

ABSTRACT

Credit Risk in Government Mortgage Lending

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The large body of existing literature on mortgage default has generally emerged from developed western economies. This dissertation examines credit risk within the context of an “upper middle-income” developing country, where the government plays a significant role in primary mortgage lending. It empirically examines the effect of borrower, loan, property, and lender characteristics on credit risk for all loans and separately for low-income and non-low-income loans. Credit risk was measured by examining the probability of default, self-cure time (a largely neglected area of study), and low-income using a proxy for weekly income of JA\$10,000. Logistic and ordinary least square modelling of probability of default and self-cure time respectively, yielded new perspectives on the impact of lender servicing approach and highlighted the continued relevance of marital status, payment source, employment status, and income on credit risk. It also shows strong support for the equity theory in explaining the likelihood of default. Interestingly, low-income, which was associated with increasing probability of default, was more responsive to lenders’ actions and had a lower default curing time. From a policy perspective, the research indicates that assessment of credit risk should take into consideration the differences in default characteristics for low-income and non-low-income borrowers. For example, debt-service ratio was a significant contributor to default probability among non-low-income but not among low-income borrowers, and there were material differences in the magnitude of the effect of payment source, loan to value ratio, loan purpose, and product type effect on default. The findings suggest that a fair strategy for extending credit should underwrite and service these groups separately. Importantly, the research also highlights the need for timely and deliberate actions on the part of government lenders to treat with non-performing loans, reduce the probability of recurring default, and facilitate more timely settlement of outstanding payments.

Keywords: Suzanne Ivorine Wynter; credit risk; mortgage; probability of default; self-cure time; low-income; lender’s actions.