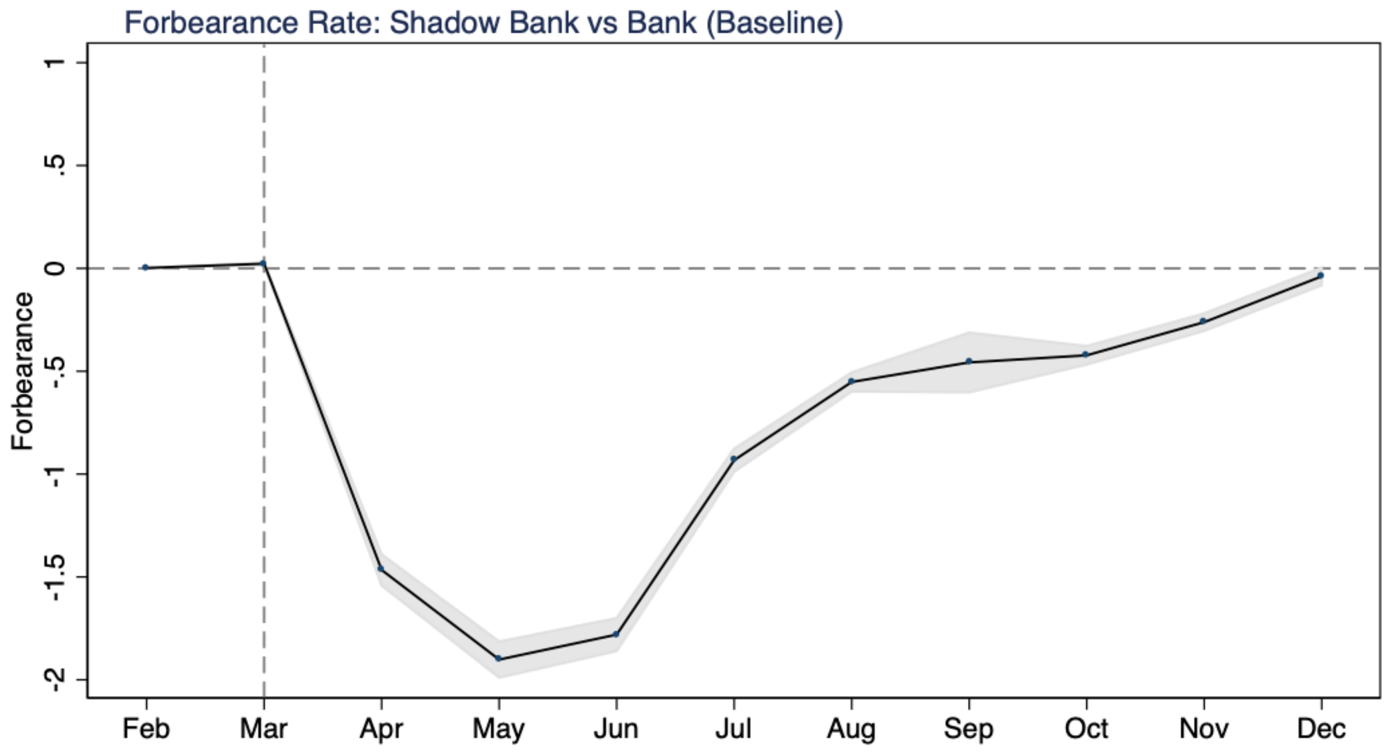
Importance of Intermediaries

- Self-section → better targeted relief program but also subject to implementation frictions
  - Forbearance provided through servicers

- Great Recession
  - Intermediary specific factors affected implementation of public debt relief programs
    - Agarwal et al. (2017, 2020), Piskorski and Seru (2018, 2020)
  - These programs required significant effort from intermediaries (e.g., HAMP, HARP)
    - Verification of eligibility requirements, etc…

- CARES Forbearance Mandates = Very Simple Debt Relief Program
  - On covered mortgages (insured by government) no need to verify anything
  - Do intermediary factors still matter?

Forbearance Rates and Intermediary Factors



- ❑ About 50% of loans serviced by shadow banks (Buchak et al. 2018)
- ❑ Loans serviced by shadow banks have lower forbearance rates than banks

Unwinding Debt Forbearance

- Liquidity vs permanent shocks
  - 60% already exited forbearance
    - Majority owed nothing on exit or repaid quickly
    - Others exited by increasing balance, month payments, or through modification (26%) [Mortgages]
  - 40% still in forbearance with majority missing payments for many months

- Forbearance debt overhang of about $60 billion (~$70 billion by Sept 2021)
  - $3,900 per individual, 1.5x monthly income, more than 2.2x for lower income borrowers
  - Clustered in regions with lower income, higher unemployment, higher minority share

- Unwinding forbearance: one time payment vs spreading out
  - For mortgage borrowers need to pay back $14,200 per individual, 3.4x monthly income
  - Could result in severe distress if need to pay in one payment
  - Adding to principal balance: $90-120 higher monthly payments (much more manageable)

Summary & Implications

- Financial institutions provided large amount of debt relief to consumers
  - Allowed 70 million US consumers to miss about $86 billion on their debt payments
  - Stark departure from the Great Recession
  - Could have significantly dampened household debt distress channel
    - Simple assessment: In the absence of forbearance, about +2 million mortgage defaults
- Government mandates associated with about third increase in the forbearance rate
- 20% of relief due to forbearance provided outside government mandates
- What has changed since the Great Recession?
  - Private sector and policymakers internalized the lessons from Great Recession?
  - Nature of the crisis: temporary and exogenous aggregate shock?
    - Limit the concerns about moral hazard effects of debt relief

1. Self-selection → fairly well targeted policy

- ❑ Mortgage mandates: Borrowers *needed to request* forbearance
  - ❍ Borrower "self-selection" → forbearance allocated to borrowers in need
    - ➢ Less than 10% of all eligible borrowers
  - ❍ Yet may help prevented significant household distress
    - ➢ More than 2 millions of mortgage defaults
    - ➢ Likely lower bound due to other effects (on house prices)

- ❑ Student loan mandates: Borrowers put *automatically* in forbearance
  - ❍ Resulted in much less targeted debt relief compared to mortgage debt

- ❑ Allowing a choice of whether to request debt relief can result in a more targeted policy

- ❑ But intermediary factors still matter
  - ❍ Despite much simpler debt relief program compared to Great Recession ones

2. Forbearance as a “cost-effective” policy

- Forbearance
  - Self-selection: $86 billion of postponed repayments
  - Forbearance is a loan and <u>not a transfer</u> (unlike unemployment benefits and stimulus checks)
    - Ultimate cost depends on the manner of exit

- Likely impact on stakeholders (setting aside impact on future behavior)
  - Borrowers (+) (free option)
  - Government (+?) [repayment already guaranteed by taxpayer]
  - Lenders/Investors (?)
    - Given large scale efforts outside of mandates likely perceived generally as positive
  - Financial institutions: servicers of loans backed by taxpayer
    - Reimbursed for the advances (timing of payments could still matter)
  - Broader (GE) effects: stabilize house prices (+?), aggregate demand externalities (+?)

- Effectiveness can depend on the manner of shock (transitory vs permanent)