

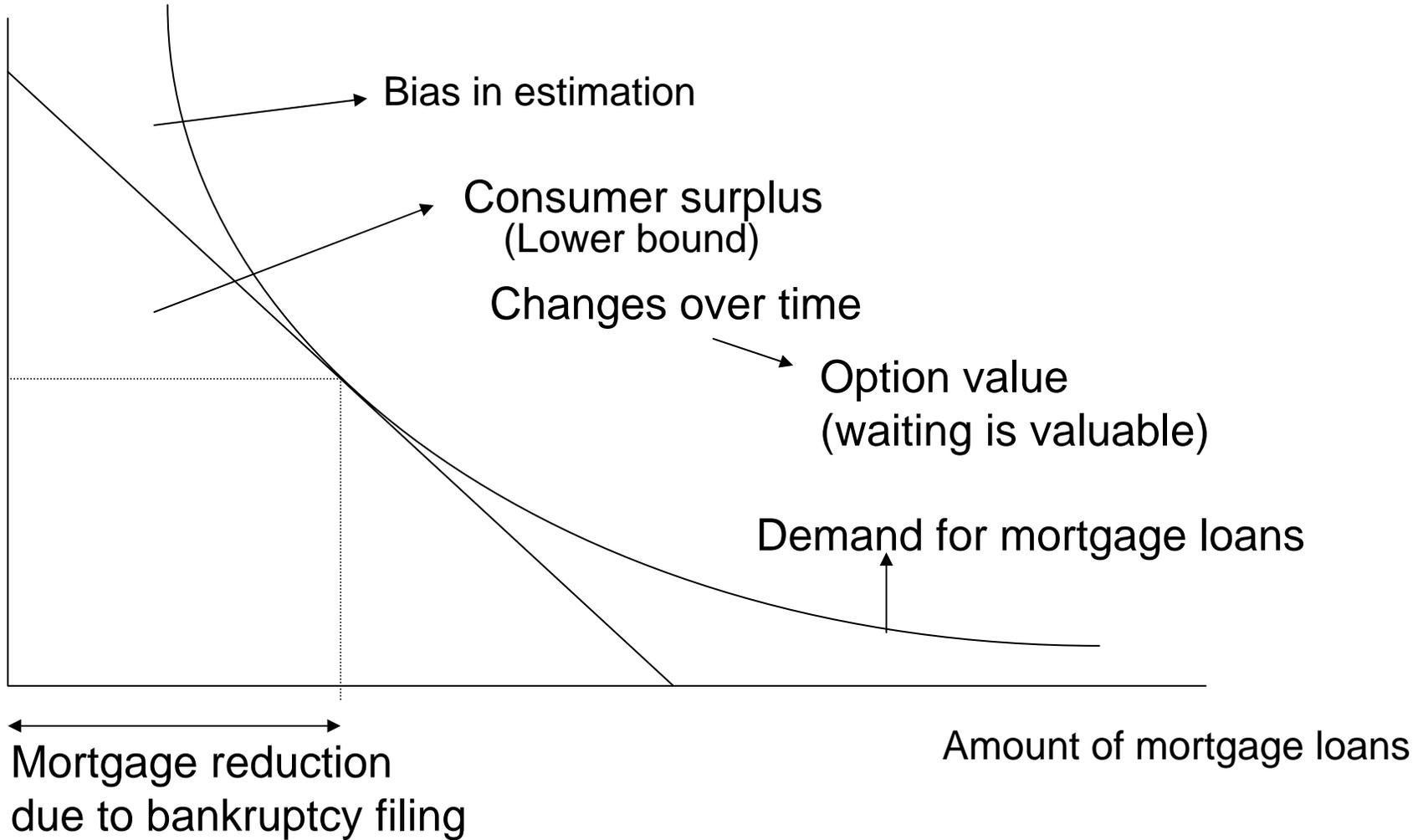
Negative effects of bankruptcy for home owners: reduced access to credit and lost option value

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Main results

1. Bankruptcy filing leads to a 30% higher probability of losing a home and a significant reduction in access to mortgage loans;
2. Bankruptcy filing has a substantial option value;
3. A typical home owner's benefit from filing for personal bankruptcy is substantially smaller than previously believed.
4. Estimates for some useful parameter values: price elasticity for mortgage loans, value of access to credit, and value of waiting in bankruptcy filing

Relevant concepts

Interest rate



Estimating negative effects of bankruptcy filing for home owners

- Mortgage reduction due to bankruptcy filing:
1989-1995 PSID data
 - A bankruptcy record increases a home owner's probability of losing home ownership by: **30%**
 - Expected loss of mortgage loans for a typical home owner: **\$7,800**
- Demand for mortgage loans & utility loss due to mortgage reduction:
1989-2001 SCF data
 - price elasticity for mortgage loans: **(0.62, 0.84)**
 - utility gain per dollar of mortgage holding: **(\$0.07, \$0.10)**
 - utility loss due to reduced mortgage: **(\$3,200, \$4,300)**
- Option value of bankruptcy filing:
SCF 1989 panel
 - option value of bankruptcy filing for home owner: **(\$290, \$380)**

Summary and implications

- Bankruptcy filing substantially reduces the access to mortgage loans for home owners, which leads to two deterrence effects: reduction in access to credit and loss in option value of bankruptcy filing;
- Access to credit is valuable and thus the reduction in mortgage loans leads to important utility loss to home owners;
- Uncertainty in demand for mortgage loans and irreversibility of bankruptcy filing make waiting valuable and the option value of bankruptcy filing non-negligible;
- Due to these two deterrence effects, the number of households that benefit from personal bankruptcy is smaller than previously believed;
- Factors that reduce the deterrence effects above will lead to higher benefit from bankruptcy filing;
- One such factor is the more readily available credit made to consumers with tarnished credit record;
- Further studies are needed to understand how credit availability has affected bankruptcy filing in the past two decades.