

A Simple Model of Mortgage Write-Downs

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Abstract

The current crisis has demonstrated that many financial institutions have underestimated the risks associated with mortgages. The resulting losses have also heightened the general interest in the mortgage market. Although there are many empirical papers on mortgage defaults and write downs, there is only little theoretical work on this issue. In this paper I develop a novel theoretical model of mortgage write-down rates that helps to understand their main underlying risk factors. Following the model, write-down rates are positively influenced by the house-price level, the loan to value of mortgages, and interest rates. They are negatively influenced by the growth of house prices and the income level. The calibration of the model for the US, the UK, and Switzerland demonstrates that it is well able to describe the overall development of the actual write-down rates.

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