Default Costs and Repayment of Underwater Mortgages[*]

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August 26, 2024

Abstract

This paper explores an overlooked phenomenon in mortgage markets: repayment of underwater mortgages. Since repayment in this case requires the borrower to use out-of-pocket funds along with the proceeds from the house sale to settle the loan, it may appear unattractive and even irrational. But if the borrower's negative equity is less than the cost of default, which includes credit impairment and possible guilt, repayment of an underwater mortgage is a wealth-maximizing strategy. The paper shows that such repayment indeed occurs, and that it is affected by the same factors commonly used in previous studies of default: the magnitude of home equity and the borrower's credit score, which captures default cost as well as liquidity. An increase in either variable raises the likelihood that the underwater loan is terminated by repayment rather than by default. In addition, the paper also gauges the magnitude of default cost by estimating lower bounds. These bounds (and thus possibly default cost itself) rise with borrower creditworthiness, a finding that is new to the literature.

1. Introduction

Suppose that a homeowner's mortgage is underwater, with the loan balance exceeding the house value. The homeowner accepted a job in another city and therefore wants to terminate the mortgage. Termination could be achieved by defaulting or by selling the house and repaying the mortgage.[1] Along with transferring the sale proceeds to the lender, repayment in this situation would require an additional out-of-pocket payment to the lender equal to the homeowner's negative equity. Whether repayment is preferable to default depends on the magnitude of negative equity (and thus the size of the required out-of-pocket payment) along with the magnitude of "default costs," which capture the various penalties associated with default.[2] While repayment of an underwater mortgage may be an unfamiliar notion, intuition suggests that paying off, say, $15,000 of negative equity could make sense for many borrowers. Doing so, for example, would allow our homeowner to secure immediate mortgage financing in the new location, rather than enduring the mortgage blacklisting that would result from default (one of its various costs). The homeowner might be reluctant, however, to pay off $75,000 of negative equity.

The first contribution of this paper is to show that repayment of underwater mortgages *actually occurs.* In mortgage data sets commonly used in the literature, it is not possible to distinguish between loans that terminate through refinancing and those that are repaid. However, our unique data enables us to draw this distinction, thereby facilitating the identification of underwater mortgage repayment. The second contribution is to explore the determinants of underwater repayment. While home equity and default costs are recognized as determinants of default in the existing mortgage literature, we explore their role in the repayment of underwater mortgages. Both contributions are new to the literature. To achieve these goals, we restrict our analysis to mortgages that have been terminated, either by default, repayment, or refinancing.[3] The literature on mortgage default, by contrast, uses data without this restriction, including mortgages with ongoing payments (current mortgages). In addition, we focus on termination that involves vacating the house, as happens with our homeowner, thus narrowing the sample to terminations that occur either by

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[1]Unless otherwise specified, the term "default" will be used throughout the paper to refer to a delinquency that ultimately leads to foreclosure. Consequently, "default" and "foreclosure" will be used interchangeably.

[2]Section 2 discusses various financial and nonfinancial costs associated with default.

[3]Because refinancing also involves the repayment of the existing mortgage, our use of "repayment" should be understood as the act of paying off the mortgage by selling the property.

default or repayment, omitting loans that are refinanced.[4] Our empirical results thus show the factors that favor repayment over default for the set of borrowers who vacate the house upon termination of the loan.

Following the literature, default costs are partly captured by the borrower's credit score, reflecting the belief that people with good credit have more to lose from default than those whose credit is bad. This assumption is consistent with the work of Brevoort and Cooper (2013), who track credit scores in the years after default. They find that borrowers with higher scores before the event have larger score declines, often ending up in the subprime category regardless of their pre-default status. Furthermore, recovery to initial status on average takes several years longer for those who initially had high scores. The borrower's credit score, however, may also be a proxy for liquidity, which can affect default and repayment behavior. Greater liquidity will make paying off an underwater mortgage easier while also making default due to trigger events such as a job loss less likely.

Consistent with the view that default is less likely for borrowers with high default costs and high liquidity, our results show that a higher credit score makes a borrower more likely to repay an underwater loan.[5] In addition, repayment is more likely the larger (the less negative) is the level of equity. These results thus show that the choice between repayment and default for borrowers with negative equity who are vacating their house responds to these focal variables in the same manner as the default decisions analyzed in the past literature. While this conclusion is perhaps natural, it provides a new insight into the behavior of mortgage borrowers. As discussed further below, our regressions also include a host of other variables that may affect borrower decisions.

While the concept of default cost is acknowledged in the mortgage default literature, it remains a subject of significant debate. Some models suggest minimal or even nonexistent default costs, whereas others imply substantial costs. Consequently, obtaining precise empirical evidence on the scale of default costs is of critical importance. However, recent studies indicate that most mortgage defaults are associated with liquidity constraints due to job loss or unforeseen medical expenses (Ganong and Noel (2023) and Low (2023)). This association complicates the task of estimating default costs for defaulters. However, a novel

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[4]This omission partly reflects the relative scarcity of negative-equity loans, which constitute our main focus, among loans that are refinanced. Among such loans, only 4.4% have negative equity, while among loans that are repaid, 8.0% have negative equity, making them almost twice as common.

[5]The credit score in our data is measured at the time of loan origination, not at termination. In the robustness section below, we discuss why this approach is unlikely to be problematic.

insight in our paper is that underwater prepayers are not liquidity constrained, providing a much cleaner environment for examination of default costs. We use our simple theoretical framework, along with data on negative equity and house values for mortgage repayers, to estimate lower bounds on borrower default costs for repayers. Our results suggest that default costs are indeed substantial. In addition, by showing that lower bounds rise across credit-score quintiles, our analysis suggests that default cost is larger for the most credit-worthy borrowers than for borrowers in the lowest quintile, a finding that appears to validate our underlying view. This conclusion appears new to the literature, and it constitutes a useful contribution of the paper. But even if one doubts a connection between default costs and credit scores drawn solely from the behavior of lower bounds, the large sizes of these bounds reinforces previous work that shows even larger default costs, using approaches more complex than ours.[6] The existence of significant default costs helps to shed greater light on default behavior, where resistance to default among borrowers whose loans are substantially underwater has sometimes proved puzzling.

The literature on mortgage default, which is now vast, is well synthesized and surveyed by Foote et al. (2008) and Foote and Willen (2018). Within this literature, papers that focus on the role of default costs are particularly relevant to our work. Early contributions in this area include Kau et al. (1993, 1994), Riddiough and Thompson (1993), Quigley and Van Order (1995). More recent work by Bajari et al. (2008) and Elul et al. (2010), Kau et al. (2011) and Gyourko and Tracy (2014) includes borrower credit scores, as we do, in its default regressions. From a different perspective, Brueckner et al. (2012) show that, by reducing default concerns, strong state-level house-price appreciation allows more borrowers with poor credit scores (and thus low default costs) to secure mortgages in the state.[7]

Much of the advancement in the recent literature lies in clarifying the role of "trigger events" such as job loss, which affect the affordability of mortgage payments, in generating defaults. The traditional approach, which we follow, is to include the unemployment rate as a regression covariate (at the state level), expecting a negative repayment effect (see for example, Bajari et al. (2008), Goodman et al. (2010), Elul et al. (2010), Gyourko and Tracy (2014)). Using newer approaches, Bhutta et al. (2017) estimate default models with

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[6]Using a structural model, Ganong and Noel (2023) deduce a "utility cost" from default equal to $100,000. Default cost in Laufer (2018), again estimated via a structural model, equals 29% of permanent income, while Kaplan et al. (2020) (also using a structural model) estimate the "disutility" from default equal to a 30% loss in annual consumption.

[7]Brueckner (2000) investigates distortions to the mortgage market when default costs are private information, unobservable to lenders.

and without negative-equity covariates, viewing the gap in predictions as due to trigger events. Gerardi et al. (2018) use data that allow measurement of financial stress at the individual borrower level, thereby precisely capturing trigger events. Ganong and Noel (2023), who also have access to individual income (bank account) data, use defaults by above-water (positive-equity) borrowers in response to income losses to gauge the contribution of trigger events to default by underwater borrowers, finding it to be large relative to the effect of negative equity. Similarly, using survey data matched to mortgage data, Low (2023) shows that nearly all mortgage defaults involve a liquidity shock (e.g., job loss, divorce, health shocks), and that above-water defaults induced by trigger events are not uncommon. In a related contribution, Low (2022) presents a theoretical model with liquidity shocks and psychic moving costs to explain above-water defaults. Ganong and Noel (2023), Low (2022), and Low's (2023) investigations of positive-equity defaults are new to the literature, and the existence of such defaults by itself reveals the power of trigger events, showing that negative equity is not a default prerequisite, with a negative trigger often sufficient. By contrast, our motivating example for negative equity repayment can be thought of as a *positive trigger*. Moving to a new job in another city without the burden of mortgage blacklisting makes use of out-of-pocket funds to pay off the existing debt worthwhile.[8]

As explained in more detail in Section 3, our study sample comes from ABSNet,[9] a data provider that covers non-agency mortgages, capturing around 90% of the non-agency market during our sample period.[10] ABSNet records whether a loan terminates through foreclosure, but it does not distinguish between terminations that result from refinancing versus loans that are repaid when the owner vacates (sells) the property. To facilitate this distinction, we merge the mortgage data with deeds data from RealtyTrac to track

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[8]Using a wealth of data from the Chicago area, Diamond et al. (2020) provide comprehensive results on the effect of foreclosure on a host of post-foreclosure outcome variables, including dwelling size, neighborhood income, school quality, divorce, crimes committed, DUI convictions, and bankruptcies, all of which may be tied to unmeasured trigger events causing a default. For outcomes more connected to our view of default costs, they show a reduction in subsequent mortgage originations and greater unpaid collections (perhaps due to reduced credit access) but find little effect on credit scores, noting that such impacts may occur earlier, with the onset of loan delinquency.

[9]The ABSNet data were compiled by Lewtan Technologies, which sourced the data from trustees and servicers. The company was acquired by Moody's Analytics in 2014. ABSNet data has been used to study mortgage fraud (Griffin and Maturana (2016) and Kruger and Maturana (2021)), the importance of mortgage originators having skin in the game (Demiroglu and James (2012)), mortgage servicer incentives (Diop and Zheng (2022)), the impact of state foreclosure laws on mortgage default (Demiroglu et al. (2014)), mortgage modifications (Agarwal et al. (2017), Maturana (2017), Conklin et al. (2019), and Korgaonkar (2021)), and the role of subprime borrowers in driving the housing boom (Conklin et al. (2022)).

[10]Non-agency mortgages are conventional mortgages not purchasable by the government-sponsored enterprises (GSEs): the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). They include loans to low-credit borrowers (subprime mortgages), loans exceeding the GSE lending limits (jumbo mortgages), and loans with deficient income/asset documentation (Alt-A mortgages).

ownership changes. For non-foreclosures, a mortgage termination that occurs with an ownership change indicates a property sale (repayment). After various exclusions, our final sample includes around 383,000 (469,000) loans that had negative (positive) equity at termination and were originated in the 2001-2007 period but terminated after 2007 but before 2016 (as noted, termination is either by repayment or default). Our study thus spans the mortgage-termination period from the beginning of the great financial crisis in 2007, which led to the world's second-worst economic recession, through the subsequent economic and housing market recovery. This is an ideal period in which to explore our research question for two reasons. First, as home prices cratered after the 2001-07 housing market boom, many borrowers with mortgages originated during that period found themselves owing far more than their houses were worth. In addition, as the economic crisis deepened, many underwater borrowers also experienced unemployment. With this "double-trigger" event (negative equity along with unemployment) the conditions were ripe for widespread mortgage defaults. As in Ganong and Noel (2023) and Low (2023), our sample also includes defaults by above-water borrowers, and we compare regressions results for the above-water subsample to those for underwater loans.

Our results show that the positive effects of the focal variables (equity and the credit score) on repayment are larger for above-water borrowers, indicating that defaults are more easily deterred by favorable values for these variables when equity is positive. This conclusion makes sense because a major force pushing the borrower toward default (negative equity) is absent in the above-water case. For both the negative- and positive-equity subsamples, we also extend our basic results through regressions that contain interactions between equity and credit score. Although our main analysis excludes terminations through refinancing, we also examine the effect of this exclusion by creating a new dependent variable indicating whether a loan was prepaid *or* refinanced, with results presented in the appendix.

Our motivating example focused on the choice between repayment and default for a negative-equity borrower who needs to terminate a mortgage in order to accept a job in another city. While our borrower is thus a mobile individual with good job opportunities, such unobservable borrower characteristics in reality are likely to differ between repayers and defaulters. Defaulters may have poorer labor-market opportunities and may be defaulting precisely because of a trigger event such as a job loss, which has occurred on top of an underwater mortgage. Repayers need not be as mobile as in our example (they may have simply bought

another house in the same city), but a negative trigger event presumably plays no role in their mortgage termination.

With unobservables likely to differ in these ways across defaulters and repayers, omitted variable bias becomes a possible threat. The absence in our data of any borrower characteristics aside from the credit score limits our ability to address this threat, but the inclusion of the state unemployment rate and median income is a rough attempt to control for trigger events, as in a number of previous papers. The upshot is that our motivating example depicts a much cleaner statistical context than we actually confront, requiring some caution in interpreting our results.[11]

Another crucial point to note is that, since our analysis is *conditional* on termination of the mortgage, an option-based analysis like those common in the mortgage literature[12] plays no role. While this option approach, which considers the future evolution of interest rates and house prices, is needed to decide *whether* an ongoing mortgage should be terminated, the borrowers in our sample have *already made* a termination decision. Therefore, option elements such as future interest rate volatility are not relevant to our analysis. Instead, our goal is to analyze which termination method, repayment or default, is chosen *conditional on the mortgage being terminated.*

The plan of the paper is as follows. Section 2 presents a simple model of strategic default and repayment in the presence of default costs, while section 3 discusses the data. Section 4 presents descriptive statistics and highlights notable patterns in the data. Section 5 presents our attempt to gauge the magnitude of default costs, and Section 6 presents the regression results. Section 7 offers conclusions.

2. An elementary mortgage-termination model with default costs

This section presents a simple strategic model of default and repayment that frames our empirical question: if a mortgage is to be terminated, either by repayment or default, which is the best choice for the borrower? While the default option, which involves future opportunities, plays no role, the cost of default is crucial. As noted above, one element of default cost is mortgage blacklisting, which prevents the borrower from

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[11] An alternative to repaying an underwater loan when vacating the house is renting out the property in anticipation that rising prices might eventually erase the negative equity. However, since all loans in our sample have been terminated, such borrowers are not included.

[12] See Deng et al. (2000) for a canonical study.

securing a new mortgage for a number of years following a default. Additional costs come from a reduction in the borrower's credit rating, which may raise the interest rate charged on other borrowing (such as car loans) while making it harder to acquire new credit cards. Guilt from abrogating a financial contract may also be an element of default cost, as seen in Guiso et al. (2013). While moving costs are a component of default cost when the choice is between default (which requires relocation) and mortgage continuation (which does not), moving costs play no role in the choice between repayment and default conditional on termination, since both choices require relocation.

Consider our homeowner from the introduction, who is moving to a different city and thus needs to terminate a mortgage. Suppose initially that default cost is absent, and let P denote the value of the house and M the mortgage balance. Then, default on the mortgage is preferable to repayment when

$$P \; < \; M, \tag{1}$$

with repayment preferred otherwise. Letting E denote home equity, which is given by $E = P - M$, the rule in (1) becomes $E < 0$, so that default is preferred when equity is negative, with the mortgage underwater, a familiar rule that also maximizes the borrower's net worth. To see this point, let A denote other financial assets, $A + E$ represents our borrower's net worth after selling the house and repaying the mortgage, which generates positive proceeds when $E > 0$ but requires an out-of-pocket payment when $E < 0$. By contrast, net worth after default equals A since both the housing asset and the mortgage debt then disappear. Thus, when equity is negative, default is preferred since yields a net worth of A instead of the smaller value of $A + E$ resulting from repayment.

Letting default cost be denoted C, net worth in the event of default becomes $A - C$ rather than A. Now default is preferred when

$$E \; < \; -C, \;\; \text{or} \;\; E \; + \; C \; < \; 0, \tag{2}$$

which requires that equity is negative enough to dominate the positive cost of default. The key implication of (2) is that a larger default cost makes (2) harder to satisfy, militating against default and in favor of repayment. With C mainly represented by the borrower's credit score in the regression, it follows that a larger credit score makes default less likely, and repayment more likely, when the mortgage is terminated. Larger

(less-negative or more-positive) equity also makes (2) harder to satisfy, yielding the same conclusions.

It is crucial to note from (2) that repayment of the mortgage may be optimal when equity is negative. For this outcome to occur, equity must be less negative than the negative of default costs, or $E > -C$ with $E < 0$. In this case, the underwater loan is repaid, a borrower decision that is the focus of this paper.

This conclusion may overturned if the borrower faces a liquidity constraint, lacking the out-of-pocket funds needed to pay off an underwater mortgage. Letting L (liquidity) denote the amount of such funds, repayment of an underwater loan (with $E < 0$) requires

$$E \; + \; C \;\; > \;\; 0 \quad \text{and} \quad L \;\; \geq \;\; -E. \tag{3}$$

The first inequality (the reverse of (2)) says that repayment is preferred while the second inequality says that liquidity is large enough to pay off the negative equity. The implication is that $E + C > 0$ is no longer sufficient for repayment of a negative-equity loan; enough liquidity is also required.

This framework also omits the transactions cost of selling the house as a cost of mortgage repayment. Ignoring the liquidity issue for the moment and letting transactions cost be denoted T, net worth after repaying the mortgage equals $A + E - T$, with $E - T$ negative when $E < 0$. With net worth under default again equal to $A - C$, default is then optimal when

$$E \; - \; T \;\; < \;\; -C. \tag{4}$$

When a liquidity constraint is reintroduced, repayment of a negative-equity loan requires

$$E \; + \; C \; - \; T \;\; > \;\; 0 \quad \text{and} \quad L \;\; \geq \;\; -E \; + \; T. \tag{5}$$

Thus, $E < 0$ and the reverse of (4) must hold, and liquidity must now be large enough to cover negative equity along with the transactions cost of selling the house.

Borrower liquidity may also reduce default due to trigger events such as a job loss, which reduce the ability to make mortgage payments. However, because our model is not rich enough to capture both strategic and trigger-based default, we cannot formalize this natural idea. Nevertheless, it is appropriate to view low

liquidity as pushing a negative-equity borrower toward default in two ways: inability to make payments when experiencing a negative trigger event, and inability to pay off the mortgage in response to either a negative or positive trigger event (such our borrower's job offer in a another city).

We will use equations (4) and (5) in section 5 below in an attempt to estimate lower and upper bounds on default cost. In doing so, we view realtor commissions as the main component of transactions cost. These commissions usually amount to 6% of the house value, which suggests that this magnitude can be used as a proxy for transactions cost. The default condition in (4) then implies that, holding equity and default cost constant, default is more likely when the house value is high, a result of higher transactions cost.

Note that inclusion of transactions cost is crucial in gaining insight into positive-equity defaults, which we consider along with the most recent literature discussed above. In the model without T, such a choice cannot be optimal, because if equity is positive, then $E > -C$ holds and (2) cannot be satisfied, making repayment the preferred termination choice. But in the presence of transactions cost, if E is positive but small, then $E - T$ can be negative in (3), and if sufficiently negative, it can be less than $-C$. In this situation, default is the preferred termination choice even though $E > 0$. When defaulting, the borrower avoids the transaction cost of selling the house, although default cost must be borne. Thus, if E, T, C are properly aligned, the default choice can be preferred for an above-water mortgage. Ganong and Noel (2023) and Low (2022, 2023) also acknowledge this argument as an explanation for positive-equity defaults, as these mortgages are effectively underwater once transaction costs are considered.[13]

To translate this simple framework into a regression context, let default cost be given by $C = X\beta + \epsilon$. X is a row vector of observable borrower characteristics that may affect default cost (including the credit score and income, proxied by the state median value), β is a coefficient vector, and ϵ is an error term representing unobserved borrower characteristics. Appending a coefficient to equity E and suppressing T, default (repayment) is then preferable when

$$\alpha E + X\beta + \epsilon < (>) \, 0. \tag{6}$$

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[13]Transaction costs alone are unlikely to fully explain above-water defaults. Ganong and Noel (2023) and Low (2022, 2023) show that default with substantial positive equity (e.g., larger than reasonable estimates of transaction costs) is not uncommon, likely due to a combination of borrower liquidity constraints and housing search frictions.

Repayment, which is our empirical focus, thus occurs when

$$\epsilon > -(\alpha E + X\beta). \tag{7}$$

The probability of the event in (7) equals $1 - F[-(\alpha E + X\beta)]$, where F is the cumulative distribution function of ϵ. This relationship can be used as the basis for a probit regression or a linear probability model, with a repayment dummy as the dependent variable (we use the latter).

Although trigger events are not part of the simple model sketched above, our empirical framework attempts to capture these events in a rough fashion by including the state unemployment rate and median income as covariates, as in much of past literature (the income measure may also help to capture borrower liquidity). The linear probability models we estimate also include a host of additional loan characteristics as controls, as described below.

3. Data

The mortgage data used in this study are from ABSNet, a non-agency mortgage data provider. ABSNet tracks loans from origination to termination, reporting whether a loan was voluntarily repaid by the borrower or foreclosed. Our initial sample includes first-lien mortgages that were outstanding at the end of 2007 with their final status recorded in the ABSNet loan history data file at the end of March 2016, the last reporting month available.[14] In addition to the loan origination data, we also collected from ABSNet the loans' balance and status at termination.

However, ABSNet misses a crucial piece of information about repaid loans that is required for this study. It does not specify whether the repayment of a loan was due to the sale or the refinancing of the property. ABSNet does note if a loan is a refinancing or purchase loan at origination, but the source of repayment when the loan is terminated is not given. Since, in the context of this study, it is important that we accurately identify the source of repayment at termination, we merge ABSNet and data from RealtyTrac.[15] RealtyTrac

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[14]This righthand truncation of the sample should not be a major issue because 98.1% of the mortgages terminated before this date.

[15]RealtyTrac is a real estate information company that compiles mortgage liens sourced from public records and property assessment data sourced from municipal real estate assessment offices.

uniquely identifies the property subject to a lien and provides information on the lien, including the type of lien, the loan amount if applicable, and its purpose (purchase or refinancing). By matching ABSNet to RealtyTrac, we are able to track the next lien on the property and the purpose of the loan associated with that lien, which was used to repay the first loan. Our final sample consists of ABSNet-RealtyTrac matched loans derived as explained below.

We started with an initial sample of about 5 million first-lien purchase and refinancing home mortgages originated in the continental U.S. between 2001 and 2007. These are loans appearing in the ABSNet December 2007 loan update file and the March 2016 ABSNet loan history file.[16] As discussed above, we matched these loans to the RealtyTrac lien data in order to identify the nature of the termination (repaid, refinanced, or foreclosed) by tracking the next lien on the property using the RealtyTrac unique property identifiers. We performed this match using property location (zip code), lien type, loan amount (in thousands), origination date, loan purpose (refinancing or purchase), and number of units. We kept unique matches where the lien registration date in RealtyTrac is within 60 days of the loan origination date in ABSNet. Our match rate was approximately 30%, which is similar to the success rate achieved by Diop et al. (2023) when matching RealtyTrac to McDash, a broader mortgage origination and servicing data set.

Our matched ABSNet-RealtyTrac sample consists of 1.34 million loans. As of the end of March 2016, 289,918 (21.6%) of the loans were repaid following the sale of property, 420,046 (31.4%) were refinanced, 561,670 (41.9%) were foreclosed, 43,113 (3.2%) were liquidated via short sales, and only 25,297 (1.9%) were still active. Because this study primarily focuses on terminations where the property is vacated, we use the subsample of 851,588 loans that were terminated by either repayment following the sale of the property or foreclosure. Therefore, our final sample regroups loans that were determined following these three mutually exclusive events: i) a positive equity property sale, ii) a foreclosure, or iii) a negative-equity property sale where the seller pays the lender for any shortfall between the mortgage balance and the sales proceeds. This third type of termination, which is largely ignored in the literature, is distinct from a short

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[16]Our sample is restricted to loans with amounts between $50,000 and $5 million, appraised property value between $50,000 and $10 million, loan-to-value ratio between 25 and 125, and non-missing property zip code, borrower credit score, and loan balance at termination. The latter data requirement resulted in loans being dropped if no information was available within 6 months of the loan termination date.

sale,[17] where the lender absolves the borrower of the shortfall.[18]

As is apparent in our discussion above, a critical piece of information required for our analysis is the borrower's equity position, or their perception of it, when the loan was terminated, which for simplicity we take as the value of the property minus the outstanding loan balance at termination. Because there is no independent valuation (appraisal) of the property at termination, we must derive our own value estimate or use an outside automated valuation model (AVM) estimate.[19] We use the former approach to derive our main value estimate by marking to market the original appraised value reported in ABSNet using changes in the Census tract house price index (HPI) from the Federal Housing Finance Agency (FHFA) and the five-digit zip code HPI from FHFA for properties with missing census tract HPIs.[20] We measure equity as the difference between the mark-to-market value of the property and the combined balance of the first mortgage and the second mortgage, if any, at termination.

Identifying second mortgages is possible because ABSNet reports lien type, loan-to-value (LTV) ratio, combined loan-to-value (CLTV) ratio, and other typical loan origination information (e.g., origination date, loan type, loan amount, maturity date, interest rate, property type, occupancy type, and payment status at termination). To identify the remaining balance at termination on a second mortgage, we match the first and second liens using loan origination date, property type, number of units, appraised value, and occupancy type. For the loans with matched second liens, we use the combined balance of the first and second liens at loan termination when computing borrower equity. For the remaining loans with CLTV greater than LTV, we use the amount of the first mortgage, LTV, and CLTV at origination to estimate the balance on the missing second mortgage at termination.[21]

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[17]In this paper we focus on the *borrower's* decision regarding mortgage repayment upon vacating the property. Conversely, short sales necessitate lender approval, placing the decision-making authority in the hands of the lender rather than the borrower. Consequently, short sales are excluded from our analysis as they fall within the lender's purview. It is worth noting that underwater repayers and defaulters in our sample may have pursued (but ultimately failed to engage in) short sales before opting for repayment or foreclosure.

[18]We also include refinanced loans in the additional analysis presented in the appendix. In theory, a borrower with an underwater mortgage can pay down the principal balance to refinance. However, merely eliminating negative equity is unlikely to be enough. The borrower must also bring the LTV ratio below current underwriting guidelines. For example, if the guidelines allow for 80% LTV refinance loans, a borrower with 110% LTV needs to reduce the loan not by 10%, but by 30% of the property value to meet the criteria. Consequently, underwater mortgage refinances are rare (see footnote 4 above).

[19]Alternatively, we could use the borrower's estimate of the value of the property. However, this information is unobservable in our data.

[20]The FHFA census tract and five-digit zip code HPIs are annual series. We use a linear approximation to estimate the HPI at the loan's termination month.

[21]We estimate the amount of the second mortgage at origination as $First\ Mortgage/LTV \times (CLTV - LTV)$. We use then

4. Descriptive Statistics and Notable Patterns

Table 1 presents the descriptive statistics for our final study sample, with Table 2 showing average variable values for the full sample as well as for the subsamples of positive- and negative-equity loans. Variable descriptions are in Table A.1. Exactly 34% of the loans were repaid via property sale, while 66% were terminated in foreclosure. The average equity of borrowers in the full sample, defined in this paper as the ratio of equity (updated property value minus loan balance at termination) to the updated property value, is −4.2%. In the sample, 45% of loans experience negative equity based on our measure. As expected, borrowers' propensity to repay loans varies significantly with equity. As seen in the first two rows of Table 2 and again in Table 3, 6% of terminated negative-equity loans were repaid, with the rest being foreclosures. While repayment of underwater loans is therefore not very common, the volume of such loans is nevertheless appreciable, justifying our focus on this phenomenon. As in Ganong and Noel (2023) and Low (2023), we also observe a relatively high rate of positive-equity (above-water) foreclosures in Table 3. Only a slight majority of our positive-equity loans (57%) were repaid, a surprisingly low share. The high frequency of positive-equity foreclosure may suggest that other trigger events, such as unemployment, were significant drivers of foreclosure during the sample period. Alternatively, these positive-equity foreclosures could be the result of high transaction costs (T) or low default costs (C), as seen in our model.

Returning to Table 1, the summary statistics show that our sample is overwhelmingly made up of single-family, owner-occupied properties: 97% single-family and roughly 85% owner-occupied. The average borrower has a credit score of 680 at origination, which indicates that our sample consists not only of subprime mortgages, but also Alt-A and jumbo loans, which typically were associated with higher credit scores than subprime loans. The median credit score is 682, suggesting no significant skewness in our data. Table 2 shows no substantial differences in property type, occupancy, and credit scores at origination between terminated positive- and negative-equity loans. As was typical during that period, the majority (68%) of our sample consists of adjustable rate mortgages (ARMs). Interestingly, ARM loans are over-represented in the negative-equity loans (81% vs. 58% in the positive-equity group). This pattern could be due to borrowers taking advantage of lower interest rates on ARMs to secure larger loans. Table 2 also shows higher con-

the average amortization speed of the matched second liens in our sample to estimate the balance of the missing second mortgages at termination.

centrations of interest-only and negative amortization loans among underwater mortgages: 37% vs. 28% and 17% vs. 6%, respectively. This pattern is not surprising because these loans amortize more slowly and are therefore more likely to end in negative-equity territory than loans without these features. In line with the above observations, the average original loan amount is smaller for positive-equity loans ($194,400 vs. $295,700). As expected, borrowers who found themselves in negative-equity territory started with significantly higher leverage both in terms of LTV (82% vs. 78%) and CLTV (87% vs. 82%), which accounts for other reported loans. Loans originated to refinance existing debt are notably over-represented in underwater mortgages (46% vs. 24%). This pattern may be due to multiple refinancings by borrowers to extract equity as house prices kept soaring during the mortgage credit boom. In summary, independent from the impact of changes in housing market conditions, loans that ended with negative equity started with a significantly higher balance, amortized more slowly, and most likely were refinancing loans.

Default and repayment behavior may depend on whether the state of origin is a recourse or a non-recourse state. However, any such effect is captured by the zip-code fixed effects used in all of our regressions (see below), which capture the effects of state-level was well as local unobservables.

As explained in the introduction, our main focus is on the effect of the credit score and equity on the type of loan termination (repayment or foreclosure). As a precursor to the regression results, Table 4 shows repayment vs. foreclosure statistics by quintiles of credit score (Panel A) and quintiles of equity (Panel B). The lower part of Panel A, which pertains to negative-equity loans, shows that the split between repayment and foreclosure shifts monotonically in favor of repayment moving up through the credit-score quintiles. In the lowest credit-score quintile, only 2.8% of loans are repaid, while in the highest quintile, 21.0% of loans are repaid. Note that negative equity is fairly stable across credit-score quintiles, ranging between −33.2% and −40.3% of the estimated property value. This pattern suggests that, holding negative equity constant, borrowers' propensity to repay negative-equity loans likely increases with credit score. This pattern is a main prediction that we seek to formally establish.

The upper part of panel A pertains to positive-equity loans. It shows that, as in the case of underwater loans, the share of loans repaid rises with the credit-score quintile. In each quintile, this share is higher than the corresponding share for underwater loans, rising from a low of 22.7% in the lowest quintile to 89.3% in the highest quintile. Positive equity also rises across the credit-score quintiles, from a low of 18.6% of value

in the lowest quintile to 30.3% in the highest quintile, indicating that the substantial amount of money that is being left on the table by above-water defaulters. Of course, disentangling the separate credit score and equity effects requires the regression analysis that is reported below.

Panel B shows statistics by equity quintile, with the lower part again pertaining to negative-equity loans. As mean (negative) equity rises across quintiles, moving from -93.0% of value in the lowest quintile to -4.0% in the highest quintile, the share of loans repaid rises as well, from 1.3% to 15.9%. The same pattern is seen for positive-equity loans in the upper part of Panel B. As mean equity in the quintiles rises from 6.5% to 64.1%, the share of these loans repaid rises from 31.4% to 88.8%. Again, the repayment percentages of positive-equity loans are larger in each case than for negative-equity loans. As noted, the importance of trigger events in mortgage default and ultimately foreclosure shows in the significant share of loans with large positive equity ending in foreclosure. For example, a staggering 33.5% of terminated loans with an average equity of 26.5% equity (third equity quintile of Panel B) ended in foreclosure.

5.   Gauging the Magnitude of Default Cost

Before turning to the regression results, we can ask whether the data combined with our theoretical framework allow us to gauge the magnitude of default costs, complementing previous efforts in the literature (see footnote 6). Ignoring liquidity constraints for the moment, note that since satisfaction of the previous default condition (4), $E - T < -C$, makes default optimal, satisfaction of $E - T > -C$ or

$$-E \; + \; T \;\; < \;\; C \tag{8}$$

makes repayment optimal. For an underwater mortgage, $-E > 0$ holds and thus $-E + T$ is the positive out-of-pocket amount the borrower needs in order to pay off the mortgage. When this amount is less than default cost, repayment is optimal.

Viewed differently, when (8) holds as an equality, it indicates the *minimum value of default cost under which it makes sense to repay a mortgage*. Let $\widehat{C}$ denote this minimum value, which gives a lower bound on default cost and satisfies $-E + T = \widehat{C}$. In view of this equality, the lower bound $\widehat{C}$ depends on $-E$ and T, rising with both the absolute value of negative equity and transactions cost. Our approach is to use this

insight, along with data on how negative equity and transactions cost vary across credit-score quintiles for mortgage repayers, to back out the variation of the lower bound on default cost across these quintiles.

The same logic could be applied to mortgage defaulters to find an upper bound on default costs. For default to be optimal, $-E + T > C$ must hold, implying that default costs must be *no larger* than $-E + T$ for default to make sense. Thus, letting $\overline{C}$ denote the upper bound on default cost for defaulters, $\overline{C} = -E + T$. While $-E + T$ therefore represents a *lower bound* on default costs in the case of repayers, it represents an *upper bound* on default cost in the case of defaulters. Using our data, we can also show how this upper bound varies across credit-score quintiles.

Does this logic require amendment in the presence of liquidity constraints? For mortgages that are repaid, it is crucial to recognize that no amendment is needed since the act of repayment means that the borrower *had sufficient liquidity to do so.* But for defaults, the condition $-E + T < C$ from (5) may be satisfied (indicating the desirability of repayment) but the second inequality in (5) may be reversed, with $L < -E + T$. This latter inequality indicates insufficient liquidity, so that default occurs even though repayment is desirable. The upshot is that, while we can still compute a lower bound on default cost for repayers, equal to $\widehat{C} = -E + T$, use of the same formula to produce an upper default-cost bound for defaulters may be illegitimate, given that their defaults may be driven by liquidity and not solely by equity and default costs. We will compute the upper bounds anyway, realizing that they are likely to unreliable.

Table 5 presents the calculations for negative-equity borrowers, showing the medians of property value and equity across the five credit-score quintiles while distinguishing between repayers and defaulters. To compute the median magnitude of $-E + T$ in a quintile, we set T equal to 0.06 times the relevant median property value (6% to reflect real estate commissions) and add it to the relevant absolute value of median equity. The results are shown in separate rows of the table.

As can be seen in the repayer panel of Table 5, the median lower bound on C rises across the credit-score quintiles, apparently validating the view that default cost rises with the credit-worthiness of a borrower. The median lower bound in quintile 5 is more than \$26,000 higher than in quintile 1. This pattern is consistent with the results of Brevoort and Cooper (2013), who document the much greater cost of credit impairment and mortgage blacklisting for the most credit-worthy borrowers. Importantly, the pattern also validates our interpretation of the positive credit-score coefficients in the subsequent regressions as showing the positive

effect of higher default costs on mortgage repayment.[22]

It could be argued that the increase of the lower bound across credit-score quintiles does not prove that default costs rise across the quintiles. Conceivably, defaults costs themselves could be constant or fall across the quintiles even when the lower bound is rising. The behavior of the lower bound is suggestive nevertheless, and even if one doubts the conclusion we draw on the default-cost/credit-score correlation, Table 5 still shows that default costs themselves must be large (as seen elsewhere in the literature) due to the large sizes of all the lower bounds.

Similarly, the defaulter panel of the table shows that the median upper bound on C also rises across the credit-score quintiles, while also being appropriately larger than the lower bound in each quintile ($\overline{C} > \widehat{C}$).[23] Despite this pattern, it should be recalled that the liquidity issues may invalidate the logic used to derive the upper bound, so that the information in the defaulter panel of Table 5 should probably be discounted even though it seems consistent with numbers in the upper panel.

Even though we recognize this limitation, Figure 1 graphs the median bounds from Table 5, while Figure 2 shows histograms of lower bounds on C for individual borrowers within each credit-score quintile. Changes in the distributions across the quintiles confirm what is seen in the medians: a tendency for lower bounds to be lower in the lower quintiles.

6. Regression Results

6.1. Main Results

Table 6 reports the basic regression results, and it confirms the patterns seen in Table 4. The regressions are linear probability models with the dependent variable equal to 1 for loans that are repaid and 0 for foreclosures. Results for positive-equity loans are shown in the first column, while the second column shows results for negative-equity loans. The third column shows results for the full sample, allowing the key coefficients to differ by subsample. All the regressions have fixed effects for origination and termination years and zip

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[22]A version of Table 5 could also be constructed for positive-equity borrowers, but the lower bound is less useful for this group since $-E + T$ then tends to be close to zero, yielding a bound that is not very informative.

[23]While this size relationship is expected to hold if repayers and defaulters differ only in their levels of negative equity and property value, other unobservable differences between the groups could in principle disrupt it.

code, and coefficient standard errors are clustered by zip code. Full regression results, including coefficients on the additional control variables not shown in Table 6, are reported in Table A.2 of the appendix.

As was seen in Table 4, a higher credit score makes repayment more likely for both positive- and negative-equity loans, as reflected in the significantly positive credit-score coefficients in the first two columns of Table 6. In addition, the positive coefficients on the equity measure show that higher equity makes repayment more likely for both positive- and negative-equity loans, as was seen in Table 4.[24] However, Table 6 shows an additional pattern that the statistics in Table 4 could not reveal. In particular, both the credit-score and equity effects are *larger for positive-equity than for negative-equity loans.* Therefore, better credit and higher equity appear to be more effective at inducing repayment (and thus preventing foreclosure) when a loan is above water than when it is underwater, a natural outcome given that a key force pushing the borrower toward default (negative equity) is then absent. These conclusions, however, are based only on a comparison of coefficients from different regressions, and to carry out a proper statistical test, we use the full-sample regression in the third column of Table 5. In this regression, the credit-score and equity effects are allowed to differ by interacting a negative-equity dummy with each of these variables.

The un-interacted credit score and equity coefficients are positive, indicating positive effects for above-water loans (for which the dummy is zero). Moreover, for each of these variables, the interaction coefficient is significantly negative, indicating that the credit-score and equity effects are smaller for negative-equity loans than for positive-equity loans. This pattern confirms more rigorously the conclusions drawn from the separate regressions in the first two columns of the table. Intuitively, since we would expect the impetus for repayment to be stronger for above-water loans than for underwater loans, we would also expect the forces that tip the borrower's decision toward repayment (a higher credit-score and equity level) to have a greater impact for such loans.

An additional variable identified by the theory of section 2 is property value, measured at mortgage termination. The prediction is that a high value, by raising transactions cost, makes repayment of a loan less likely. This prediction is upheld by the significantly negative property-value coefficients for positive-equity borrowers and for the full sample, while the coefficient for negative-equity borrowers is positive

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[24]It could be argued that, in addition to capturing default costs, the credit score may be a proxy for the availability of liquid funds for use in paying off an underwater mortgage, although this possibility is hard to evaluate empirically (we thank David Low for suggesting this point).

and insignificant. This instability of the property-value coefficients is also seen in some of the subsequent regressions.

Many of the control variables in Table 6's regressions also have effects on repayment. The variables designed to capture trigger events, the state-level unemployment rate and median income, perform somewhat as expected, with the unemployment coefficient negative in the positive-equity and full-sample regressions, where it is significant. But the coefficient is significant with the wrong sign (positive) in the negative-equity regression. The coefficient of median income, which may help capture liquidity effects, is significant with the expected positive sign in the positive-equity regression but is significantly negative (the wrong sign) in the other two regressions. These results suggest that our state-level variables are (unsurprisingly) not doing a very good job of capturing trigger events. But it is not clear that use of better variables (were they available) would change our main qualitative findings on the effects of the credit score and equity.

Among the other controls, the results also show that large loans are more likely to be repaid, and that repayment of refinancing loans is less likely, results that hold in all three regressions. The latter finding makes sense because refinancing loans are generally riskier given that they may reflect equity extraction by risky, financially constrained borrowers. For this reason, refinancing loans are overrepresented in the negative-equity subsample (46% vs. 24% for positive-equity loans), as noted above. Even though we control for equity in our regressions, the fact of equity extraction may imply that a borrower is unobservably riskier and less likely to prepay.

In addition, ARM loans and loans with a high initial interest rate are uniformly less likely to repay. The ARM effect possibly captures the default-inducing trigger event of an ARM interest-rate reset, an event that may be more punishing the higher is the initial interest rate. Single-family loans are more likely to repay, and higher mortgage rates at termination also make repayment more likely in two of the regressions. This latter effect seems counterintuitive given that consumers are less likely to seek a mortgage on a new house, which requires repayment of their existing mortgage, when interest rates are high.[25] The effects of the remaining controls are inconsistent across the three regressions in Table 6. The regressions contain a number of additional control variables whose coefficients are not reported, with the full set of results shown in Table A.2 in the appendix.

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[25]Indeed, the current interest rate might be viewed as affecting default cost, with a high rate reducing the loss from mortgage blacklisting (since a new mortgage is then less attractive). However, the result from Table 6 undercuts this view.

Tables 7 and 8 present the kinds of comparisons seen in Table 4 in a regression setting. Table 7 allows the effect of equity on repayment to depend on the credit-score quintile, while Table 8 allows the effect of the credit score to depend on the equity quintile. In Table 7, the first and third columns, which lack interaction terms, show positive equity effects on repayment along with dummy-variable coefficients for credit-score quintiles. As can be seen, these dummy coefficients rise monotonically across the credit-score quintiles, recapitulating the positive effect from the continuous credit-score variable in Table 6. Note that the equity coefficient and most of the quintile dummy coefficients are larger in the positive-equity regression than in the negative-equity regression, again recapitulating Table 6.

Turning to the second and fourth columns of Table 7, which contain the interaction variables, we can see that, because the interaction coefficients for positive-equity loans in the second column are positive for quintiles 2, 3, and 4, the equity effect on repayment is larger in credit-score quintiles 2, 3, and 4 than in quintile 1, where the effect is given by the positive uninteracted equity coefficient. The negative coefficient of the quintile 5 coefficient shows that the equity effect is smaller in that quintile than in quintile 1. Therefore, for positive-equity loans, the equity effect has a hump-shaped pattern across credit-score quintiles, a pattern that is perhaps unexpected.

For negative-equity loans, the interaction coefficients in the fourth column are all positive, and they rise in magnitude across the credit-score quintiles. Therefore, for underwater loans, the equity effect on repayment becomes larger moving up through the credit-score quintiles. An increase in equity thus raises the likelihood of repayment most for a high-credit-score borrower, an outcome that seems intuitive.

Turning to Table 8, the first and third columns, which again lack interaction terms, show a positive credit-score effect on repayment along with dummy-variable coefficients for equity quintiles. In both columns, these dummy coefficients rise monotonically across the equity quintiles, recapitulating Table 6 positive effect from the continuous equity variable. Again, the credit-score coefficient and all of the quintile dummy coefficients are larger in the first than in the third column.

In column 2, the coefficients of the equity-quintile/credit-score interactions rise between equity quintiles 1 and 2 and then fall across the remaining quintiles, showing that, for above-water loans, the credit-score effect on repayment has a hump-shaped pattern. In column 4, the interaction coefficients are monotonically increasing across the quintiles, so that the credit-score impact on repayment becomes larger moving up

through the equity quintiles. Therefore, for underwater loans, an increase in the credit score raises the likelihood of repayment most when equity is in the highest quintile, again an intuitive result. These results obviously parallel those in Table 7. Note that the property-value coefficients are significantly negative in all of the regressions of Table 8, showing the expected transactions-cost effect on repayment.

6.2. Robustness Checks

Table 9 presents robustness checks for the basic specification in Table 6. To check the possible effect of measurement error in equity around the value of zero, the first robustness check drops observations where equity is between -5% and $+5\%$ of property value. The second check is to exclude loans in the repaid category that had been delinquent but were repaid at termination.[26] The third check is to add an observation-level income variable generated by using the debt-to-income ratio (DTI) for the loan at origination.

The main regularities seen in Table 6's coefficients were positive equity and credit-score effects on repayment. As can be seen from columns 1 and 5 of Table 9, these same regularities hold for the most important robustness check, the one addressing equity measurement error. The same conclusions hold for the other robustness checks, as can be seen in columns 2 and 6, in columns 3 and 7 (the first two modifications are imposed together), and columns 4 and 8 (where all three modfications are applied together), showing substantial robustness of the earlier results. Robustness checks for the interaction specifications in Tables 6 and 7 are shown in Tables A.3 and A.4 in the appendix. These tables again show strong robustness of interaction results.

Recalling that loans that were terminated by refinancing were dropped from the sample, an additional robustness check is to combine those observations with repaid loans in a new category denoted "Repaid or Refinanced," with foreclosed loans remaining the other category. This change overturns our clean focus on terminations that require the borrower to vacate the house, but it is worthwhile seeing how it affects the results.

Appendix Tables A.5, A.6 and A.7 replicate Tables 5, 6 and 7 under this modification. As can be seen,

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[26]Of the 19,472 negative equity repayers, only 1,103 were in delinquency prior to repayment. Delinquency would reduce credit scores and thus the incentive to repay an underwater mortgage. This information addresses a potential concern about our measurement of credit status. In particular, since the credit score in our data is captured at the time of loan origination, not at termination, it could be a "stale" measure of a borrower's credit status (and default costs). But since underwater repayers are rarely late on their mortgages, it follows that their credit scores, and hence default costs, are still high at loan termination. Moreover, as seen below, excluding underwater repayers with mortgage delinquencies has no material impact on our regression results.

the main conclusions of the earlier tables remain: the effects of equity and credit score on loan termination by repayment or refinancing remain positive, and the effects of these variables are larger for positive-equity loans.

7. Conclusion

This paper has explored an overlooked phenomenon in mortgage markets: repayment of underwater mortgages. Since repayment in this case requires the borrower to use out-of-pocket funds along with the proceeds from the house sale to settle the loan, it may appear unattractive and even irrational. But if the borrower's negative equity is less than the cost of default, which includes credit impairment and possible guilt, repayment of an underwater mortgage may be a wealth-maximizing strategy, provided that sufficient liquidity is available.

The paper shows that repayment of underwater mortgages indeed occurs, and that it is affected by the same factors commonly used in previous studies of default: the magnitude of home equity and the borrower's credit score, which we view as capturing default cost along with borrower liquidity. An increase in either variable raises the likelihood that a loan is terminated by repayment rather than by default, doing so less strongly for underwater than above-water loans. Another contribution of the paper, which does not rely on regression analysis, is the use of our theoretical model along with summary statistics by credit-score quintile to gauge the magnitude of default cost for mortgage repayers and how it varies across these quintiles. We show that the lower bound on default cost is much higher for the most credit-worthy repayers than for those in the lowest quintile, which may suggest that default cost rises with a borrower's credit worthiness, an empirical conclusion that would be new to the literature.

It could be argued, however, that our lower-bound pattern does not prove that default cost moves in step with the credit score, in which case our regression results showing the positive repayment impact of good credit could simply testify to the greater liquidity enjoyed by such borrowers. With greater liquidity, more funds are available to pay off an underwater mortgage or to cushion the impact of lost income, making default less likely. This alternate interpretation of our regressions matches the views of Ganong and Noel (2023) and Low (2023), who argue that defaults are typically not strategic (making default costs unimpor-

tant) but are more driven by liquidity issues. Even if one takes such a view, our results on the default-cost lower bounds nevertheless establish a different significant point: the large values of the bounds indicate that default costs are high, as argued in other papers in the literature.

As a final point, it is worth noting that the existence of underwater mortgage repayment may help to explain mortgage servicer and lender decisions regarding short sales,[27] where the lender allows the borrower to sell the property at a transaction price below the outstanding mortgage balance. The shortfall is generally forgiven by the lender and the damage to the borrower's credit is less than with a foreclosure. The lender agrees to the short sale to avoid costs associated with foreclosure. Because of these benefits to borrowers and lenders, many commentators viewed short sales as a "win-win" proposition in the global financial crisis, and questioned why short sales were not more common. Informational asymmetries related to underwater repayment may help to resolve this puzzle. Some borrowers will fully repay underwater mortgages, and lenders want to avoid offering short sales to these borrowers. However, a borrower's willingness to repay an underwater mortgage is not fully observed by the lender. This uncertainty can reduce the optimal level of short sales in equilibrium, analogous to the "information theory" put forth by Adelino et al. (2013) to explain mortgage modifications. We leave to future research a formal treatment of this theory.

[27]Short sales are not included in our empirical analyis.

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Figures
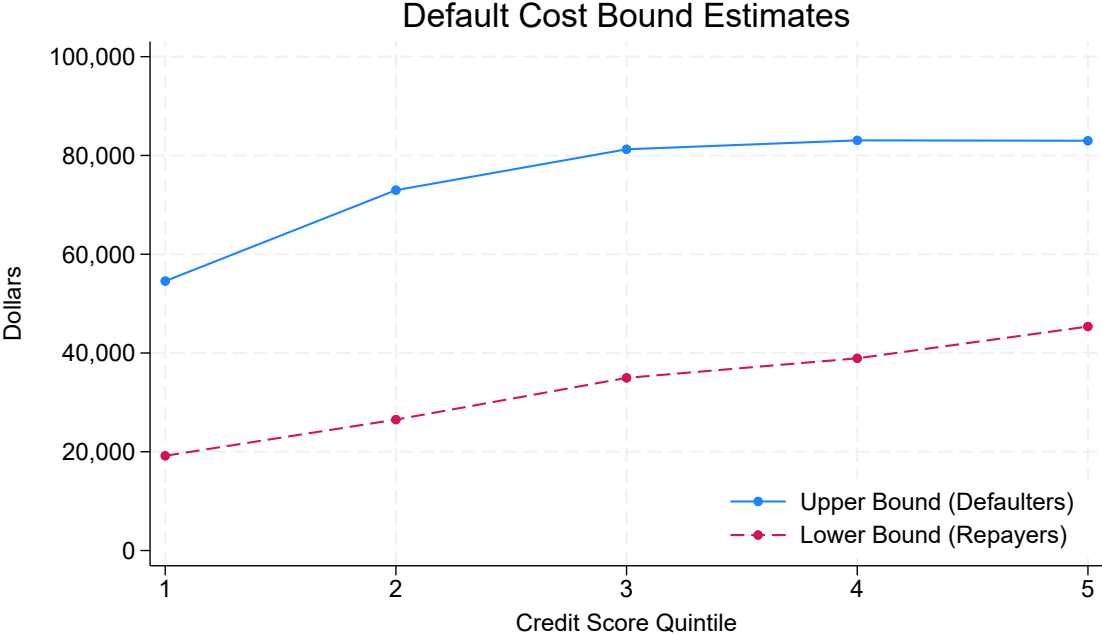
Note: This figure presents the lower and upper bound estimates of default costs by credit score quintiles from Table 5. Lower bounds are estimated using the sample of negative equity repayers, while upper bound estimates are derived from negative equity defaulters.

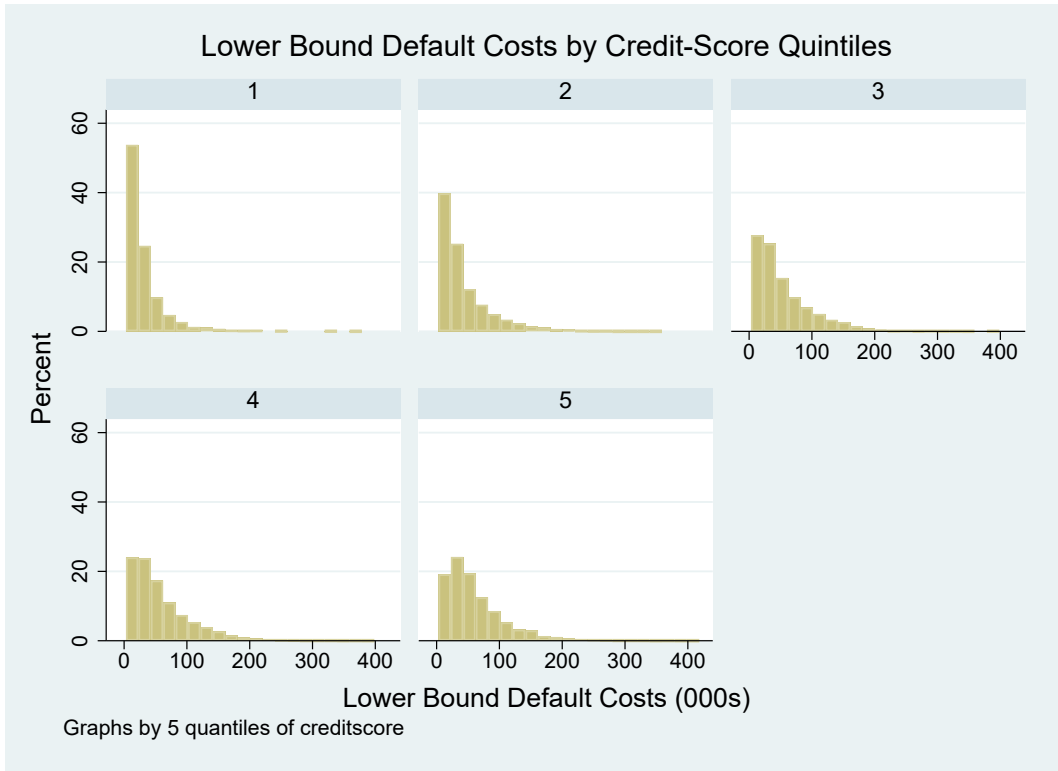Figure 1. Lower and Upper Bounds on Average Default Costs

Figure 2. Histograms of Lower Bounds on Default Costs by Credit Score Quintiles for Negative Equity Repayers

Tables

Table 1. Descriptive Statistics of the Full Sample

Variable	N. Obs.	Mean	Std. Dev.	Min	Max
Repaid	851,588	0.340		0	1
Foreclosed	851,588	0.660		0	1
Credit Score (00s)	851,588	6.80	0.70	3.38	8.49
Equity	851,588	-0.042	0.408	-4.213	1.000
Negative Equity Dummy	851,588	0.450		0	1
Property Value (ln)	851,588	12.408	0.760	9.864	16.181
Original CLTV	851,588	84.5	12.4	25.0	180.0
Original LTV	851588	79.6	9.9	25.0	125.0
Loan Amount (ln)	851,588	12.419	0.694	10.820	15.425
Refinancing Loan	851,588	0.338		0	1
Non-Owner Occupancy	851,588	0.144		0	1
Occupancy Unknown	851,588	0.007		0	1
Interest Rate	851,576	6.674	2.040	1.000	11.800
Loan Term (ln)	836,301	5.906	0.123	4.094	6.400
DTI	851,588	0.012	0.069	0.000	0.500
DTI Missing	851,588	0.762		0	1
PMI	851,588	0.099		0	1
PMI Missing	851,588	0.284		0	1
Neg. Amortization	851,588	0.105		0	1
ARM	851,588	0.681		0	1
Balloon	851,588	0.083		0	1
Interest Only	851,588	0.320		0	1
Interest Only Missing	851,588	0.017		0	1
Single Family	851,588	0.965		0	1
Inflation	851,588	222.027	8.428	207.667	238.034
Mortgage Rates	851,588	4.789	0.848	3.345	6.572
Unemployment Rate	851,588	8.449	2.345	2.600	13.700
HPI End	851,588	199.305	46.782	98.400	417.700
HPI Origination	851,588	240.253	62.249	109.060	383.310
HPI Volatility	851,588	25.906	17.469	0.784	87.928
Median Income (000s)	851,588	81.114	28.710	12.260	250.001

Note: The variable descriptions are in Table A.1 of the appendix.

Table 2. Variable Means for the Full Sample, and for Negative- and Positive-Equity Loans

Variable	Full Sample		Negative-Equity Loans		Positive-Equity Loans	
	N. Obs.	Mean	N. Obs.	Mean	N. Obs.	Mean
Repaid	851,588	0.340	383,000	0.061	468,588	0.569
Foreclosed	851,588	0.660	383,000	0.94	468,588	0.43
Credit Score (00s)	851,588	6.80	383,000	6.660	468,588	6.916
Equity	851,588	-0.042	383,000	-0.383	468,588	0.237
Negative Equity Dummy	851,588	0.450	383,000	1	468,588	0
Property Value (ln)	851,588	12.408	383,000	12.178	468,588	12.597
Original CLTV	851,588	84.5	383,000	87.4	468,588	82.1
Original LTV	851,588	79.6	383,000	82.2	468,588	77.5
Loan Amount (ln)	851,588	12.419	383,000	12.465	468,588	12.381
Refinancing Loan	851,588	0.338	383,000	0.458	468,588	0.239
Non-Owner Occupancy	851,588	0.144	383,000	0.135	468,588	0.150
Occupancy Unknown	851,588	0.007	383,000	0.006	468,588	0.008
Interest Rate	851,576	6.674	382,995	6.738	468,581	6.623
Loan Term (ln)	836,301	5.906	372,756	5.932	463,545	5.885
DTI	851,588	0.012	383,000	0.015	468,588	0.009
DTI Missing	851,588	0.762	383,000	0.738	468,588	0.782
PMI	851,588	0.099	383,000	0.076	468,588	0.118
PMI Missing	851,588	0.284	383,000	0.301	468,588	0.271
Neg. Amortization	851,588	0.105	383,000	0.165	468,588	0.056
ARM	851,588	0.681	383,000	0.810	468,588	0.576
Balloon	851,588	0.083	383,000	0.129	468,588	0.046
Interest Only	851,588	0.320	383,000	0.371	468,588	0.278
Interest Only Missing	851,588	0.017	383,000	0.019	468,588	0.016
Single Family	851,588	0.965	383,000	0.965	468,588	0.965
Inflation	851,588	222.027	383,000	221.291	468,588	222.629
Mortgage Rates	851,588	4.789	383,000	4.744	468,588	4.826
Unemployment Rate	851,588	8.449	383,000	9.474	468,588	7.611
HPI End	851,588	199.305	383,000	186.825	468,588	209.505
HPI Origination	851,588	240.253	383,000	270.417	468,588	215.598
HPI Volatility	851,588	25.906	383,000	34.954	468,588	18.510
Median Income (000s)	851,588	81.114	383,000	71.406	468,588	89.048

Note: The variable descriptions are in Table A.1 of the appendix.

Table 3. Loan Termination (repaid vs. foreclosed) by Borrower Equity Position

	Full Sample		Positive-Equity Loans		Negative-Equity Loans	
	N. Obs.	Percent	N. Obs.	Percent	N. Obs.	Percent
Repaid	289,918	34.04	266,588	56.89	23,330	6.09
Foreclosed	561,670	65.96	202,000	43.11	359,670	93.91
Total	851,588	100.00	468,588	100.00	383,000	100.00

Note: Our study sample includes loans showing in the ABSNet January 2008 loan update data set that were terminated by the end as reported in the ABSNet March 2016 loan history database, the end of the study period, matched to loans in the RealtyTrac Recorder database, which allows us to link loans to properties to identify if loans were repaid with the sale of the property or refinanced. "*Repaid*" designates loans repaid from the sale of the sale of the property, whereas "*Foreclosed*" identifies loans whose properties were foreclosed due to borrower delinquency. We separately report loan statuses for the full sample and by borrower equity position ("*Positive Equity*" or "*Negative Equity*") based on the estimated property values at loan termination – the adjusted appraisal values of the properties using tract house price indices (HPI), or five-digit zip code HPIs for locations with missing tract numbers, from the Federal Housing Finance Agency (FHFA).

Table 4. Loan Termination by Credit Score and Equity Quintiles

Panel A: Credit Score Quintiles	Quintile 1	Quintile 2	Quintile 3	Quintile 4	Quintile 5
Positive Equity:					
N. Loans	91,849	83,095	88,106	94,870	110,668
Average Equity (%)	18.64	19.12	22.50	25.86	30.34
Loan Status:					
Repaid (%)	22.68	36.45	54.06	72.70	89.33
Foreclosed (%)	77.32	63.55	45.94	27.30	10.67
Negative Equity:					
N. Loans	93,596	107,160	90,167	61,126	30,951
Average Equity (%)	-37.62	-40.25	-39.23	-36.96	-33.19
Loan Status:					
Repaid (%)	2.79	3.56	5.35	9.14	20.98
Foreclosed (%)	97.21	96.44	94.65	90.86	79.02
Panel B: Equity Quintiles	Quintile 1	Quintile 2	Quintile 3	Quintile 4	Quintile 5
Positive Equity:					
N. Loans	132,753	119,297	102,371	73,096	41,071
Average Equity (%)	6.48	17.14	26.52	38.88	64.11
Loan Status:					
Repaid (%)	31.36	53.19	66.52	77.90	88.78
Foreclosed (%)	68.64	46.81	33.48	22.10	11.22
Negative Equity:					
N. Loans	81,790	79,523	77,203	74,329	70,155
Average Equity (%)	-93.00	-46.35	-26.82	-13.64	-4.02
Loan Status:					
Repaid (%)	1.29	2.19	4.16	8.28	15.91
Foreclosed (%)	98.71	97.81	95.84	91.72	84.09

Note: This table reports the number of loans (*N. Loans*), average equity (*Average Equity*), and loan termination status (*Repaid* or *Foreclosed*) as a percentage of total loans by credit score quintiles in Panel A and equity quintiles in Panel B. The credit-score quintiles are based on credit scores at origination – credit score quintiles: FICO 300 - 623, 624 - 670, 671 - 711, 712 - 756, and 757 - 849 at origination. Panel B presents the same data by quintiles for positive- and negative-equity loans at termination. Our sample includes ABSNet-RealtyTrac matched loans as described in Table 3. *Average Equity* is the mean of borrower equity measured as the ratio of updated property value (HPI- adjusted appraised value) minus first and second mortgage balance at termination to the updated property value at termination.

Table 5. Default Costs by Credit Score Quintiles for Repayers and Defaulters on Loans with Negative Equity

	Quintile 1	Quintile 2	Quintile 3	Quintile 4	Quintile 5
Repayers:					
Median Property Value	$141,188	$177,979	$215,664	$247,427	$318,253
Median Equity	-$10,727	-$15,832	-$22,019	-$24,079	-$26,265
Median Lower Bound on C	*$19,198*	*$26,510*	*$34,959*	*$38,925*	*$45,360*
Defaulters:					
Median Property Value	$152,110	$185,170	$212,895	$227,863	$234,876
Median Equity	-$45,439	-$61,854	-$68,478	-$69,384	-$68,886
Median Upper Bound on C	*$54,565*	*$72,964*	*$81,251*	*$83,056*	*$82,978*

Note: This table reports median property value, borrower equity, and default costs in dollars at termination for repaid and foreclosed negative-equity loans by credit score quintiles. The credit-score quintiles are based on credit scores at origination – credit score quintiles: FICO 300 - 623, 624 - 670, 671 - 711, 712 - 756, and 757 - 849 at origination. Our sample includes ABSNet-RealtyTrac matched loans as described in Table 3. Borrower equity is the updated property value (HPI- adjusted appraised value) minus the balance of the first and second mortgages at loan termination.

Table 6. Loan Repayment vs. Foreclosure as a Function of Equity and Credit Score

Sample:	Positive Equity	Negative Equity	Full Sample
Dependent Variable:	Repaid	Repaid	Repaid
Credit Score	0.1080***	0.0444***	0.1100***
	(0.0011)	(0.0011)	(0.0009)
Negative Equity Dummy × Credit Score			-0.0179***
			(0.0003)
Equity	0.5059***	0.0925***	0.6716***
	(0.0051)	(0.0072)	(0.0054)
Negative Equity Dummy × Equity Ratio			-0.5781***
			(0.0065)
Property Value	-0.0281***	0.0054	-0.0116**
	(0.0038)	(0.0101)	(0.0043)
Unemployment Rate	-0.0028*	0.0088***	-0.0052***
	(0.0011)	(0.0011)	(0.0009)
Median Income	0.0005***	-0.0007***	-0.0006***
	(0.0001)	(0.0002)	(0.0001)
Loan Amount	0.0503***	0.0171	0.0493***
	(0.0036)	(0.0103)	(0.0041)
Refinancing Loan	-0.5398***	-0.0874***	-0.2934***
	(0.0023)	(0.0012)	(0.0029)
Non-Owner Occupancy	-0.0004	0.0138***	-0.0032*
	(0.0019)	(0.0015)	(0.0015)
Interest Rate	-0.0324***	-0.0062***	-0.0190***
	(0.0006)	(0.0002)	(0.0004)
Loan Term	0.0621***	-0.0454***	0.0585***
	(0.0037)	(0.0044)	(0.0035)
DTI	-0.0068	-0.0134***	0.0150**
	(0.0096)	(0.0038)	(0.0051)
ARM	-0.0884***	-0.0317***	-0.0766***
	(0.0013)	(0.0012)	(0.0010)
Single Family	0.0710***	0.0325***	0.0639***
	(0.0040)	(0.0023)	(0.0026)
Inflation	-0.0034***	-0.0025***	-0.0038***
	(0.0003)	(0.0002)	(0.0002)
Mortgage Rates	0.0137***	0.0004	0.0089***
	(0.0019)	(0.0013)	(0.0012)
Additional Control Variables	Y	Y	Y
Origination-Year FE	Y	Y	Y
Termination-Year FE	Y	Y	Y
Location (Zip Code) FE	Y	Y	Y
Clustered SE (Zip Code)	Y	Y	Y
Observations	462,828	371,592	835,627
Adjusted R-squared	0.583	0.189	0.595

Note: This table reports linear probability model (LPM) estimation using OLS of the likelihood of loan termination (repayment vs. foreclosure). *Repaid* is a binary variable identifying whether a loan was paid off with the sale of the property or the foreclosure of the property. Columns (1), (2), and (3) report LPM likelihood of loan termination (repayment) for positive-equity loans, negative-equity loans, and the full sample, respectively. The additional variables included in these regressions are the same as in the appendix Table A.2. In parentheses are White-robust standards errors clustered at the zip code level. *** p<0.001, ** p<0.01, * p<0.05.

Table 7. Likelihood of Loan Repayment by Credit-Score Quintiles

Sample:	Positive Equity		Negative Equity	
Dependent Variable:	*Repaid*	*Repaid*	*Repaid*	*Repaid*
Credit-Score Quintile 2	-0.0008	-0.0431***	-0.0074***	0.0013
	(0.0020)	(0.0030)	(0.0009)	(0.0015)
Credit-Score Quintile 3	0.0596***	0.0074*	0.0027*	0.0255***
	(0.0023)	(0.0033)	(0.0011)	(0.0018)
Credit-Score Quintile 4	0.1389***	0.1232***	0.0290***	0.0751***
	(0.0023)	(0.0034)	(0.0014)	(0.0025)
Credit-Score Quintile 5	0.2085***	0.2831***	0.1260***	0.2360***
	(0.0025)	(0.0033)	(0.0028)	(0.0044)
Equity Ratio	0.4928***	0.4893***	0.0964***	0.0432***
	(0.0050)	(0.0095)	(0.0072)	(0.0062)
Credit-Score Quintile 2 × Equity Ratio		0.2327***		0.0229***
		(0.0118)		(0.0021)
Credit-Score Quintile 3 × Equity Ratio		0.2554***		0.0559***
		(0.0110)		(0.0030)
Credit-Score Quintile 4 × Equity Ratio		0.0888***		0.1165***
		(0.0107)		(0.0051)
Credit-Score Quintile 5 × Equity Ratio		-0.2174***		0.3110***
		(0.0098)		(0.0105)
Property Value	-0.0373***	-0.0478***	-0.0121	-0.0158
	(0.0038)	(0.0038)	(0.0101)	(0.0102)
Control Variables	Y	Y	Y	Y
Origination-Year FE	Y	Y	Y	Y
Termination-Year FE	Y	Y	Y	Y
Location (Zip Code) FE	Y	Y	Y	Y
Clustered SE (Zip Code)	Y	Y	Y	Y
Observations	*462,828*	*462,828*	*371,592*	*371,592*
Adjusted R-squared	*0.588*	*0.592*	*0.201*	*0.213*

Note: This table reports linear probability model (LPM) estimation of loan termination (repayment vs foreclosure) using OLS for positive- and negative-equity loans at termination with the inclusion of credit-score quintiles (defined in Table 4) interacted with equity. *Repaid* is a binary variable identifying whether a loan was paid off with the sale of the property or foreclosed. The control variables included in these regressions are the same as in the appendix Table A.2. In parentheses are White-robust standards errors clustered at the zip code level. *** p<0.001, ** p<0.01, * p<0.05.

Table 8. Likelihood of Loan Repayment by Equity Quintiles

Sample:	Positive Equity		Negative Equity	
Dependent Variable:	*Repaid*	*Repaid*	*Repaid*	*Repaid*
Equity Quintile 2	0.1154***	-0.2405***	0.0168***	-0.0486***
	(0.0018)	(0.0138)	(0.0013)	(0.0091)
Equity Quintile 3	0.1933***	-0.1462***	0.0374***	-0.2014***
	(0.0020)	(0.0148)	(0.0019)	(0.0111)
Equity Quintile 4	0.2562***	0.1181***	0.0712***	-0.4465***
	(0.0023)	(0.0163)	(0.0025)	(0.0136)
Equity Quintile 5	0.2986***	0.4319***	0.1306***	-0.7939***
	(0.0029)	(0.0203)	(0.0030)	(0.0160)
Credit Score	0.1087***	0.0818***	0.0434***	-0.0081***
	(0.0011)	(0.0018)	(0.0010)	(0.0010)
Equity Quintile 2 × Credit Score		0.0524***		0.0100***
		(0.0020)		(0.0014)
Equity Quintile 3 × Credit Score		0.0497***		0.0361***
		(0.0021)		(0.0017)
Equity Quintile 4 × Credit Score		0.0210***		0.0780***
		(0.0023)		(0.0021)
Equity Quintile 5 × Credit Score		-0.0160***		0.1388***
		(0.0028)		(0.0025)
Property Value	-0.0600***	-0.0584***	-0.0177**	-0.0111*
	(0.0039)	(0.0040)	(0.0054)	(0.0054)
Control Variables	Y	Y	Y	Y
Origination-Year FE	Y	Y	Y	Y
Termination-Year FE	Y	Y	Y	Y
Location (Zip Code) FE	Y	Y	Y	Y
Clustered SE (Zip Code)	Y	Y	Y	Y
Observations	*462,828*	*462,828*	*371,592*	*371,592*
Adjusted R-squared	*0.587*	*0.589*	*0.198*	*0.215*

Note: This table reports linear probability model (LPM) estimation of loan termination (repayment vs foreclosure) using OLS for positive- and negative-equity loans at termination with the inclusion of equity quintiles interacted with credit score. *Repaid* is a binary variable identifying whether a loan was paid off with the sale of the property or foreclosed. We generate separate quintile groups for positive and negative equity loans at termination. The control variables included in these regressions are the same as in the appendix Table A.2. In parentheses are White-robust standards errors clustered at the zip code level. *** p<0.001, ** p<0.01, * p<0.05.

Table 9. Robustness Checks: Equity Measurement Error, Default at Termination, and Income

Sample:	Positve Equity				(5)	Negative Equity		
	(1)	(2)	(3)	(4)		(6)	(7)	(8)
Dependent Variable:	Repaid	Repaid	Repaid	Repaid	Repaid	Repaid	Repaid	Repaid
Credit Score	0.1018***	0.1119***	0.1059***	0.1206***	0.0336***	0.0431***	0.0327***	0.0279***
	(0.0011)	(0.0011)	(0.0012)	(0.0024)	(0.0010)	(0.0010)	(0.0009)	(0.0012)
Equity	0.4329***	0.5169***	0.4449***	0.5702***	0.0781***	0.0894***	0.0752***	0.0695***
	(0.0049)	(0.0051)	(0.0050)	(0.0104)	(0.0063)	(0.0070)	(0.0061)	(0.0065)
Property Value	-0.0164***	-0.0299***	-0.0184***	-0.0640***	-0.0047	0.0021	-0.0065	-0.0055
	(0.0036)	(0.0039)	(0.0037)	(0.0085)	(0.0096)	(0.0098)	(0.0093)	(0.0108)
Unemployment Rate	-0.0029*	-0.0036**	-0.0037**	-0.0147***	0.0071***	0.0084***	0.0068***	0.0053***
	(0.0011)	(0.0011)	(0.0012)	(0.0025)	(0.0010)	(0.0011)	(0.0010)	(0.0016)
Median Income	0.0004**	0.0005**	0.0004**	0.0013***	-0.0005**	-0.0007***	-0.0005**	-0.0005*
	(0.0001)	(0.0002)	(0.0001)	(0.0003)	(0.0002)	(0.0002)	(0.0002)	(0.0002)
Loan Amount	0.0344***	0.0516***	0.0358***	0.0736***	0.0227**	0.0190	0.0236*	0.0166
	(0.0035)	(0.0037)	(0.0036)	(0.0083)	(0.0098)	(0.0100)	(0.0095)	(0.0110)
Refinancing Loan	-0.5815***	-0.5246***	-0.5663***	-0.5476***	-0.0687***	-0.0831***	-0.0654***	-0.0418***
	(0.0024)	(0.0023)	(0.0024)	(0.0033)	(0.0010)	(0.0012)	(0.0010)	(0.0012)
Interest Rate	-0.0336***	-0.0317***	-0.0330***	-0.0233***	-0.0048***	-0.0058***	-0.0045***	-0.0011***
	(0.0006)	(0.0006)	(0.0006)	(0.0012)	(0.0002)	(0.0002)	(0.0002)	(0.0003)
DTI	-0.0067	-0.0666***	-0.0699***	-0.1614***	-0.0165***	-0.0181***	-0.0173***	-0.0131
	(0.0102)	(0.0099)	(0.0107)	(0.0496)	(0.0035)	(0.0036)	(0.0033)	(0.0158)
ARM	-0.0884***	-0.0888***	-0.0891***	-0.0940***	-0.0242***	-0.0300***	-0.0228***	-0.0170***
	(0.0013)	(0.0013)	(0.0014)	(0.0030)	(0.0011)	(0.0012)	(0.0011)	(0.0015)
Borrower Income				-0.0000				-0.0000
				(0.0000)				(0.0000)
Additional Control Variables	Y	Y	Y	Y	Y	Y	Y	Y
Fixed Effects	Y	Y	Y	Y	Y	Y	Y	Y
Equity Measurement Error	✓		✓	✓	✓		✓	✓
Default at Termination		✓	✓	✓		✓	✓	✓
Borrower Income				✓				✓
Observations	414,400	446,772	399,092	90,974	328,637	370,292	327,842	100,673
Adjusted R-squared	0.590	0.583	0.591	0.567	0.148	0.183	0.144	0.144

Note: This table presents robustness checks of our linear probability model (LPM) estimation of loan termination (repayment *vs.* foreclosure) using OLS for positive- and negative-equity loans at termination using the model as columns (1) and (2) of Table 6. *Repaid* is a binary variable identifying whether a loan was paid off with the sale of the property or foreclosed. Columns (1) and (5) control for potential error in equity value calculation by excluding loans with equity falling between -5% and 5%, exclusive. Columns (2) and (6) removed loans repaid loans that were delinquent at termination. Columns (3) and (7) control for both equity measurement errors and loan delinquency at termination. In addition to controlling for equity measurement errors and delinquency, columns (4) and (8) include borrower income estimated from DTI ratio at origination. The full set of control variables included in these regressions is the same as in the appendix Table A.2. The fixed effects include origination-year, termination-year, and zip code fixed effects. In parentheses are White-robust standards errors clustered at the zip code level. *** p<0.001, ** p<0.01, * p<0.05.

A. Appendix

Table A.1. Variable Description

Variable	Description	Source
Repaid	A binary variable set to 1 if the loan is terminated with the sale of the property	ABSNet/RealtyTrac
Foreclosed	A binary variable set to 1 if the loan is terminated with the foreclosure of the property	ABSNet
Credit Score	The primary borrower's FICO score at loan origination divided by 100	ABSNet
Property Value	The natural log of the estimated value (HPI- adjusted appraised value) of the property at termination	ABSNet (estimated)
Negative Equity Dummy	A binary variable set to 1 if the estimated value of the property is less than the first and second mortgage loan balance at termination	ABSNet (estimated)
Equity	The ratio of HPI- adjusted appraised value minus the first and second mortgage loan balance the updated property value at termination	ABSNet (estimated)
Original CLTV	The combined loan-to-value (CLTV) ratio of the loan at origination	ABSNet
Original LTV	The loan-to-value (LTV) ratio of the loan at origination	ABSNet
Loan Amount	The natural log of the loan amount at origination	ABSNet
Refinancing Loan	A binary variable set to 1 for refinancing loans	ABSNet
Non-Owner Occupancy	A binary variable equal to 1 if the property is not occupied by the owner	ABSNet
Occupancy Unknown	A binary variable equal to 1 if the occupancy of the property is unknown	ABSNet
Interest Rate	Original interest rate on the loan	ABSNet
Loan Term	The natural log value of the original loan term	ABSNet
DTI	Total debt-to-income ratio at origination	ABSNet
DTI Missing	A binary variable equal to 1 if DTI information is missing	ABSNet
Borrower Income	Estimated at origination using DTI and annual loan payment, in thousands (000s)	ABSNet (estimated)
PMI	A binary variable equal to 1 if private mortgage insurance was required	ABSNet
PMI Missing	A binary variable equal to 1 if PMI information is missing	ABSNet
Neg. Amortization	A binary variable identifying mortgages with negative amortization	ABSNet
ARM	A binary variable identifying adjustable rate mortgages	ABSNet
Balloon	A binary variable identifying mortgages with a balloon payment structure	ABSNet
Interest Only	A binary variable equal to 1 if the mortgage includes interest-only payments	ABSNet
Interest Only Missing	A binary variable identifying mortgages with missing interest-only information	ABSNet
Single Family	A binary variable identifying single-family properties	ABSNet
Inflation	Monthly consumer price index at loan termination	St. Louis Fed
Mortgage Rate	Monthly average 30-year fixed rate mortgage rates at loan termination	St. Louis Fed
Unemployment Rate	Annual state unemployment rate	BLS
HPI End	Quarterly 3-digit zip code house price index at loan origination	FHFA
HPI Origination	Quarterly 3-digit zip code house price index at loan termination	FHFA
HPI Volatility	Standard deviation of quarterly 3-digit house price index over 20 quarters at loan termination	FHFA
Median Income	State median annual income of homeowners 2007-11 and 2012-16 in thousands (000s)	ACS

Table A.2. Likelihood of Loan Termination: Full Results

Sample:	Positive Equity	Negative Equity	Full Sample
Dep. Variable:	Repaid	Repaid	Repaid
Credit Score	0.1080***	0.0444***	0.1100***
	(0.0011)	(0.0011)	(0.0009)
Negative Equity Dummy x Credit Score			-0.0179***
			(0.0003)
Equity Ratio	0.5059***	0.0925***	0.6716***
	(0.0051)	(0.0072)	(0.0054)
Negative Equity Dummy $\times$ Equity Ratio			-0.5781***
			(0.0065)
Property Value	-0.0281***	0.0054	-0.0116**
	(0.0038)	(0.0101)	(0.0043)
Unemployment Rate	-0.0028*	0.0088***	-0.0052***
	(0.0011)	(0.0011)	(0.0009)
Median Income	0.0005***	-0.0007***	-0.0006***
	(0.0001)	(0.0002)	(0.0001)
Loan Amount	0.0503***	0.0171	0.0493***
	(0.0036)	(0.0103)	(0.0041)
Refinancing Loan	-0.5398***	-0.0874***	-0.2934***
	(0.0023)	(0.0012)	(0.0029)
Non-Owner Occupancy	-0.0004	0.0138***	-0.0032*
	(0.0019)	(0.0015)	(0.0015)
Occupancy Unknown	0.0393***	0.0322***	0.0411***
	(0.0049)	(0.0051)	(0.0039)
Interest Rate	-0.0324***	-0.0062***	-0.0190***
	(0.0006)	(0.0002)	(0.0004)
Loan Term	0.0621***	-0.0454***	0.0585***
	(0.0037)	(0.0044)	(0.0035)
DTI	-0.0068	-0.0134***	0.0150**
	(0.0096)	(0.0038)	(0.0051)
DTI Missing	-0.0181***	0.0150***	-0.0074***
	(0.0015)	(0.0010)	(0.0010)
PMI	0.0233***	0.0357***	0.0338***
	(0.0018)	(0.0020)	(0.0014)
PMI Missing	-0.0344***	-0.0119***	-0.0279***
	(0.0014)	(0.0009)	(0.0009)
Neg. Amortization	-0.1667***	-0.0183***	-0.0874***
	(0.0034)	(0.0020)	(0.0024)
ARM	-0.0884***	-0.0317***	-0.0766***
	(0.0013)	(0.0012)	(0.0010)
Balloon	-0.0661***	-0.0029	-0.0372***
	(0.0034)	(0.0015)	(0.0018)
Interest Only	-0.0293***	-0.0220***	-0.0455***
	(0.0014)	(0.0012)	(0.0010)
Interest Only Missing	-0.0714***	-0.0082***	-0.0513***
	(0.0046)	(0.0023)	(0.0027)
Single Family	0.0710***	0.0325***	0.0639***
	(0.0040)	(0.0023)	(0.0026)
Inflation	-0.0034***	-0.0025***	-0.0038***
	(0.0003)	(0.0002)	(0.0002)
Mortgage Rates	0.0137***	0.0004	0.0089***
	(0.0019)	(0.0013)	(0.0012)
HPI End	0.0008***	0.0013***	0.0007***
	(0.0000)	(0.0000)	(0.0000)
HPI Origination	-0.0006***	-0.0006***	-0.0008***
	(0.0000)	(0.0000)	(0.0000)
HPI Volatility	0.0029***	0.0022***	0.0027***
	(0.0001)	(0.0001)	(0.0001)
Fixed Effects	Y	Y	Y
Observations	462,828	371,592	835,627
Adjusted R-squared	0.583	0.189	0.595

Note: This table reports the full results of linear probability model (LPM) estimation of loan termination by repayment vs. foreclosure reported in Table 6. The set of fixed effects includes loan origination and termination years, and location (zip code) fixed effects. In parentheses are White-robust standards errors clustered at the zip code level. *** p<0.001, ** p<0.01, * p<0.05.

Table A.3. Robustness Checks: Equity Measurement Error, Default at Termination, and Income (Credit Score-Quintile Interactions)

Sample:	Positive Equity				Negative Equity			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Dependent Variable:	Repaid	Repaid	Repaid	Repaid	Repaid	Repaid	Repaid	Repaid
Credit-Score Quintile 2	-0.0395***	-0.0429***	-0.0403***	-0.0166*	-0.0001	0.0018	0.0003	0.0069**
	(0.0037)	(0.0030)	(0.0037)	(0.0076)	(0.0014)	(0.0014)	(0.0014)	(0.0024)
Credit-Score Quintile 3	0.0255***	0.0033	0.0202***	0.0258***	0.0188***	0.0245***	0.0183***	0.0210***
	(0.0038)	(0.0033)	(0.0039)	(0.0077)	(0.0018)	(0.0017)	(0.0017)	(0.0027)
Credit-Score Quintile 4	0.1433***	0.1216***	0.1418***	0.1384***	0.0572***	0.0728***	0.0556***	0.0483***
	(0.0039)	(0.0034)	(0.0040)	(0.0080)	(0.0025)	(0.0024)	(0.0024)	(0.0035)
Credit-Score Quintile 5	0.2876***	0.2886***	0.2939***	0.3008***	0.1961***	0.2310***	0.1908***	0.1476***
	(0.0037)	(0.0033)	(0.0038)	(0.0078)	(0.0048)	(0.0044)	(0.0047)	(0.0064)
Equity	0.5001***	0.4839***	0.4970***	0.5894***	0.0412***	0.0416***	0.0395***	0.0387***
	(0.0106)	(0.0096)	(0.0107)	(0.0230)	(0.0056)	(0.0059)	(0.0054)	(0.0064)
Credit-Score Quintile 2 × Equity	0.1893***	0.2347***	0.1935***	0.1517***	0.0167***	0.0227***	0.0164***	0.0128***
	(0.0133)	(0.0119)	(0.0135)	(0.0297)	(0.0019)	(0.0020)	(0.0019)	(0.0028)
Credit-Score Quintile 3 × Equity	0.1563***	0.2759***	0.1788***	0.2089***	0.0409***	0.0535***	0.0394***	0.0302***
	(0.0120)	(0.0111)	(0.0122)	(0.0270)	(0.0027)	(0.0029)	(0.0026)	(0.0033)
Credit-Score Quintile 4 × Equity	-0.0193	0.1137***	0.0035	0.0572*	0.0828***	0.1120***	0.0798***	0.0663***
	(0.0116)	(0.0108)	(0.0118)	(0.0259)	(0.0044)	(0.0050)	(0.0043)	(0.0048)
Credit-Score Quintile 5 × Equity	-0.2869***	-0.2019***	-0.2751***	-0.2328***	0.2408***	0.3040***	0.2340***	0.1824***
	(0.0106)	(0.0099)	(0.0108)	(0.0237)	(0.0093)	(0.0104)	(0.0092)	(0.0102)
Property Value	-0.0361***	-0.0494***	-0.0381***	-0.0852***	-0.0195*	-0.0184	-0.0208*	-0.0134
	(0.0037)	(0.0039)	(0.0038)	(0.0085)	(0.0097)	(0.0099)	(0.0094)	(0.0109)
Borrower Income				0.0000				0.0000
				(0.0000)				(0.0000)
Control Variables	Y	Y	Y	Y	Y	Y	Y	Y
Fixed Effects	Y	Y	Y	Y	Y	Y	Y	Y
Equity Measurement Error	✓		✓	✓	✓		✓	✓
Default at Termination		✓	✓	✓		✓	✓	✓
Borrower Income				✓				✓
Observations	414,400	446,772	399,092	90,974	328,637	370,292	327,842	100,673
Adjusted R-squared	0.598	0.593	0.599	0.574	0.167	0.207	0.162	0.159

Note: This table presents robustness checks of our linear probability model (LPM) estimation of loan termination (repayment vs. foreclosure) using OLS for positive- and negative-equity loans at termination using the model as columns (2) and (4) of Table 7. *Repaid* is a binary variable identifying whether a loan was paid off with the sale of the property or foreclosed. Columns (1) and (5) control for potential error in equity value calculation by excluding loans with equity falling between -5% and 5%, exclusive. Columns (2) and (6) removed loans repaid loans that were delinquent at termination. Columns (3) and (7) control for both equity measurement errors and loan delinquency at termination. In addition to controlling for equity measurement errors and delinquency, columns (4) and (8) include borrower income estimated from the DTI ratio at origination. The control variables included in these regressions are the same as in the appendix Table A.2. The fixed effects include origination-year, termination-year, and zip code fixed effects. In parentheses are White-robust standards errors clustered at the zip code level. *** p<0.001, ** p<0.01, * p<0.05.

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Table A.4. Robustness Checks: Equity Measurement Error, Default at Termination, and Income (Equity-Quintile Interactions)

Sample:	Positve Equity				Negative Equity			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Dependent Variable:	Repaid	Repaid	Repaid	Repaid	Repaid	Repaid	Repaid	Repaid
Equity Quintile 2	-0.1545***	-0.2615***	-0.1726***	-0.2198***	-0.0517***	-0.0456***	-0.0486***	-0.0444***
	(0.0153)	(0.0140)	(0.0154)	(0.0316)	(0.0089)	(0.0089)	(0.0087)	(0.0097)
Equity Quintile 3	-0.0607***	-0.1821***	-0.0926***	-0.1738***	-0.2041***	-0.1959***	-0.1982***	-0.1473***
	(0.0163)	(0.0149)	(0.0164)	(0.0335)	(0.0110)	(0.0109)	(0.0108)	(0.0137)
Equity Quintile 4	0.2036***	0.0803***	0.1701***	0.1081**	-0.4518***	-0.4327***	-0.4375***	-0.3751***
	(0.0176)	(0.0166)	(0.0178)	(0.0363)	(0.0137)	(0.0135)	(0.0136)	(0.0199)
Equity Quintile 5	0.4951***	0.3986***	0.4663***	0.4292***	-0.6789***	-0.7739***	-0.6572***	-0.5424***
	(0.0211)	(0.0208)	(0.0216)	(0.0458)	(0.0227)	(0.0158)	(0.0223)	(0.0392)
Credit Score	0.0854***	0.0823***	0.0861***	0.0908***	-0.0045***	-0.0075***	-0.0041***	-0.0017
	(0.0021)	(0.0018)	(0.0021)	(0.0041)	(0.0009)	(0.0010)	(0.0009)	(0.0010)
Equity Quintile 2 × Credit Score	0.0362***	0.0555***	0.0388***	0.0468***	0.0100***	0.0095***	0.0095***	0.0085***
	(0.0022)	(0.0020)	(0.0022)	(0.0046)	(0.0014)	(0.0014)	(0.0013)	(0.0015)
Equity Quintile 3 × Credit Score	0.0335***	0.0551***	0.0383***	0.0524***	0.0359***	0.0351***	0.0348***	0.0263***
	(0.0024)	(0.0022)	(0.0024)	(0.0049)	(0.0017)	(0.0017)	(0.0017)	(0.0021)
Equity Quintile 4 × Credit Score	0.0048	0.0269***	0.0101***	0.0236***	0.0781***	0.0756***	0.0756***	0.0651***
	(0.0025)	(0.0024)	(0.0026)	(0.0052)	(0.0021)	(0.0021)	(0.0021)	(0.0031)
Equity Quintile 5 × Credit Score	-0.0293***	-0.0103***	-0.0242***	-0.0113	0.1180***	0.1350***	0.1141***	0.0951***
	(0.0029)	(0.0029)	(0.0030)	(0.0063)	(0.0035)	(0.0024)	(0.0035)	(0.0061)
Property Value	-0.0566***	-0.0604***	-0.0589***	-0.1164***	0.0023	-0.0123*	0.0007	0.0059
	(0.0039)	(0.0040)	(0.0039)	(0.0090)	(0.0050)	(0.0053)	(0.0048)	(0.0062)
Borrower Income				-0.0000				-0.0000
				(0.0000)				(0.0000)
Control Variables	Y	Y	Y	Y	Y	Y	Y	Y
Fixed Effects	Y	Y	Y	Y	Y	Y	Y	Y
Equity Measurement Error	✓		✓	✓	✓		✓	✓
Default at Termination		✓	✓	✓		✓	✓	✓
Borrower Income				✓				✓
Observations	414,400	446,772	399,092	90,974	328,637	370,292	327,842	100,673
Adjusted R-squared	0.595	0.589	0.596	0.571	0.166	0.208	0.160	0.164

Note: This table presents robustness checks of our linear probability model (LPM) estimation of loan termination (repayment *vs.* foreclosure) using OLS for positive- and negative-equity loans at termination using the model as in columns (2) and (4) Table 8. *Repaid* is a binary variable identifying whether a loan was paid off with the sale of the property or foreclosed. Columns (1) and (5) control for potential error in equity value calculation by excluding loans with equity falling between -5% and 5%, exclusive. Columns (2) and (6) removed loans repaid loans that were delinquent at termination. Columns (3) and (7) control for both equity measurement errors and loan delinquency; columns (4) and (8) include borrower income estimated from the DTI ratio at origination. The control variables included in these regressions are the same as in the appendix Table A.2. The fixed effects include origination-year, termination-year, and zip code fixed effects. In parentheses are White-robust standards errors clustered at the zip code level. *** p<0.001, ** p<0.01, * p<0.05.

Table A.5. Likelihood of Loan Repayment or Refinancing

Sample:	*Positive Equity*	*Negative Equity*	*Full Sample*
Dep. Variable:	*Repaid or Refinanced*	*Repaid or Refinanced*	*Repaid or Refinanced*
Credit Score	0.0999***	0.0747***	0.1142***
	(0.0009)	(0.0013)	(0.0008)
Negative Equity Dummy × Credit Score			-0.0412***
			(0.0004)
Equity	0.7073***	0.1480***	0.6905***
	(0.0052)	(0.0106)	(0.0053)
Negative Equity Dummy × Equity			-0.4439***
			(0.0063)
Property Value	-0.1045***	0.0448**	-0.0846***
	(0.0032)	(0.0145)	(0.0033)
Unemployment Rate	-0.0023*	0.0112***	-0.0042***
	(0.0011)	(0.0014)	(0.0009)
Median Income	0.0013***	-0.0007**	0.0006***
	(0.0001)	(0.0002)	(0.0001)
Loan Amount	0.1181***	-0.0265	0.1011***
	(0.0030)	(0.0150)	(0.0032)
Refinancing Loan	0.0031**	0.0084***	0.0062***
	(0.0011)	(0.0012)	(0.0009)
Non-Owner Occupancy	-0.0320***	-0.0074***	-0.0249***
	(0.0018)	(0.0018)	(0.0015)
Interest Rate	-0.0381***	-0.0091***	-0.0223***
	(0.0005)	(0.0003)	(0.0004)
DTI	-0.0286***	-0.0394***	-0.0244***
	(0.0083)	(0.0048)	(0.0050)
ARM	-0.1132***	-0.0492***	-0.0977***
	(0.0011)	(0.0015)	(0.0009)
Single Family	0.0479***	0.0360***	0.0466***
	(0.0034)	(0.0029)	(0.0026)
Inflation	-0.0042***	-0.0048***	-0.0043***
	(0.0002)	(0.0003)	(0.0002)
Mortgage Rates	0.0139***	0.0029	0.0114***
	(0.0015)	(0.0016)	(0.0011)
Additional Control Variables	Y	Y	Y
Origination-Year FE	Y	Y	Y
Termination-Year FE	Y	Y	Y
Location (Zip Code) FE	Y	Y	Y
Clustered SE (Zip Code)	Y	Y	Y
Observations	*861,818*	*389,914*	*1,252,879*
Adjusted R-squared	*0.325*	*0.207*	*0.561*

Note: This table reports linear probability model (LPM) estimation of loan termination by repayment or refinancing vs. foreclosure using OLS. The dependent variable is a binary variable set to 1 if a loan terminated either with the sale of the property or foreclosure and 0 otherwise. Columns (1), (2), and (3) report LPM likelihood of loan termination (repayment) for the full sample, positive-equity loans, and negative-equity loans at termination, respectively. The additional variables included in these regressions are the same as in the appendix Table A.2. In parentheses are White-robust standards errors clustered at the zip code level. *** $p<0.001$, ** $p<0.01$, * $p<0.05$.

Table A.6. Likelihood of Loan Repayment or Refinancing by Credit-Score Quintiles

Sample	Positive Equity		Negative Equity	
Dependent Variable	Repaid or Refi.	Repaid or Refi.	Repaid or Refi.	Repaid or Refi.
Credit-Score Quintile 2	0.0105***	0.0077**	0.0031**	0.0067***
	(0.0018)	(0.0028)	(0.0012)	(0.0019)
Credit-Score Quintile 3	0.0746***	0.1088***	0.0264***	0.0454***
	(0.0019)	(0.0031)	(0.0014)	(0.0023)
Credit-Score Quintile 4	0.1442***	0.2611***	0.0689***	0.1151***
	(0.0019)	(0.0031)	(0.0018)	(0.0031)
Credit-Score Quintile 5	0.1872***	0.4143***	0.1830***	0.2941***
	(0.0020)	(0.0029)	(0.0031)	(0.0047)
Equity	0.7006***	1.0261***	0.1548***	0.1053***
	(0.0051)	(0.0073)	(0.0106)	(0.0094)
Credit-Score Quintile 2 × Equity		0.0218**		0.0112***
		(0.0078)		(0.0028)
Credit-Score Quintile 3 × Equity		-0.1407***		0.0485***
		(0.0076)		(0.0036)
Credit-Score Quintile 4 × Equity		-0.4014***		0.1214***
		(0.0074)		(0.0060)
Credit-Score Quintile 5 × Equity		-0.6800***		0.3297***
		(0.0069)		(0.0112)
Property Value	-0.1082***	-0.1058***	0.0177	0.0120
	(0.0032)	(0.0029)	(0.0147)	(0.0148)
Additional Control Variables	Y	Y	Y	Y
Origination-Year FE	Y	Y	Y	Y
Termination-Year FE	Y	Y	Y	Y
Location (Zip Code) FE	Y	Y	Y	Y
Clustered SE (Zip Code)	Y	Y	Y	Y
Observations	861,818	861,818	389,914	389,914
Adjusted R-squared	0.328	0.345	0.215	0.224

Note: This table reports linear probability model (LPM) estimation of loan termination by repayment or refinancing vs. foreclosure using OLS for positive- and negative-equity loans at termination with credit-score quintiles (defined in Table 4) interacted with equity. dependent variable is a binary variable set to 1 if a loan terminated either with the sale of the property or refinancing and 0 otherwise. The control variables included in these regressions are the same as in the appendix Table A.2. In parentheses are White-robust standards errors clustered at the zip code level. *** $p < 0.001$, ** $p < 0.01$, * $p < 0.05$.

Table A.7. Likelihood of Loan Repayment or Refinancing by Equity Quintiles

Sample	Positive Equity		Negative Equity	
Dependent Variable	Repaid or Refi	Repaid or Refi	Repaid or Refi	Repaid or Refi
Equity Quintile 2	0.1154***	-0.2405***	0.0168***	-0.0486***
	(0.0018)	(0.0138)	(0.0013)	(0.0091)
Equity Quintile 3	0.1933***	-0.1462***	0.0374***	-0.2014***
	(0.0020)	(0.0148)	(0.0019)	(0.0111)
Equity Quintile 4	0.2562***	0.1181***	0.0712***	-0.4465***
	(0.0023)	(0.0163)	(0.0025)	(0.0136)
Equity Quintile 5	0.2986***	0.4319***	0.1306***	-0.7939***
	(0.0029)	(0.0203)	(0.0030)	(0.0160)
Credit Score	0.1087***	0.0818***	0.0434***	-0.0081***
	(0.0011)	(0.0018)	(0.0010)	(0.0010)
Equity Quintile 2 × Credit Score		0.0524***		0.0100***
		(0.0020)		(0.0014)
Equity Quintile 3 × Credit Score		0.0497***		0.0361***
		(0.0021)		(0.0017)
Equity Quintile 4 × Credit Score		0.0210***		0.0780***
		(0.0023)		(0.0021)
Equity Quintile 5 × Credit Score		-0.0160***		0.1388***
		(0.0028)		(0.0025)
Property Value	-0.0600***	-0.0584***	-0.0177**	-0.0111*
	(0.0039)	(0.0040)	(0.0054)	(0.0054)
Additional Control Variables	Y	Y	Y	Y
Origination-Year FE	Y	Y	Y	Y
Termination-Year FE	Y	Y	Y	Y
Location (Zip Code) FE	Y	Y	Y	Y
Clustered SE (Zip Code)	Y	Y	Y	Y
Observations	462,828	462,828	371,592	371,592
Adjusted R-squared	0.587	0.589	0.198	0.215

Note: This table reports linear probability model (LPM) estimation of loan termination by repayment or refinancing vs. foreclosure using OLS for positive- and negative-equity loans at termination with the equity quintiles (defined in Table 4) interacted with credit score. dependent variable is a binary variable set to 1 if a loan terminated either with the sale of the property or refinancing and 0 otherwise. The control variables included in these regressions are the same as in the appendix Table A.2. In parentheses are White-robust standards errors clustered at the zip code level. *** $p<0.001$, ** $p<0.01$, * $p<0.05$.