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
- National emergency declared
- Fed slashes rates to near zero, restart of QE
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
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

- 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 $\rightarrow$ 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)
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

- 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

- 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

<table>
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<th>Window -/+ 10%</th>
<th>Forbearance Rate</th>
<th>Missing Defaults</th>
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<td>Conforming</td>
<td>1.667*** (0.115)</td>
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<td>1.639*** (0.136)</td>
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<td>Mean of Dependent Variable</td>
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<td>Adjusted R-squared</td>
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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
  - 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?
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 $\rightarrow$ fairly well targeted policy

- **Mortgage mandates**: Borrowers *needed to request* forbearance
  - Borrower “self-selection” $\rightarrow$ forbearance allocated to borrowers in need
    - Less than 10% of all eligible borrowers
  - Yet may help prevent 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 not a transfer (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)