

End of the Line: Behavior of Credit-constrained HELOC Borrowers

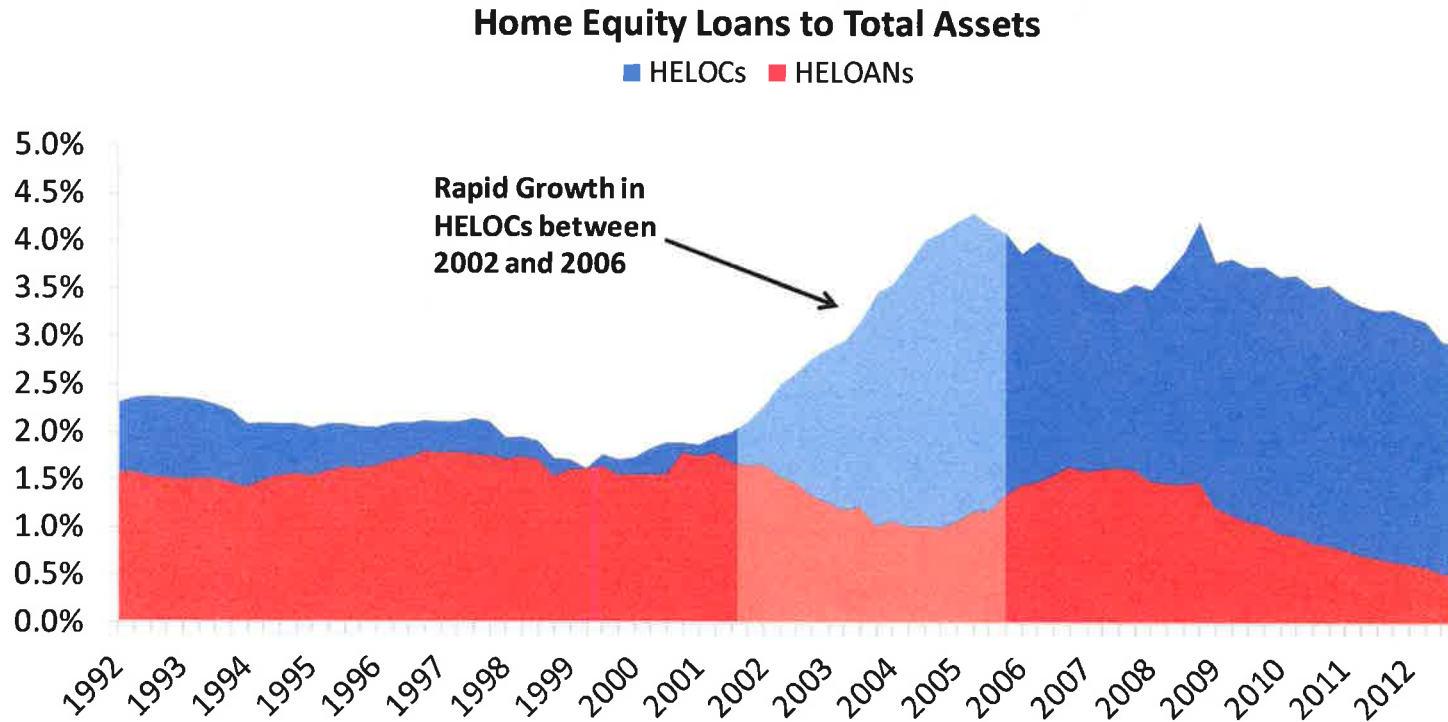
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Rapid growth in HELOC balances between 2002 and 2006



Source: FR Y-9C, all BHCs.

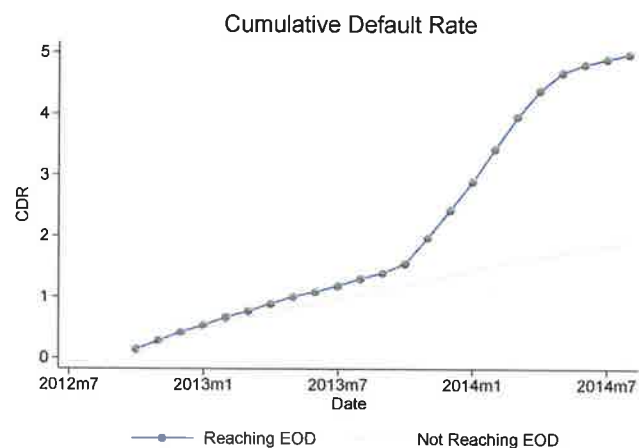
- ▶ Under a typical HELOC, borrowers make only interest payments on outstanding debt during the draw period, and the loan converts to closed-end amortizing loans at the end of the draw period.

Effect of payment change on default

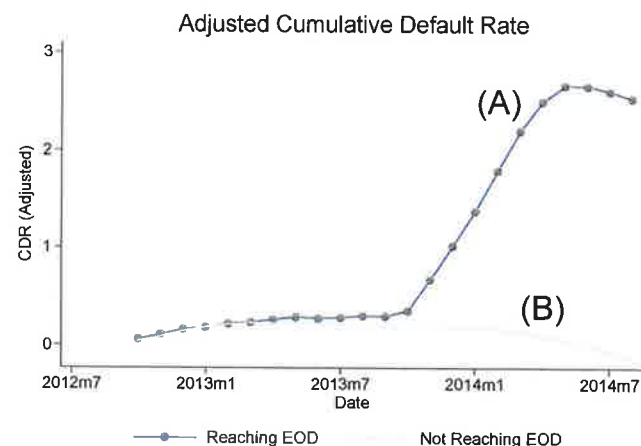
- ▶ Nearly 60 percent of outstanding HELOCs will reach the end of their draw (EOD) periods in the next several years
 - ▶ required payments will increase for many borrowers, and
 - ▶ renewed demand for credit if borrowers wish to maintain same household leverage.
- ▶ Often borrowers repay or refinance just prior to end of draw
 - ▶ but may have insufficient income or assets to repay
 - ▶ or may not be able to refinance
- ▶ **How will payment increase affect default rates?**
 - ▶ **Will the effect be different for different types of borrowers?**

Our approach

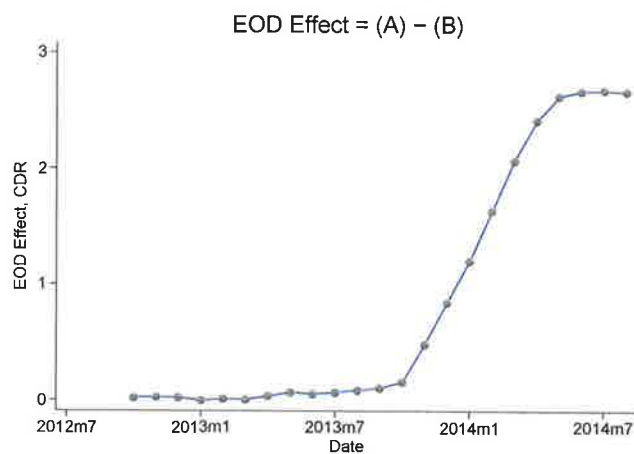
Step 1: Calculate cum. default rates (CDRs)



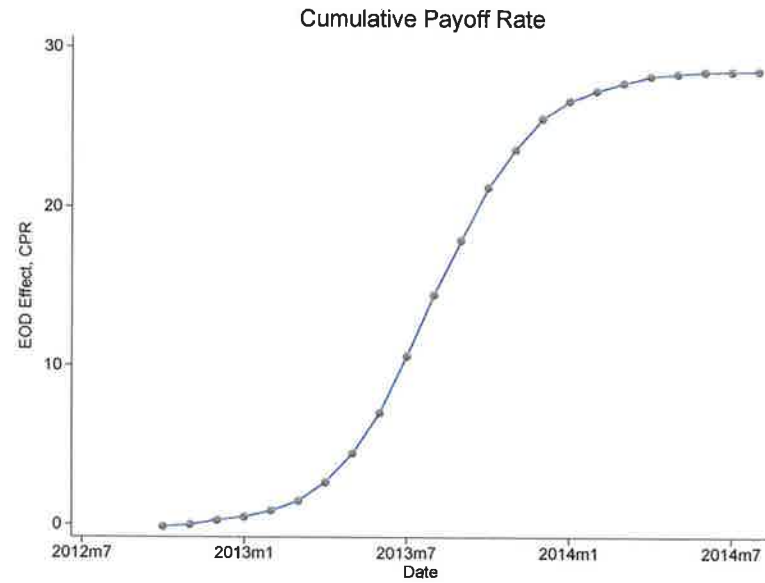
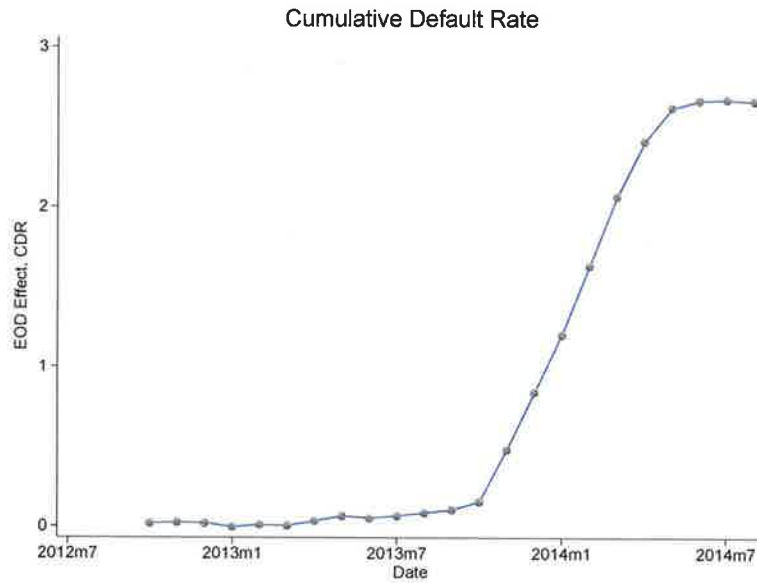
Step 2: Subtract predicted CDRs (estimated with competing hazard model)



Step 3: EOD effect is difference between adjusted CDR curves

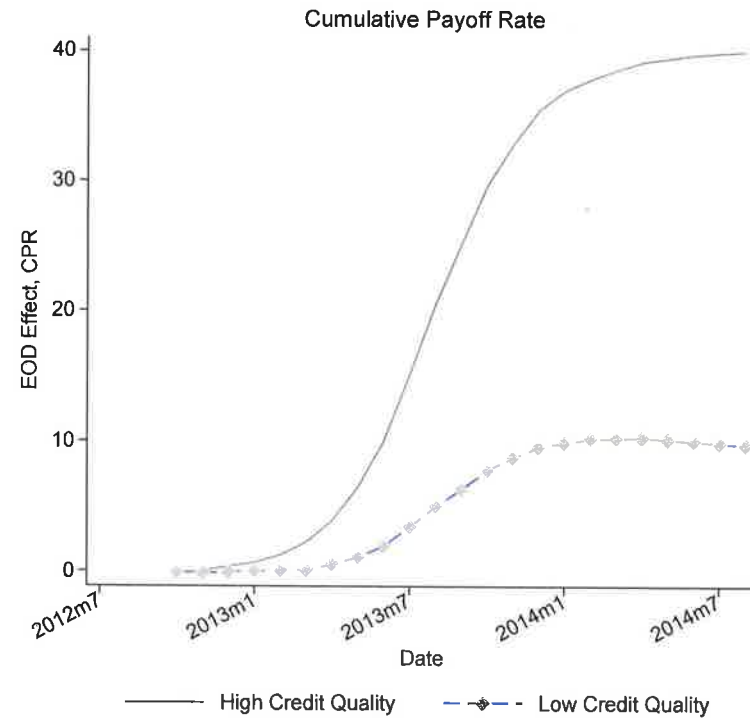
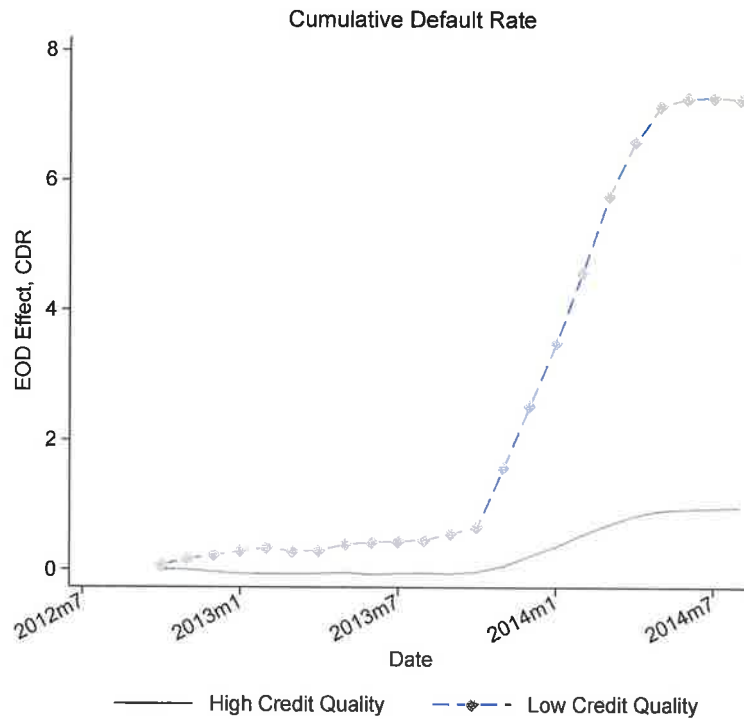


Overall effect



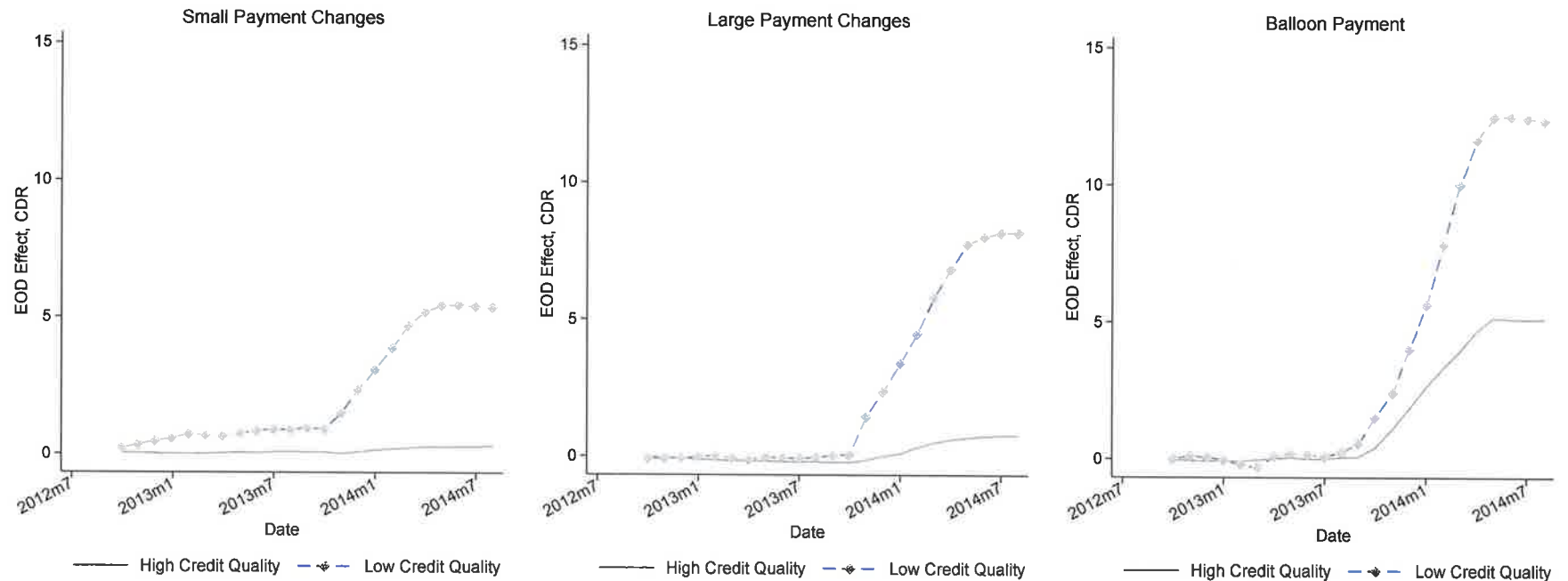
- ▶ Higher default and payoff rates for loans reaching EOD

Does borrower credit quality matter?



- ▶ “Low Quality” HELOCs (FICO < 725 and CLTV > 80) default at higher rate than “High Quality” HELOCs (FICO > 725 and CLTV < 80)

What is the role of the size of the payment change?



- ▶ “Low Quality” HELOCs more sensitive to size of payment increase

Thank you

Please send any feedback you have to Kathleen Johnson
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