STMS 2015: Effects of Payment Shocks and Interest Rate Resets on Mortgage Credit Risk

Moderated by James Vickery, Federal Reserve Bank of New York

Opinions in this presentation are my own and do not represent the views of the Federal Reserve Bank of New York or the Federal Reserve System.

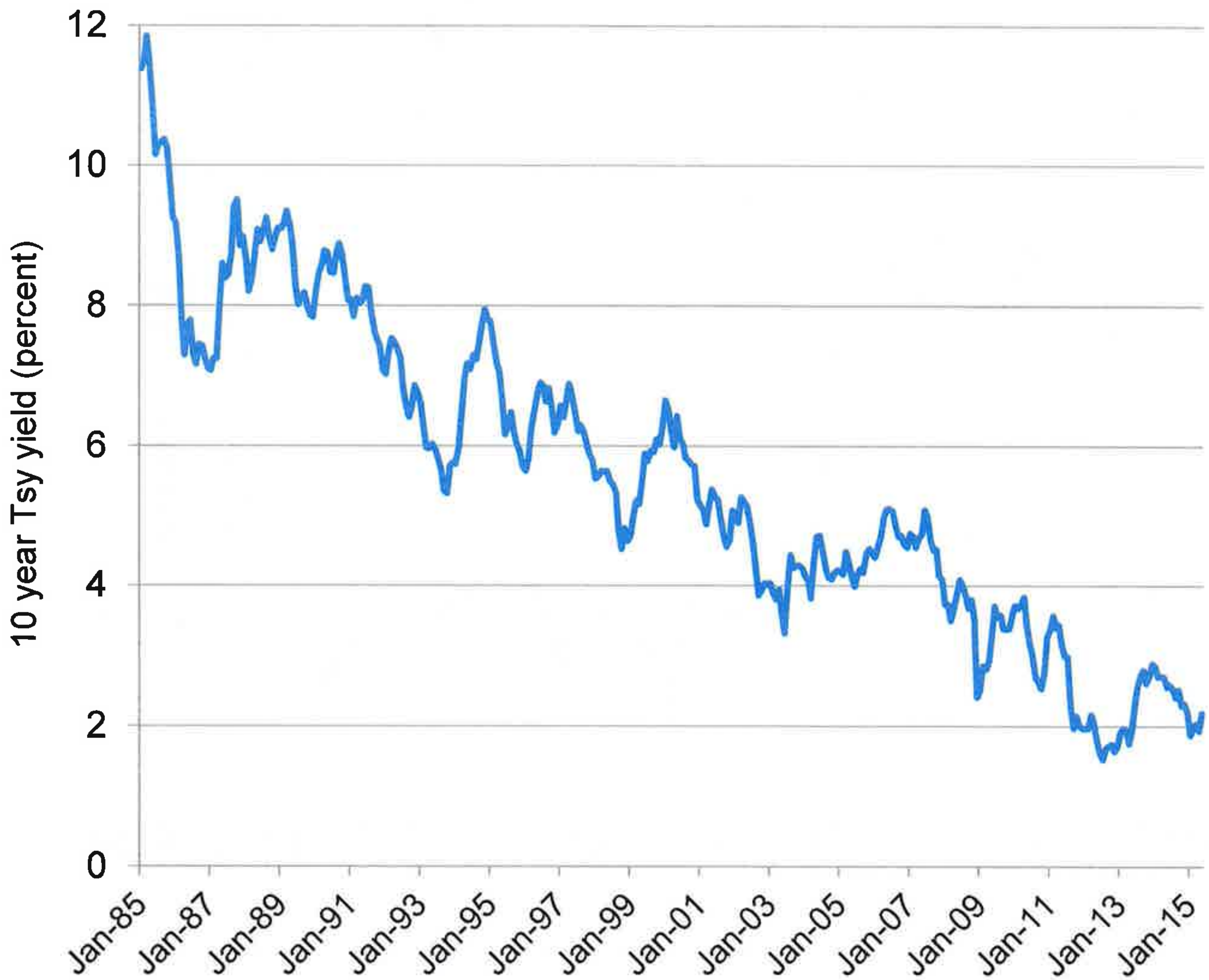
Mortgages and payment shocks

- Many types of mortgages involve payment changes & resets:
  - Home equity lines of credit (HELOCs) reaching end of draw
  - Adjustable-rate mortgages (ARMs)
  - Non-amortizing loans requiring refinancing (e.g., CRE)
  - Interest-only mortgages
  - etc.

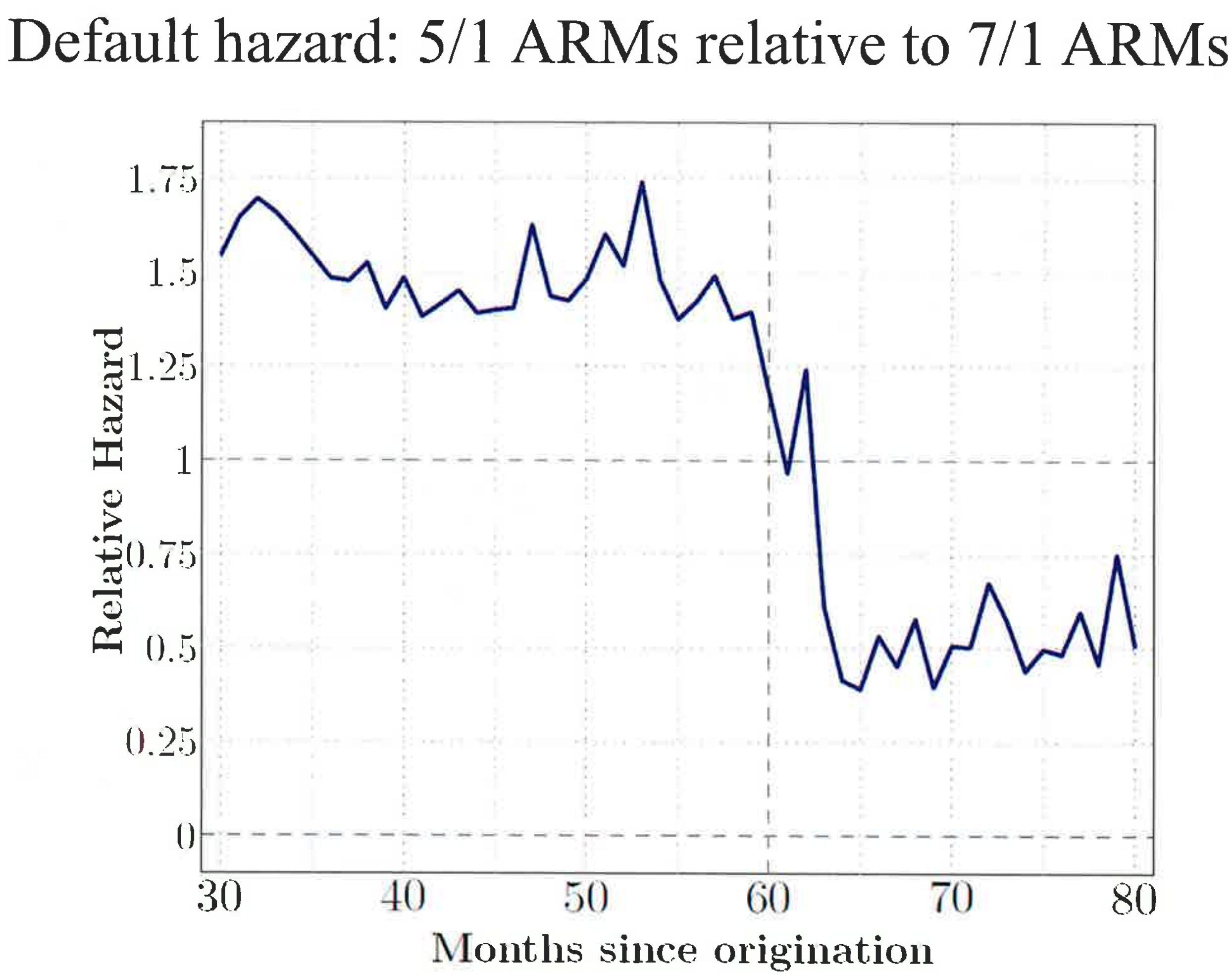
- Payment shocks can have important effects on default and credit losses for both commercial and residential mortgages.

- Particularly relevant as we contemplate a rising interest rate environment.

10 year Treasury yield: 1985-2015



Payment resets helped as interest rates fell…



Econometric estimate: Cutting payment by half reduces default hazard by 55%.

Source: Fuster and Willen (2015): Payment Size, Negative Equity and Mortgage Default.

Our panelists

- Robert Sarama, Economist
  Federal Reserve Board of Governors

- PJ Petersen, Senior Vice President
  Huntington National Bank

- Kiran Yalavarthy, Senior Vice President
  Wells Fargo