Economic Policy Papers

Foreclosure Delay and the U.S. Labor Market

Mortgage foreclosure delays during the Great Recession improved job match quality, homeownership retention and national income

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EXECUTIVE SUMMARY

The time required to complete a home foreclosure rose substantially during the Great Recession, due both to lender bottlenecks in processing foreclosures and to government policies intended to slow the foreclosure process. This paper shows that foreclosure delay had the unintentional benefit of giving unemployed homeowners additional time to search for high-paying jobs.

Our economic model analyzes foreclosure delay as equivalent to extending additional credit to unemployed homeowners that is paid back if the homeowners find jobs and fulfill their delinquent mortgage obligations before foreclosure is completed. Model simulations estimate that foreclosure delay during the recession improved the quality of new employment matches, raised national income by about 0.3 percent and increased homeownership by about 800,000 units.

Introduction

The average time required to complete a home foreclosure in the United States increased from about nine months to about 15 months during the Great Recession. Our analysis shows that this increase had the unintended, positive consequence of helping unemployed homeowners increase their chances of finding high-paying jobs and keeping their homes, rather than losing them to foreclosure. The main quantitative finding is that foreclosure delay during the recession increased national income by about 0.3 percent and increased homeownership by about 800,000 units.

Background

The collapse of the U.S. housing market, massive financial crisis and subsequent Great Recession led to a record increase in home foreclosures between 2007 and 2011, as job loss and a tightening mortgage market pushed many households into default. By 2009, roughly 2.8 million homes were in the foreclosure process, compared with about 700,000 homes in foreclosure before the recession

(RealtyTrac 2009). Roughly one of 45 homeowners received a foreclosure notice in 2009.

This large increase in mortgage default was accompanied by a large increase in time required to complete the foreclosure process. Before the recession, it took about nine months on average to complete a residential foreclosure. By 2010, the average time had increased to about 15 months, and to more than two years in states such as Michigan, New Jersey and Florida.

This increase primarily reflected two factors. First, the sheer volume of foreclosed properties created foreclosure processing bottlenecks for lenders and courts. Second, several government policy responses slowed the foreclosure process. Policies to keep defaulting homeowners in their homes included federal mortgage modification programs that required a halt to the foreclosure process until a lender evaluated a borrower's modification request (see Mulligan 2010). Other policies also delayed foreclosure, such as the National Mortgage Settlement Act.

The positive effects of foreclosure delay

Foreclosure delay policies were considered an effort to help distressed homeowners by providing continuity for families and additional time to reorganize their affairs. But our analysis and new data reveal other positive effects. In a recent working paper for the National Bureau of Economic Research, we analyze how delays enhance the prospects of unemployed homeowners for finding better-paying jobs (Herkenhoff and Ohanian 2015). The analysis is based on two premises: (1) that unemployed homeowners would like to remain in their homes, but may not be able to pay their mortgages while unemployed, and (2) that lenders prefer not to foreclose on a home, since foreclosure is a costly process that often results in sizable losses for the lender.

By contrast, lenders benefit considerably when a delinquent homeowner is able to pay back previously missed mortgage payments. In this event, the lender not does not incur the cost of foreclosure processing and potentially taking a loss on the property; the lender also receives late fees on delinquent payments. This process in which a delinquent mortgagor pays back previously missed mortgage payments is known as *curing*, and it occurs frequently. In fact, our research documents that roughly half of all mortgagors who are in foreclosure successfully exit foreclosure through curing.

We find that foreclosure delay was also important for other reasons, particularly for unemployed homeowners, because job creation remained far below normal during the Great Recession. The job creation rate—the number of hired workers in a month relative to the total number of individuals working in that month—fell by almost half during the recession. Low job creation lengthened average unemployment substantially, as a large pool of job seekers, many of whom lost their jobs during the recession, were competing over a relatively small number of job openings.

While low-paying jobs may be easy to find, it can take a long time for a job seeker to find a high-paying job well-suited to his or her specific skills and experience—even in a vigorous economy. This suggests that the time to find a high-paying job during the recession rose substantially relative to a normal economy. Foreclosure delay gives unemployed homeowners time to search for high-paying jobs that match their skills, rather than feeling forced into low-paying jobs to prevent impending foreclosure.

Our research views this foreclosure delay as an implicit credit line from lender to borrower. Specifically, missed mortgage payments are an implicit loan to the borrower, and late fees are the implicit interest payment to the lender. The credit line is closed if the homeowner cures, or runs out if the homeowner does not cure and foreclosure is completed.

Trade-offs for the unemployed

To study how foreclosure delay impacts the economy, we develop an economic model of the economic decisions made by unemployed homeowners. The model specifies two trade-offs for unemployed homeowners:

- ***Job search intensity***
  How hard should unemployed homeowners search for jobs? The harder the search, the more likely they'll receive a good, high-paying job offer, but the less time they'll have for other valuable activities such as home production (cooking, child care, house repair and the like) and job retraining.
- ***To pay or not to pay?***
  Should unemployed homeowners make mortgage payments on time? Missing a payment allows households to use their scarce resources to increase nonhousing consumption. But it also means that mortgagors either become delinquent (if they had not defaulted on their mortgage previously) or go further into delinquency, ultimately risking foreclosure.

Theoretically, foreclosure delay—by policy or process slowdown—provides unemployed homeowners the opportunity to search longer for high-paying jobs. To what degree might this potential opportunity *actually* help them find better jobs and keep their homes? To address this question, we simulate the model economy with differences in the amount of time it takes to complete a foreclosure. We simulate the model economy with foreclosure timelines of (1) nine months, the U.S. average prior to the Great Recession, (2) 15 months, the U.S. average between 2009 and 2011, and (3) 24 months, the average among the states with the longest foreclosure delays: New Jersey, Florida and New York.

Our model estimates that a six-month increase in foreclosure delay significantly reduces employment, as unemployed homeowners take more time to search for higher-paying jobs. Nonetheless, national labor earnings are predicted to be higher, as foreclosure delay ultimately results in better job matches and higher wages. More exactly, the employment rate of homeowners during the 2009–11 period was estimated by our model to be about 0.75 percentage points lower due to the increase in the time to foreclose from nine months to 15 months. However, the model also indicates that labor income of homeowners would be about 0.3 percentage points higher, as unemployed homeowners had more time to search. We also estimate that foreclosure delays comparable to those seen in the recession would increase homeownership by about 800,000 housing units.

Reasonable estimates?

To test the plausibility of these results, we use data from the Panel Study of Income Dynamics on employment, mortgage delinquency and foreclosure and from the Survey of Consumer Finance, which also provides data on employment and borrower delinquency.

We analyze the re-employment rates of unemployed homeowners at different stages of delinquency, as the model predicts that job acceptance rates for the unemployed should increase considerably around the time of foreclosure. We find evidence consistent with this prediction, as employment rates tend to be very low for households who are 60 days delinquent, or 90 or more days delinquent, but the employment rate rises considerably once the homeowner is in the foreclosure process.

In addition, the model predicts that job search effort should rise as homeowners get closer to foreclosure. We also find evidence consistent with this prediction, as unemployed homeowners self-report considerably higher search effort when they are in foreclosure compared with search effort prior to.

Policy discussion

This analysis suggests that the large increase in time required to complete mortgage foreclosure experienced during the Great Recession had the positive if unintended consequence of helping unemployed homeowners to search longer for better-paying jobs. Given the deep drop in job creation at the time, this was particularly beneficial. Our estimates indicate that foreclosure delay helped unemployed, mortgage-delinquent homeowners considerably.

From a policy perspective, these results suggest that providing additional credit to unemployed homeowners is valuable for both homeowners and society, particularly when job markets are such that it takes considerable time for the unemployed to find jobs that match their skills. Policymakers may wish to consider permanent policies to increase the likelihood that unemployed and delinquent homeowners can pay back missing mortgage payments and remain in their homes. However, it is important that such policies preserve incentives to search vigorously for good job matches. Policy design would benefit from current research on the incentive effects of unemployment insurance (Meyer 2002).

References

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