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# Equifax Develops Unique Method to Help Mortgage Investors Measure Payment Hierarchy

ORLANDO, Fla., Feb. 8, 2011 /PRNewswire/ -- Faced with high unemployment and strategic default rates, mortgage investors are more focused than ever before on achieving greater transparency into the collateral health of non-agency mortgage-backed securities. While there has been some preliminary research on payment and default hierarchy, [Equifax Capital Markets](#) has taken a unique approach to analyzing borrower behavior. In a recent study, Equifax defined a new metric – default distance – which provides strategic insight into default timing. Default distance is the number of months between the default of a revolving debt and the first occurrence of foreclosure (as reported by MBA status) in a non-agency securitized mortgage. A positive number means that a borrower defaulted on a revolving debt first while a negative number indicates that the borrower defaulted on their mortgage loan first.

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"Having the ability to accurately measure default behavior is critical for investors looking for better ways to assess mortgages that on the surface appear healthy," said Afshin Goodarzi, Equifax Capital Markets. "Our analysis underscores the importance of evaluating payment hierarchy and its relationship to loan performance- especially among more creditworthy borrowers."

Equifax analysis showed that on average revolving account defaults continue to occur before first mortgage loan defaults, with the timespan between them decreasing over time. The most substantial decrease in default distance can be seen among loans with high current combined loan to values (CLTVs) – a trend driven in part by rising strategic defaults. However, even for very high CLTV loans, borrowers on average still default on revolving accounts before their first mortgage – underscoring the need for investors to look at borrower performance on revolving accounts as a leading indicator of loan performance.

In its study, Equifax linked anonymous borrower credit information to CoreLogic loan-level, mortgage-backed securities data to measure default distance at every point in the life of all non-agency securitized loans. Analysis was performed utilizing FHFA home price data on mortgage loans for borrowers with only one mortgage outstanding and revolving debt included credit card and HELOC loans. The following findings provide an in-depth look at this analysis by geography, market segment and credit score.

**Does Geography Matter?**

According to Equifax analysis, the answer is yes. Equifax data reveals that default distance has shrunk in most states – especially those significantly impacted by challenging economic conditions and the housing correction. Leading the way were Florida, California and Michigan – all with average default distances inJanuary 2010 of less than five months. As the graphic below shows, Texas and South Dakota had the longest default distances during the same time period, with both states having an average distance of more than 15 months.

**Chart 1: Default Distance for the U.S., January 2010**

**Default Distance by Market Segment: A Series of Ups and Downs**

According to Equifax data, prime loans have started to see some stabilization, with default distance increasing over time for this segment. In addition, default distance for sub-prime loans has plateaued at 10 months and leveled off at slightly more than 5 months for option ARM loans.

**High Credit Scores not equal to Long Default Distances**

While one might expect creditworthy borrowers to have the longest default distance, Equifax analysis revealed that this is not the case. In fact, Equifax data shows that in late 2008 and early 2009 borrowers in the two highest VantageScore bands had the lowest average distance between revolving and mortgage defaults. Why? In general, borrowers in these score bands consistently pay nearly all of their credit obligations on time. However, when these borrowers default on one account, many of them end up defaulting on multiple other accounts at the same time. This behavior ultimately leads to a shorter default distance, as the chart below shows.

**Chart 2: Default Distance by VantageScore**

(Note, positive numbers in the chart represent default on revolving debt before mortgage.)

**Has Payment Hierarchy Changed?**

According to Equifax analysis, mortgage loan defaults still occur after revolving debt defaults, although, default distance between revolving debt and foreclosed mortgages has decreased since 2005. Chart 3 shows that the majority of mortgage loans have a positive default distance of 12 months or more.

The market segment in which the default gap has narrowed the most is high CLTV mortgages. In fact, Equifax analysis reveals that in some cases high CLTV loans default first – making CLTV a better predictor of mortgage default. Chart 4 provides a snapshot of the relationship between CLTV and default distance.

**Chart 3: Percent of Loans by Default Distance**

(Note, negative numbers represent default on mortgage before revolving debt. Positive numbers represent default on revolving debt before mortgage.)

**Chart 4: Default Distance as a Function of CLTV**

(CLTV was calculated using the Equifax measure of total mortgage debt, including all closed-end HELOC balances. Property value was determined using the FHFA Home Price Index.)

**Equifax Capital Markets**

Equifax's suite of Capital Markets solutions empowers lenders and investors to make buy/sell decisions with the most up-to-date borrower and property value information available. Leveraging unique data with advanced analytics and risk projection strategies, Equifax provides unique, forward-looking information to help investors manage through this highly sensitive credit environment. For more information about Equifax Capital Markets, visit [www.equifax.com/capitalmarkets](www.equifax.com/capitalmarkets).



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