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The Impact of Interstate Foreclosure Cost Differences and the Value of Mortgages on Default Rates

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Abstract

Previous research on mortgage default has focused on the costs, benefits, and characteristics of the mortgagor. In such studies default rates have been taken as a measure of mortgage risk. In this paper we present a model where the position of the lender affects the default-foreclosure process. Important to the lender's decision to foreclose rather than renegotiate an existing loan are the value of mortgage and the legal costs associated with foreclosure.

The empirical evidence supports the hypothesis that both the value of the mortgage and legal foreclosure costs affect the foreclosure rate. In those states where legal foreclosure costs are high rates are significantly less than where costs are low. This suggests that previous models which include only the costs and benefits of default to the borrower are incomplete and that foreclosure rates can not be taken as a strict measure of mortgage risk. That is, low foreclosure rates may indicate that losses occur in other forms of loan negotiation rather than in expensive legal costs.

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