

Estimation of Discrete Choice Network Models with Missing Outcome Data*

Denghui Chen[†] Hua Kiefer[‡] Xiaodong Liu[§]

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[†]Office of the Comptroller of the Currency, denghui.chen@occ.treas.gov.

[‡]Federal Deposit Insurance Corporation, hkiefer@fdic.gov.

[§]Department of Economics, University of Colorado Boulder, xiaodong.liu@colorado.edu.

Abstract

This paper considers the problem of missing observations on the outcome variable in a discrete choice network model. The research question is motivated by an empirical study of the spillover effect of home mortgage delinquencies, where mortgage repayment decisions can only be observed for a sample of all the borrowers in the study region. We show that the nested pseudo-likelihood (NPL) algorithm can be readily modified to address this missing data problem. Monte Carlo simulations indicate that the proposed estimator works well in finite samples and ignoring this issue leads to a severe downward bias in the estimated spillover effect. We apply the proposed estimation procedure to study single-family residential mortgage delinquency decisions in Clark County of Nevada in 2010, and find strong evidence of the spillover effect. We also conduct some counterfactual experiments to illustrate the importance of consistently estimating the spillover effect in policy evaluation.

Keywords: missing data, mortgage defaults, networks, NPL, rational expectation.

JEL: C21, R31

1 Introduction

The past decades have seen a fast progress in the theoretical development of network models. Yet, the empirical applications of network models are still limited due to the high cost of collecting network data. Moreover, most existing estimation methods for network models require that the whole network, instead of a random sample of the network nodes or links, to be observed by the researcher, which escalates the difficulty of data collection. Hence, it is of great practical importance to develop econometric methods to analyze network models with partially observed or sampled network data. The current literature on this topic can be divided into two research strands. The first strand focuses on partially observed or completely unobserved network links (see, e.g., [Liu 2013](#), [Chandrasekhar & Lewis 2016](#), [de Paula et al. 2019](#), [Hardy et al. 2019](#), [Lewbel et al. 2019](#), [Breza et al. 2020](#), [Boucher & Houndetoungan 2020](#), [Griffith 2020](#)), while the second strand focuses on the missing data problem in the outcomes or covariates of network nodes (see, e.g., [Sojourner 2013](#), [Wang & Lee 2013a,b](#), [Boucher et al. 2014](#), [Liu et al. 2017](#)). Our paper contributes to the second research strand by studying the problem of missing observations on the outcome variable in a discrete choice network model. It complements the studies by [Boucher et al. \(2014\)](#), [Wang & Lee \(2013a,b\)](#) and [Liu et al. \(2017\)](#) for the same missing data problem in linear network models.

The research question in this paper is motivated by an empirical study of the spillover effect of mortgage delinquencies. To establish a direct link connecting mortgage repayment decisions of neighboring homeowners, we build an empirical model based on the discrete choice network model in [Lee et al. \(2014\)](#), where a mortgage borrower’s repayment decision depends on not only neighboring foreclosures in the previous time period (the contagion effect in [Towe & Lawley 2013](#)) but also the rational expectation of neighbors’ repayment decisions in the current time period (the spillover effect in [Chomsisengphet et al. 2018](#)).¹ An

¹In the literature, “contagion effects” and “spillover effects” are often used interchangeably. To distinguish between the time-lagged effect of past foreclosures from the contemporaneous effect of current default decisions, we refer to the former as the contagion effect (as in [Towe & Lawley 2013](#)), and the latter as the spillover effect.

underlying assumption in [Lee et al. \(2014\)](#) is that the researcher can observe the outcomes and covariates of all individuals in the network. Although this assumption is quite common for network models, it is not realistic for a mortgage repayment behavior study. More specifically, the outcome variable in this empirical model is defined as being 90 days past due or worse (90+ DPD). Such information is only available in loan performance data, which is usually collected by the mortgage servicer serving the loans and only covers a portion of all the active mortgage borrowers in the study region depending on the mortgage servicer's market share. Ignoring this missing data issue, by treating the sampled borrowers in the loan performance data as the full population of all the active mortgage borrowers in the study region, may introduce a measurement error to the rational expectation of neighbors' repayment decisions, and thus lead to an inconsistent estimate of the spillover effect.

In this paper, we show that, by supplementing the loan performance data with public records on covariates of all the borrowers in the study region, the nested pseudo-likelihood (NPL) algorithm ([Aguirregabiria & Mira 2007](#)) can be readily modified to address this missing data issue. The NPL algorithm is an iterative algorithm that starts from an initial guess of the delinquency probabilities for all borrowers in the study region, and repeatedly estimates the model to update the delinquency probabilities until the process converges. The main intuition of the proposed method is that, since the delinquency probabilities of all borrowers can be calculated as long as their covariates are known, the aforementioned measurement error problem can be avoided. Our Monte Carlo simulations indicate that the proposed estimator works well in finite samples and ignoring this missing data issue leads to a severe downward bias in the estimated spillover effect. Using empirical data on single-family residential mortgage delinquencies in Clark County of Nevada in 2010, we find evidence for both a time-lagged contagion effect ([Towe & Lawley 2013](#)) and a contemporaneous spillover effect ([Chomsisengphet et al. 2018](#)). Consistent with the Monte Carlo simulations, we find that the spillover effect is underestimated when the missing data problem is left unaddressed. We complement our estimation effort with two counterfactual studies to illustrate the impor-

tance of consistently estimating the spillover effect in policy evaluation. In the first study, we hypothetically remove properties in foreclosure, one at a time, from the data, and calculate the corresponding reduction in the aggregate delinquency level. In the second study, we introduce a positive utility shock, which can be interpreted as a mortgage payment reduction, to all residents in the study region, and plot the percentage reduction in delinquency rates as the shock increases. In both counterfactual studies, we find that the overall reduction in mortgage delinquencies tends to be understated when the contemporaneous spillover effect is ignored or underestimated due to the missing data problem.

In the empirical study, besides the missing data problem, we face another identification challenge of disentangling the spillover effect from the correlated effect, i.e., neighbors may behave alike because they share similar (and possibly unobserved) characteristics or face a common environment (Manski 1993). In this case, it often requires additional exogenous variation such as an instrumental variable (IV) to establish a direct causal interpretation of the delinquency spillover effect (see, e.g., Munroe & Wilse-Samson 2013, Gupta 2019). In this paper, we adopt the spatial fixed effect approach that is widely used in the literature (see, e.g., Bayer et al. 2008, Grinblatt et al. 2008, Campbell et al. 2011, Towe & Lawley 2013, Gerardi et al. 2015).² As argued by Bayer et al. (2008), the thin housing market limits people’s ability to pick the exact residential location in their desired neighborhood, and, hence, people’s immediate neighbors can be considered as quasi-random conditional on the spatial fixed effect. Including spatial fixed effects also helps to control for common environments and regional random shocks faced by neighboring households. It is worth mentioning that the fixed effect approach is also a prevailing technique to account for the correlated effect in the social network models (see, e.g., Bramoullé et al. 2009, Calvó-Armengol et al. 2009, Liu et al. 2014). To evaluate the effectiveness of the spatial fixed effect approach in controlling for the correlated effect in this empirical application, we conduct Moran I tests on the estimation residuals (see Kelejian & Prucha 2001, Section 4.1), and

²Campbell et al. (2011) include census-tract-by-year fixed effects in their panel data model. As we have cross-sectional data, we cannot incorporate time-varying fixed effects.

find a strong spatial correlation *without* spatial fixed effects while no spatial correlation *with* spatial fixed effects.

Our empirical findings contribute to a large literature on mortgage defaults and corresponding neighborhood effects. In this literature, some work has shown that mortgage defaults have a significant and highly localized impact on house prices in the neighborhood (Immergluck & Smith 2006, Schuetz et al. 2008, Harding et al. 2009, Campbell et al. 2011, Hartley 2014, Gerardi et al. 2015); while other work has been focusing on the impact of negative equity on default likelihood (Deng et al. 2000, Foote et al. 2008, Bhutta et al. 2010, Elul et al. 2010, Calomiris et al. 2013, Gerardi et al. 2018). Nevertheless, with a few exceptions, little work has been done to study the interaction of neighboring mortgage borrowers' default decisions. Towe & Lawley (2013) relate a homeowner's default decision to the *observed* default decisions of the neighbors in the previous time period (i.e., neighboring foreclosures). Munroe & Wilse-Samson (2013) investigate the impact of a completed foreclosure on future neighboring foreclosure filings. Gupta (2019) studies the contagion effect of foreclosures triggered by an interest rate increase. Huang et al. (2021) develop an exogenous proxy for the fraction of mortgages in negative equity based on the timing of foreclosures in a neighborhood, and use it to estimate the spillover effect of foreclosures. The most close work to ours is Chomsisengphet et al. (2018), which establishes a direct connection between neighboring mortgage borrowers' contemporaneous default decisions. However, in Chomsisengphet et al. (2018), the aforementioned missing data problem is left unaddressed.

The rest of the paper proceeds as follows. Section 2 describes the model, NPL estimation strategy and Monte Carlo simulation experiments. Section 3 presents the data, empirical results and counterfactual studies. Section 4 concludes. The detailed derivation of asymptotic properties and marginal effects, and additional Monte Carlo simulation results are collected in the Online Appendix.

2 Model and NPL Estimation

2.1 Model

Consider a network with a set of n individuals $\mathcal{N} \equiv \{1, \dots, n\}$. The topology of the network is represented by an $n \times n$ adjacency matrix $W = [w_{ij}]$, with w_{ij} as the (i, j) th element of W . Let $y_i \in \{0, 1\}$ denote the dichotomous choices of individual $i \in \mathcal{N}$, X_i denote a row vector of exogenous covariates, and $F(\cdot)$ denote a distribution function. [Lee et al. \(2014\)](#) propose a binary choice network model, where, in the rational expectation equilibrium, the probability of $y_i = 1$ is given by

$$p_i \equiv \Pr(y_i = 1) = F(X_i\beta + \lambda \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij}p_j). \quad (1)$$

In Equation (1), the spatial lag term $\sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij}p_j$ is the weighted sum of the expected outcomes of individual i 's connections, with the coefficient λ capturing the network spillover effect.

To motivate the general econometric model defined in Equation (1), we consider a random utility model for home mortgage delinquencies. As in a standard random utility model, the utility of delinquency ($y_i = 1$) is normalized to zero, and the utility of making loan payments ($y_i = 0$) is given by

$$\epsilon_i - X_i\beta - \lambda \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij}y_j, \quad (2)$$

where ϵ_i is an i.i.d. idiosyncratic shock with the distribution function $F(\cdot)$. In the empirical study, $F(\cdot)$ is the standard logistic function, and $w_{ij} = w_{ij}^* / \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij}^*$, where w_{ij}^* is a known constant capturing the geographical proximity between i and j . More specifically, as the literature suggests the spillover effect of distressed properties is very local and decays rapidly with distance (e.g., [Campbell et al. 2011](#), [Gerardi et al. 2015](#), [Cohen et al. 2016](#)), we assume $w_{ij}^* = 1/d_{ij}$ if i and j are within a cutoff distance (say, 0.5 mile), where d_{ij} denotes the geographical distance between i and j , and $w_{ij}^* = 0$ otherwise. Thus, $\sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij}y_j$

is the distance-weighted delinquency rate in mortgage borrower i 's neighborhood, with its coefficient λ representing the spillover effect of mortgage delinquencies.

As mortgage delinquencies (90+ DPD) cannot be directly observed by other borrowers, we assume borrowers make delinquency decisions y_i simultaneously. We further assume that $X = (X'_1, \dots, X'_n)'$ and the distribution of ϵ_i are common knowledge among all borrowers in the area, but the realization of ϵ_i is privately observed by borrower i . In the random utility model, borrower i goes delinquent on loan payments if the *expected* utility of $y_i = 0$, given the information set $\mathcal{I}_i = \{W, X, \epsilon_i\}$, is less than zero, i.e.,

$$\mathbb{E}(\epsilon_i - X_i\beta - \lambda \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} y_j | \mathcal{I}_i) < 0$$

or, equivalently,

$$\epsilon_i < X_i\beta + \lambda \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} \mathbb{E}(y_j | \mathcal{I}_i).$$

As the distribution function of ϵ_i is $F(\cdot)$, borrower i 's probability of delinquency is

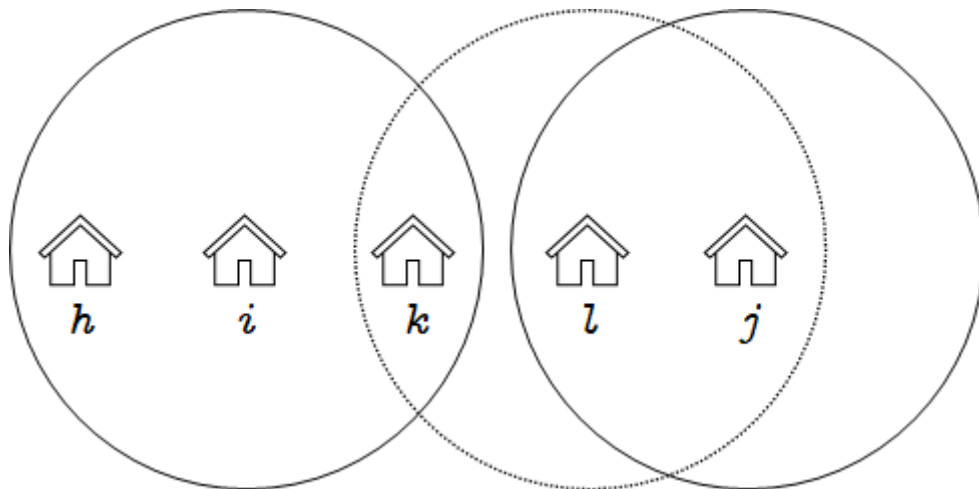
$$p_i \equiv \Pr(y_i = 1) = F(X_i\beta + \lambda \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} \mathbb{E}(y_j | \mathcal{I}_i)).$$

In the rational expectation equilibrium (Brock & Durlauf 2001a,b), borrower i 's expectation on borrower j 's delinquency decision, i.e., $\mathbb{E}(y_j | \mathcal{I}_i)$, should be equal to the mathematical probability for borrower j to be delinquent, i.e., p_j . Therefore, the equilibrium of the random utility model is given by Equation (1). Lee et al. (2014) provide a sufficient condition for the existence of a unique solution to the fixed point problem defined in Equation (1). In the case where $F(\cdot)$ is the standard logistic function and $\sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} = 1$ for all $i \in \mathcal{N}$, Equation (1) has a unique solution if $|\lambda| < 4$.

To highlight the importance of the spillover effect, we consider the following example. Suppose X_i is a scalar representing the number of foreclosures initiated in the previous period in borrower i 's neighborhood.³ In the absence of the spillover effect, i.e., $\lambda = 0$, the *direct*

³In the empirical study, the initiation of foreclosure is indicated by the notice of default (NOD) or the

Figure 1: The Spillover Effect of Home Mortgage Delinquencies



marginal effect of X_i on borrower i 's own delinquency probability p_i is

$$\frac{\partial p_i}{\partial X_i} = f(X_i\beta)\beta,$$

where $f(x) = \partial F(x)/\partial x$. For borrower j who is far from i , the *indirect* marginal effect of X_i on borrower j 's delinquency probability p_j is

$$\frac{\partial p_j}{\partial X_i} = 0.$$

That is, when the neighborhoods of borrowers i and j (represented by the solid circles in Figure 1) do not overlap, foreclosures in borrower i 's neighborhood have no impact on borrower j 's delinquency decision. On the other hand, when $\lambda \neq 0$, the *direct* marginal effect of X_i on borrower i 's own delinquency probability p_i is⁴

$$\frac{\partial p_i}{\partial X_i} = (1 + \lambda\psi_{ii})f_i\beta, \tag{3}$$

notice of trustee sale (NOTS) filed in the county office. Thus, different from the delinquency decision in the current period that is unobservable to the neighbors, foreclosures in the previous period are publicly observable.

⁴Online Appendix B provides a detailed derivation of the marginal effects.

and the *indirect* marginal effect of X_i on borrower j 's delinquency probability p_j ($j \neq i$) is

$$\frac{\partial p_j}{\partial X_i} = \lambda \psi_{ji} f_j \beta, \quad (4)$$

with $f_i = f(X_i \beta + \lambda \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} p_j)$ and ψ_{ij} denoting the (i, j) th element of the matrix

$$\Psi = W(I_n - \lambda \text{diag}\{f_i\}W)^{-1} \text{diag}\{f_i\},$$

where $\text{diag}\{f_i\}$ is an $n \times n$ diagonal matrix with the i th diagonal element being f_i . Equation (4) implies that, when $\lambda \neq 0$, foreclosures in borrower i 's neighborhood may affect borrower j 's delinquency decision even if they are far from each other. This can be seen in Figure 1. Suppose house h goes into foreclosure. Knowing that a foreclosure in borrower i 's neighborhood has an impact on borrower i 's delinquency risk, borrower k will adjust the delinquency decision accordingly. As borrower k is in borrower l 's neighborhood (represented by the dotted circle in Figure 1), borrower k 's delinquency risk will affect borrower l , which will in turn affect borrower j . Thus, as a result of the chain reaction, a borrower's delinquency decision can be influenced by a foreclosure in a far away neighborhood.

2.2 NPL estimation with missing outcome data

The main difficulty in estimating Equation (1) is that $p = (p_1, \dots, p_n)'$ is not observable. Lee et al. (2014) suggest to use the nested fixed point (NFXP) algorithm (Rust 1987), with an internal subroutine that solves the fixed point problem given by Equation (1) for p , to implement the maximum likelihood (ML) estimation. To bypass the computational burden of the NFXP algorithm, which repeatedly solves the fixed point problem at each candidate parameter value in the search for the maximum of the log-likelihood function, Lin & Xu (2017) adopt the computationally more efficient NPL algorithm (Aguirregabiria & Mira 2007). The NPL algorithm is an iterative algorithm that starts from an initial value of p , and estimates the model with the spatial lag $\sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} p_j$ evaluated at the initial value

of p . During each iteration, it re-estimates the model with the spatial lag $\sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} p_j$ evaluated at the predicted value of p from the previous iteration. The algorithm repeats this process until it converges.

Both [Lee et al. \(2014\)](#) and [Lin & Xu \(2017\)](#) assume that the researcher can observe the outcomes and exogenous characteristics of all individuals in the network. In our empirical study of home mortgage delinquencies, the exogenous variables X_i include house characteristics (such as house square footage, the number of bedrooms, and ownership status), loan characteristics (such as property value and loan-to-value (LTV) ratio), and the number of foreclosures initiated in the previous period in borrower i 's neighborhood.⁵ All this information is public and available for all borrowers in the study region of our empirical analysis, which is in a disclosure state. On the other hand, the outcome variable y_i is defined as being 90+ DPD, which is not public information and is only available in the loan performance data. In the empirical study, we use the loan performance data assembled by a government agency that regulates several national mortgage servicers. Similarly to other popular residential mortgage databases that are commercially available (e.g., CoreLogic or Black-Knight), the coverage of this data depends on the mortgage servicers' market shares. For the specific study region of our empirical analysis, Clark County of Nevada, this data covers about 26% of the single-family residential mortgages. In other words, among all the mortgage repayment decisions in the population, about 26% of them are observed and recorded in our data.

More generally, suppose we can observe the exogenous variables X_i for all $i \in \mathcal{N}$, and the outcome variable y_i for $i \in \mathcal{N}^*$, where \mathcal{N}^* is a random sample of \mathcal{N} with the sample size given by $n^* = |\mathcal{N}^*|$. If one drops individuals with missing outcome data and only uses information of individuals in the sample \mathcal{N}^* for the estimation, then the estimated model

⁵The house characteristics (i.e., house square footage, the number of bedrooms, and ownership status) are from the 2009 tax assessment record. The loan characteristics (i.e., property value and LTV ratio) are recorded on the loan origination date in the publicly available transaction data. The initiation of foreclosure indicated by the NOD or NOTS is also publicly available.

becomes

$$\Pr(y_i = 1) = F(X_i\beta + \lambda \sum_{j \in \mathcal{N}^* \setminus \{i\}} w_{ij} p_j^*), \quad (5)$$

where p_j^* is the solution of the fixed point problem

$$p_i^* = F(X_i\beta + \lambda \sum_{j \in \mathcal{N}^* \setminus \{i\}} w_{ij} p_j^*), \quad (6)$$

for $i \in \mathcal{N}^*$. Comparing Equation (5) with Equation (1), we can see that the exclusion of individuals with missing outcome data introduces a measurement error to the spatial lag term $\sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} p_j$. The measurement error comes from two sources. First, some neighbors of individual i are omitted from the spatial lag term. Second, the equilibrium delinquency probability obtained from Equation (6) is miscalculated. Take the network in Figure 1 as an example. Suppose we do not observe the delinquency decision of borrower k , i.e., $k \notin \mathcal{N}^*$. If we exclude borrower k from the network in the estimation, then the connection between borrowers i and j is cut off. As a result, the interdependence of i and j 's delinquency decisions will be attributed to some other confounding factors, leading to an underestimated spillover effect. Hence, simply excluding individuals with missing outcome data may lead to inconsistent estimation results. In the following, we propose a modified NPL algorithm to address this missing data problem.

Let $\theta = (\lambda, \beta)'$. The modified NPL algorithm starts from an initial value $p^{(0)} = (p_1^{(0)}, \dots, p_n^{(0)})'$ and takes the following iterative steps:

Step 1 Given $p^{(t-1)} = (p_1^{(t-1)}, \dots, p_n^{(t-1)})'$, obtain $\hat{\theta}^{(t)} = \arg \max \ln L(\theta; p^{(t-1)})$, where

$$\begin{aligned} \ln L(\theta; p^{(t-1)}) &= \sum_{i \in \mathcal{N}^*} \{y_i \ln F(X_i\beta + \lambda \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} p_j^{(t-1)}) \\ &\quad + (1 - y_i) \ln [1 - F(X_i\beta + \lambda \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} p_j^{(t-1)})]\}. \end{aligned}$$

Step 2 Given $\widehat{\theta}^{(t)}$, update $p^{(t)} = (p_1^{(t)}, \dots, p_n^{(t)})'$ according to

$$p_i^{(t)} = F(X_i \widehat{\beta}^{(t)} + \widehat{\lambda}^{(t)} \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} p_j^{(t-1)}). \quad (7)$$

Repeat Steps 1 and 2 until the process converges.

It is worth noting that the updating rule for delinquency probabilities given by Equation (7) depends only on X_i , but not on y_i . As we observe X_i for all $i \in \mathcal{N}$, Equation (7) calculates the updated delinquency probabilities for all $i \in \mathcal{N}$, which allows us to obtain the spatial lag term in the log-likelihood function free of measurement error. This idea is similar to that in Wang & Lee (2013a), where the authors consider the same missing data problem in a linear spatial autoregressive (SAR) model. One of the solutions that Wang & Lee (2013a) suggest is to impute the unobserved y_i from the reduced form of the SAR model using X_i for all $i \in \mathcal{N}$, and replace the unobserved y_i 's in the spatial lag by their imputed values.

Kasahara & Shimotsu (2012) show that a key determinant of the convergence of the NPL algorithm is the contraction property of Equation (1), which is ensured by the condition $|\lambda| < 4$ in the case with $F(\cdot)$ being the standard logistic function and $\sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} = 1$ for all $i \in \mathcal{N}$. When the NPL algorithm converges, the NPL estimator $\widehat{\theta}$ satisfies $\widehat{\theta} = \arg \max \ln L(\theta; \widehat{p})$, where

$$\begin{aligned} \ln L(\theta; \widehat{p}) &= \sum_{i \in \mathcal{N}^*} \{y_i \ln F(X_i \beta + \lambda \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} \widehat{p}_j) \\ &\quad + (1 - y_i) \ln [1 - F(X_i \beta + \lambda \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} \widehat{p}_j)]\}, \end{aligned}$$

and $\widehat{p} = (\widehat{p}_1, \dots, \widehat{p}_n)'$ is the solution of the system of equations

$$\widehat{p}_i = F(X_i \widehat{\beta} + \widehat{\lambda} \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} \widehat{p}_j),$$

for $i \in \mathcal{N}$. Under some standard regularity conditions, it follows by a similar argument as in [Aguirregabiria & Mira \(2007\)](#) that the proposed NPL estimator is consistent and asymptotically normal.⁶

The estimation of the asymptotic variance of the NPL estimator $\hat{\theta}$ also needs to take this missing data issue into consideration. Let $\hat{\Omega}$ be an $n \times n$ diagonal matrix with the i th diagonal element being $\hat{f}_i^2 / [\hat{F}_i(1 - \hat{F}_i)]$, where $\hat{F}_i = F(X_i\hat{\beta} + \hat{\lambda} \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij}\hat{p}_j)$ and $\hat{f}_i = f(X_i\hat{\beta} + \hat{\lambda} \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij}\hat{p}_j)$. Let J be a $n^* \times n$ selector matrix such that JX collects elements in $X = (X'_1, \dots, X'_n)'$ corresponding to $i \in \mathcal{N}^*$. The asymptotic variance of $\hat{\theta}$ can be estimated by

$$(\hat{\Sigma}_1 + \hat{\lambda}\hat{\Sigma}'_2)^{-1}\hat{\Sigma}_1(\hat{\Sigma}_1 + \hat{\lambda}\hat{\Sigma}_2)^{-1},$$

where

$$\begin{aligned}\hat{\Sigma}_1 &= [W\hat{p}, X]'J'J\hat{\Omega}J'J[W\hat{p}, X], \\ \hat{\Sigma}_2 &= [W\hat{p}, X]'J'J\hat{\Omega}J'JW(I_n - \hat{\lambda}\text{diag}\{\hat{f}_i\}W)^{-1}\text{diag}\{\hat{f}_i\}[W\hat{p}, X].\end{aligned}$$

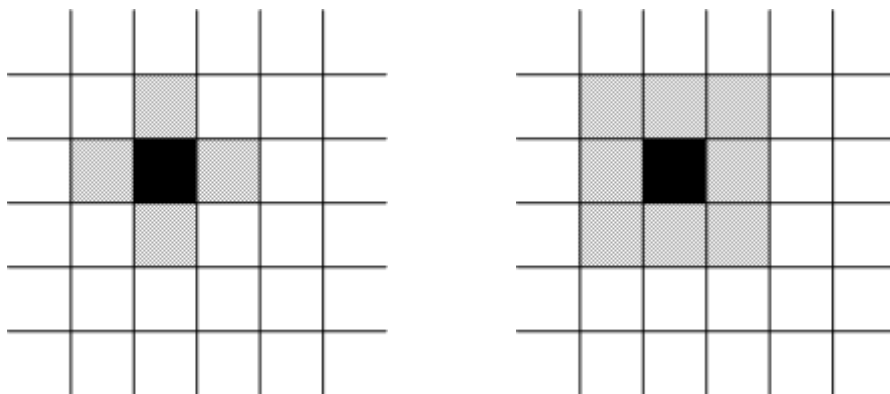
2.3 Monte Carlo simulations

To investigate the finite sample performance of the proposed NPL algorithm, we conduct a simulation study. In the data generating process, we consider both generated and empirical networks. The generated network provides stylized facts on how the missing data bias is affected by the network configuration (e.g., a sparse network v.s. a dense network). The empirical network shows how the proposed estimator performs in a more realistic setting.

The generated network has two spatial layouts based on the rook contiguity and the queen contiguity. More specifically, we allocate $n = 2500$ spatial units into a lattice of 50×50 squares. Under the rook contiguity, two spatial units i and j are considered as neighbors if the squares containing them share a common side. In the left panel of [Figure 2](#),

⁶Online Appendix [A](#) derives the asymptotic distribution of the proposed NPL estimator.

Figure 2: The Rook and Queen Contiguity



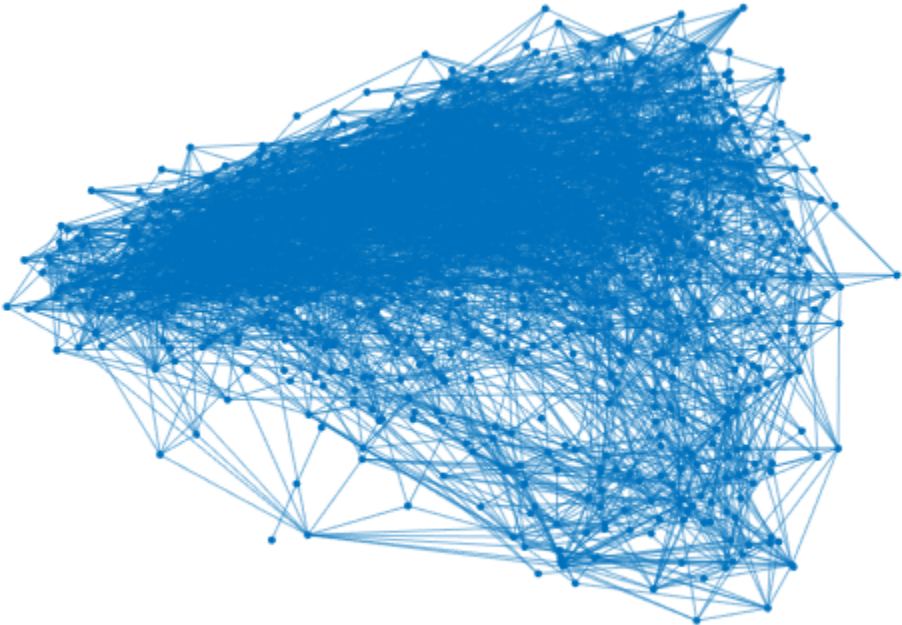
the grey squares are neighbors of the black square under the rook contiguity. Under the queen contiguity, two spatial units i and j are considered as neighbors if the squares containing them share a common side or vertex. In the right panel of Figure 2, the grey squares are neighbors of the black square under the queen contiguity. For both spatial layouts, we set $w_{ij}^* = 1$ if i and j are neighbors and $w_{ij}^* = 0$ otherwise. The adjacency matrix is given by $W = [w_{ij}]$ with $w_{ij} = w_{ij}^* / \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij}^*$.

The empirical network is pulled from the Add Health survey, which collected data on the social environment of students in grades 7-12 from roughly 130 private and public schools in the United States in the academic year of 1994-95. In the Add Health survey, every student attending the sampled schools on the interview day was asked to identify his/her friends (up to five males and five females) from the school roster. We use School #56 in the Add Health survey for the simulation study. After removing isolated students with no friends, the remaining 1546 students in School #56 are directly or indirectly connected in the friendship network as shown in Figure 3. On average, the students nominated 4.71 friends, with a standard deviation of 2.85. Let $w_{ij}^* = 1$ if student i nominated student j as a friend and $w_{ij}^* = 0$ otherwise. The adjacency matrix is given by $W = [w_{ij}]$ with $w_{ij} = w_{ij}^* / \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij}^*$.

In the data generating process, $F(\cdot)$ in Equation (1) is given by the standard logistic function,⁷ and $X_i = (1, x_{i2})$, where x_{i2} is a scalar that is generated from a uniform distribution

⁷The NPL estimators also assume that $F(\cdot)$ is the standard logistic function. That is, $F(\cdot)$ is correctly specified in the estimation. In Online Appendix C, we conduct additional Monte Carlo simulations to

Figure 3: Friendship Network



on $[-1, 1]$. The true values of the parameters are $\lambda = 2$ and $\beta = (\beta_1, \beta_2)' = (-1, 2)'$. We use recursive iterations to solve for $p = (p_1, \dots, p_n)'$ that is implicitly defined in Equation (1), and then set $y_i = 1$ if $X_i\beta + \lambda \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij}p_j > \epsilon_i$ and $y_i = 0$ otherwise, where ϵ_i is a logistic distributed random innovation. We randomly draw samples \mathcal{N}^* from the generated data \mathcal{N} under different sampling rates $n^*/n \in \{0.75, 0.5, 0.25\}$, and assume that X_i is observable for all $i \in \mathcal{N}$ while y_i is observable only for $i \in \mathcal{N}^*$.

We consider two NPL estimators in the simulation study. The NPL-1 estimator excludes individuals with missing observations on the outcome variable and only uses the sample \mathcal{N}^* for the estimation. Hence, the NPL-1 estimator is likely to be inconsistent due to the measurement error in the spatial lag term as explained in Section 2.2. The NPL-2 estimator follows the modified NPL algorithm described in Section 2.2. We conduct 1000 simulation repetitions. The mean and standard deviation (SD) of the empirical distribution of the NPL estimates are reported in Table 1. With the NPL-1 estimator, the estimated spillover effect (λ) is downward biased, the estimated intercept (β_1) is upward biased, and the estimated slope (β_2) seems to be unbiased. The bias increases as the sampling rate decreases. Comparing the rook contiguity and the queen contiguity, we can see that the bias is larger when the underlying network is more sparse (i.e., under the rook contiguity). The intuition is that, as the network becomes more sparse, the spatial lag term calculated based on the sample \mathcal{N}^* becomes less representative of the true spatial lag term $\sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij}p_j$. The direction and size of the NPL-1 estimator's bias are comparable between the generated rook/queen network and the empirical friendship network. On the other hand, the NPL-2 estimates are essentially unbiased with both generated and empirical networks, even when the sampling rate is low ($n^*/n = 0.25$).

investigate the robustness of the proposed estimator with respect to the misspecification of $F(\cdot)$.

Table 1: Monte Carlo Simulation Results

	NPL-1			NPL-2		
	$\lambda = 2$	$\beta_1 = -1$	$\beta_2 = 2$	$\lambda = 2$	$\beta_1 = -1$	$\beta_2 = 2$
Rook contiguity						
$n^*/n = 0.75$	1.314(0.327)	-0.655(0.168)	2.026(0.112)	1.991(0.356)	-0.996(0.180)	2.001(0.115)
$n^*/n = 0.50$	0.625(0.290)	-0.294(0.152)	2.054(0.131)	1.973(0.441)	-0.987(0.223)	2.006(0.138)
$n^*/n = 0.25$	0.232(0.311)	-0.077(0.145)	2.061(0.189)	1.958(0.615)	-0.976(0.314)	2.004(0.198)
Queen contiguity						
$n^*/n = 0.75$	1.511(0.405)	-0.757(0.206)	2.006(0.109)	1.985(0.413)	-0.994(0.209)	1.999(0.109)
$n^*/n = 0.50$	0.894(0.418)	-0.445(0.215)	2.020(0.132)	1.955(0.495)	-0.978(0.250)	2.003(0.134)
$n^*/n = 0.25$	0.289(0.394)	-0.127(0.198)	2.033(0.188)	1.929(0.715)	-0.962(0.362)	2.006(0.193)
Friendship network						
$n^*/n = 0.75$	1.560(0.308)	-0.795(0.142)	1.991(0.133)	1.983(0.327)	-0.993(0.150)	2.002(0.133)
$n^*/n = 0.50$	1.103(0.353)	-0.577(0.163)	1.987(0.161)	2.005(0.417)	-1.002(0.195)	2.006(0.162)
$n^*/n = 0.25$	0.572(0.414)	-0.320(0.173)	1.995(0.238)	1.974(0.587)	-0.989(0.271)	2.023(0.242)
Mean(SD)						

Table 2: Variable Definitions and Summary Statistics

	Definition	RRP data		MM data	
		Mean	SD	Mean	SD
<i>Dependent Variable</i>					
delinquency	1 if 90+ DPD in 2010, and 0 otherwise.			0.19	0.39
<i>Explanatory Variables</i>					
neighbor foreclosures	# of foreclosures initiated in 2009 within the 0.1 mile neighborhood.	16.69	13.68	14.88	12.04
square footage	The property size in thousand square feet.	2.05	0.78	2.04	0.75
bedrooms	# of bedrooms of the property.	3.39	0.83	3.40	0.82
owner	1 if the property is occupied by the owner.	0.73	0.44	0.78	0.41
log property value	The logarithm of the property's value at the loan origination date.	12.35	0.52	12.27	0.51
LTV_60to80	1 if the LTV ratio at the loan origination date is between 60% and 80%.	0.28	0.45	0.31	0.46
LTV_80to100	1 if the LTV ratio at the loan origination date is between 80% and 100%.	0.56	0.50	0.52	0.50
LTV_gt100	1 if the LTV ratio at the loan origination date is greater than 100%.	0.07	0.25	0.07	0.26
# of observations		221,947		58,526	

3 Empirical Analysis

3.1 Data

Our main data sources are the Mortgage Metrics (MM) database and the Renwood Realty Property (RRP) database. The MM data, assembled by the Office of the Comptroller of the Currency (OCC) since January 2008, consists of loan-level origination and monthly performance information of residential first-lien mortgages serviced by seven national banks and a federal savings association regulated by the OCC. The RRP data covers over 151 million properties and 3,143 counties which translates into 99% of the U.S. population coverage.⁸ We focus on the single-family residential mortgage repayment information in the MM data for Clark County of Nevada in 2010. The RRP data provides a wholistic coverage on the covariates of almost all single-family mortgage borrowers in that region, including those not in the MM data. Using the notation in Section 2.2, we consider the set of borrowers in the RRP data as \mathcal{N} and that in the MM data as \mathcal{N}^* . In our study region, the RRP transaction data contains 221,947 loan records distributed across 155 census tracts,⁹ whereas the MM sample only has 58,526 records.

The MM data is in a panel structure with monthly updated information for loan performance. The outcome variable of the empirical model – mortgage delinquency (90+ DPD) – is extracted from this data. It is worth pointing out that a mortgage delinquency is different from a foreclosure. The former is a decision made by a homeowner to stop making a mortgage payment, while the latter is a legal process in which a lender attempts to recover

⁸The RRP database consists of three types of data: (1) the transaction data, which provides a history of sales and financing activities on residential housing units, (2) the property tax assessment data collected from county (township) tax assessor’s office, and (3) the pre-foreclosure data (e.g., public records of NOD and NOTS). We use mortgage transaction data (excluding cash transactions) in RRP to construct the pool of active mortgages in the study region. Although we do not know if a mortgage is paid off at the time of our analysis, we feel comfortable that our RRP mortgage data provides a reasonable proxy of the true “active” mortgage population given the fact that the average loan age of the mortgages in our study region is 5.2 years as of the end of 2009. We use the RRP tax assessment data for a complete set of housing characteristic measures. The pre-foreclosure data of RRP provides us information of the existing foreclosure filings, through which we can identify the contagion effect.

⁹We focus on census tracts where most single family homes are located by dropping census tracts with less than 1000 single-family loan records in the RRP data.

the balance of a loan from a borrower who has stopped making payments to the lender by forcing the sale of the asset used as the collateral for the loan. Once a loan reaches a serious delinquency state, such as 90+ DPD, it is usually up to the state level laws and policies (e.g., the foreclosure law) as well as financial institute level programs (e.g., proprietary modification programs for loss mitigation) to determine how the foreclosure process proceeds. Because we are interested in a borrower’s decision instead of the legal aspect of its consequence, we define the outcome variable as being 90+ DPD in 2010. On the other hand, it is well documented that mortgage delinquency decisions could be affected by neighboring foreclosures in the previous time period (Towe & Lawley 2013). Hence, we include the number of foreclosures initiated in 2009 in a borrower’s neighborhood as a covariate in the empirical model. The initiation of foreclosure is indicated by the notice of default (NOD) or the notice of trustee sale (NOTS) filed in the county office. This information is publicly available in a disclosure state (e.g., Nevada) and contained in the RRP data. Other covariates in the empirical model include house square footage, the number of bedrooms, ownership status, property value (on the loan origination date), and LTV ratio (on the loan origination date). All this information is also publicly available and contained in the RRP data. We match the loans in the MM data with those in the RRP data based on encrypted property IDs.¹⁰

Table 2 lists the definitions of the dependent variable and explanatory variables as well as their summary statistics for both the RRP and MM datasets. Overall, the summary statistics of the explanatory variables are comparable between these two datasets. In both datasets, the average number of neighbor foreclosures is 15~17. The average size of the property is 2000 square feet, and the typical number of bedrooms is between 3 and 4. The majority of mortgage borrowers claimed to be the owners of their properties. The average property value is about \$220K. The number of borrowers with an initial LTV greater than 80% is slightly more than the number of borrowers with an initial LTV less than 80%.

¹⁰The encrypted property IDs were generated based on the actual address of each property. After the encrypted property IDs were generated, address information has been removed from both the RRP and MM data. Thus we, as the end data user, have no access to personally identifiable information.

In the empirical analysis, we treat a census tract as a spatial network.¹¹ Thus, the scope of spatial interactions is restricted to the census tract level. It is natural to think that the interdependence of delinquency decisions is more likely to exist between nearby houses. We therefore adopt the conventional inverse-distance-based spatial weights and assign zero weights to houses located farther than a cutoff-distance apart. More specifically, we define the spatial weight as $w_{ij}^* = 1/d_{ij}$ if i and j are within a cutoff distance, where d_{ij} denotes the geographical distance between i and j , and $w_{ij}^* = 0$ otherwise. We normalize the spatial weight as $w_{ij} = w_{ij}^* / \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij}^*$, so that the spatial lag term $\sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} p_j$ can be interpreted as the distance-weighted average delinquency probability in a borrower’s neighborhood. The radius of the neighborhood is given by the cutoff distance for $w_{ij}^* = 0$. In the empirical study, we experiment with different cutoff distances ranging from 0.5 miles to 0.1 miles and find the estimation results are robust. Figures 4-6 give a visualization of the average number of neighbors of each house with different cutoff distances for the census tracts used in the empirical analysis. Figure 7 plots the distribution of the delinquency rate in each house’s neighborhood with different cutoff distances using the MM data. We can see that the distribution of the delinquency rate is quite stable with different cutoff distances.

3.2 Estimation results

The main estimation results are reported in Table 3. The first column reports the standard logit estimates without accounting for the delinquency spillover effect. The second and third columns report the NPL estimates of Equation (1) with the delinquency spillover effect. The NPL-1 estimator falsely treats the borrowers in the MM data as the whole population and only uses the information on those borrowers and their properties to estimate the model. As explained in Section 2.2, the NPL-1 estimator is likely to be inconsistent due to the measurement error in the spatial lag term. The NPL-2 estimator is the consistent estimator proposed in Section 2.2 for data with missing values on the dependent variable.

¹¹We also conduct a robustness check by defining a block group, which is a subdivision of a census tract, as a spatial network, and find that the estimated spillover effect is robust to the scope of spatial networks.

Figure 4: Average Number of Neighbors in a Census Tract with Cutoff Distance of 0.5 miles

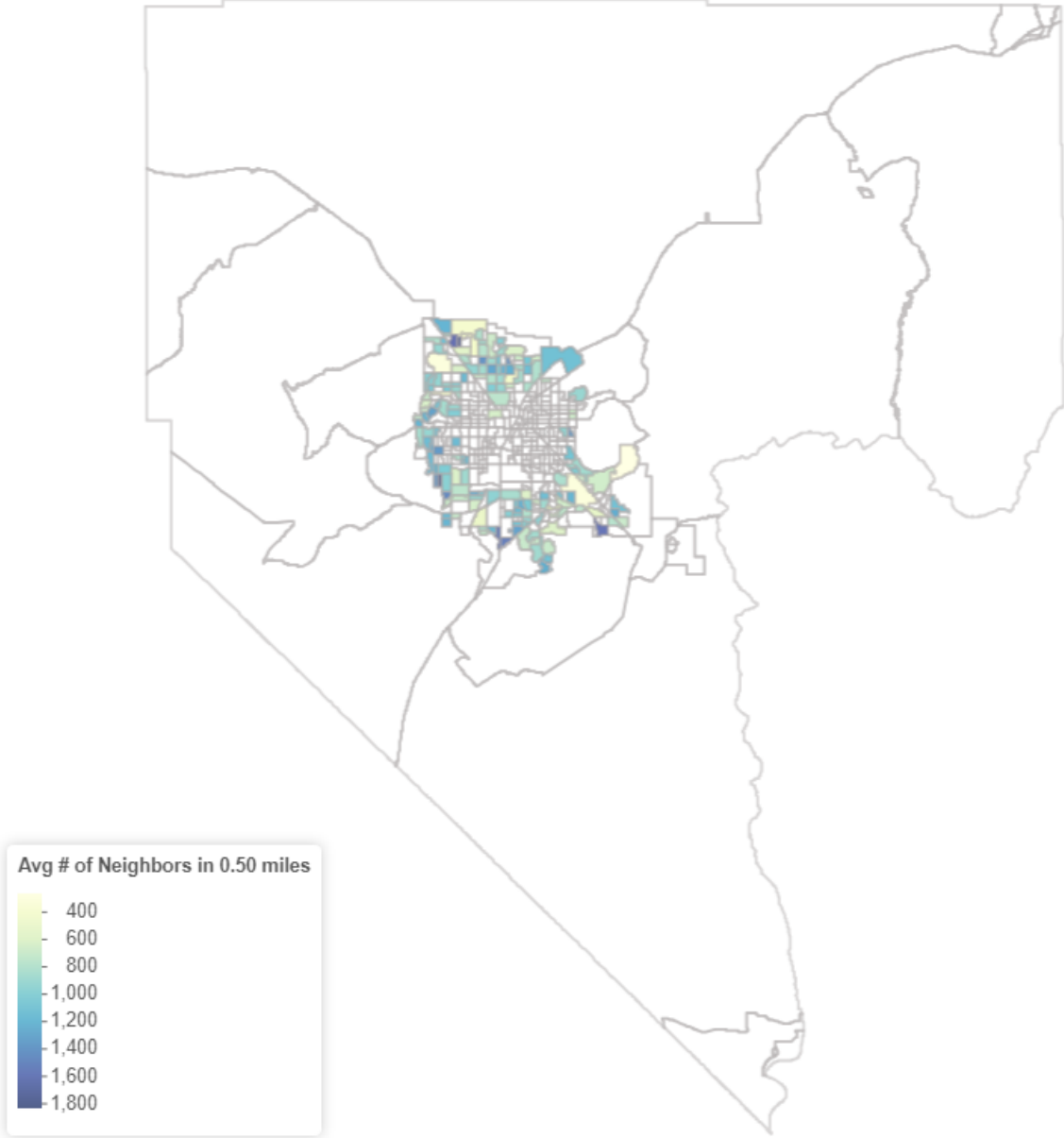


Figure 5: Average Number of Neighbors in a Census Tract with Cutoff Distance of 0.25 miles

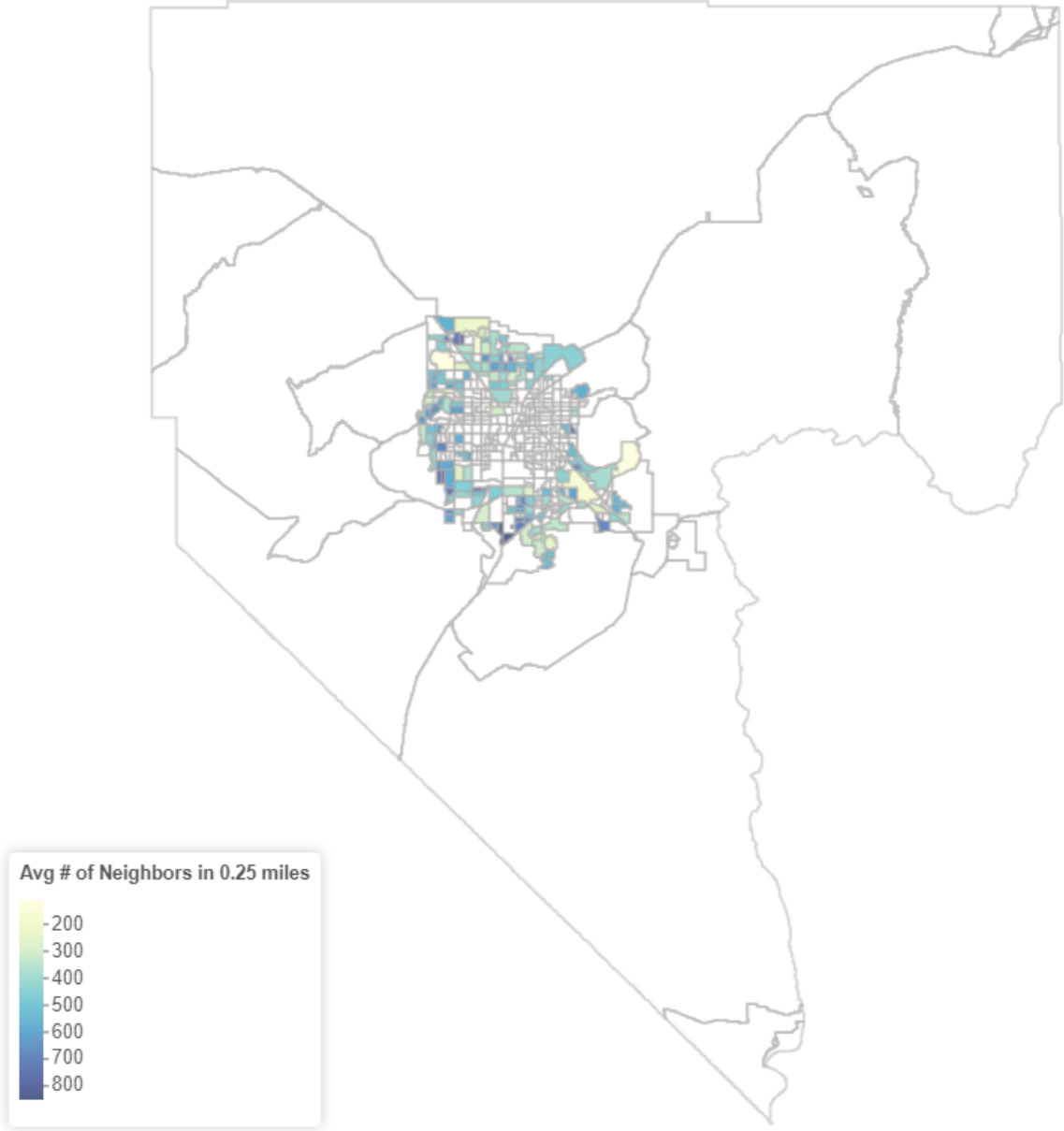


Figure 6: Average Number of Neighbors in a Census Tract with Cutoff Distance of 0.1 miles

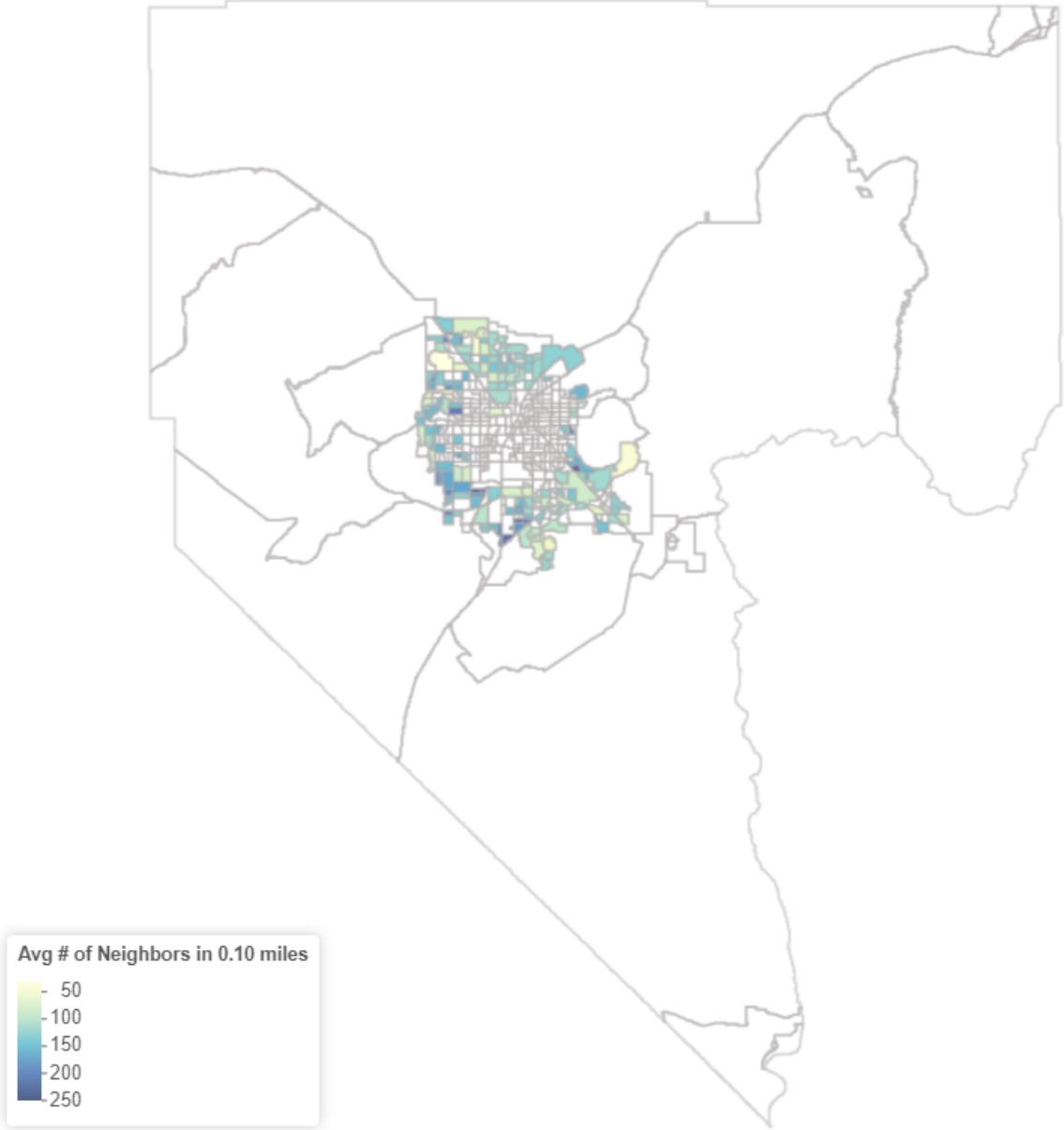
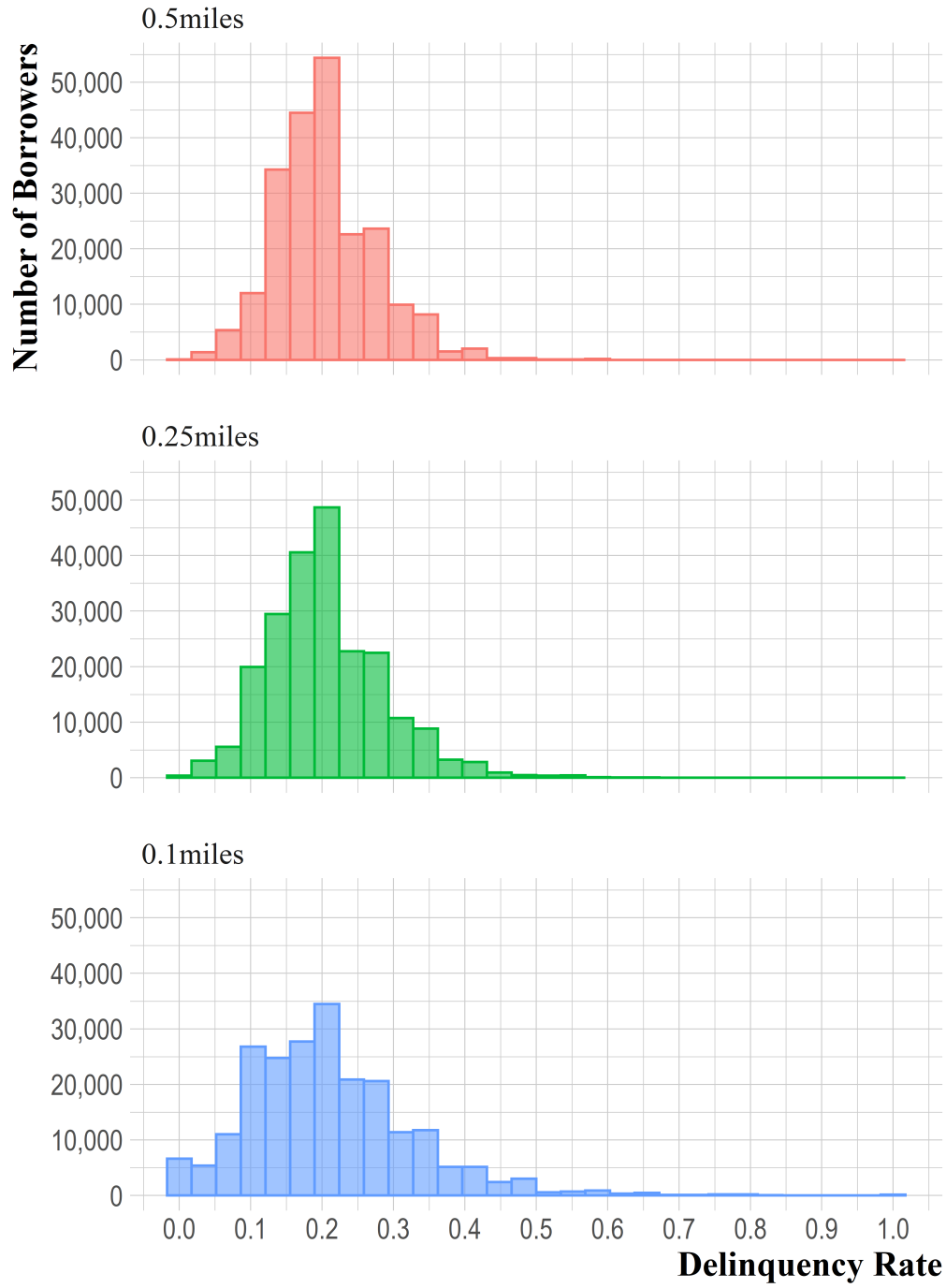


Figure 7: Distribution of Delinquency Rates with Different Cutoff Distances



Besides the missing data problem, an important identification challenge for this empirical analysis is the underlying sorting problem, i.e., neighbors may behave alike because they share similar (and possibly unobserved) characteristics or face a common environment. This is known as the correlated effect in the peer effect literature (Manski 1993). To establish a direct causal interpretation of the delinquency spillover effect in the presence of sorting, some papers take the IV approach. For instance, Munroe & Wilse-Samson (2013) propose an IV based on random assignment of chancery-court judges, and Gupta (2019) introduces an IV based on exogenous shocks to interest rates on adjustable-rate mortgage (ARM) loans.

In this paper, instead of resorting to IVs, we adopt the spatial fixed effect approach that is originated in Bayer et al. (2008) and Grinblatt et al. (2008) and widely followed in the literature (see, e.g., Campbell et al. 2011, Towe & Lawley 2013, Gerardi et al. 2015). The rationale of the spatial fixed effect approach is that the thin housing market limits people’s ability to pick the exact residential location in their desired neighborhood, and, hence, people’s immediate neighbors can be considered as quasi-random conditional on the broad-neighborhood fixed effect. Including spatial fixed effects also helps to control for other confounding factors such as common environments (e.g., educational resources and crime rates) and regional random shocks (e.g., regional layoffs¹²). It is worth pointing out that the identification assumption in our model is stronger than some of the aforementioned papers. For instance, Campbell et al. (2011) study the causal impact of neighboring foreclosures on housing prices. Hence, their identification strategy requires that, after controlling for spatial fixed effects, there is no unobservable that drives the co-movement of foreclosures and prices of neighboring houses. By contrast, as we study the direct connection between neighboring households’ mortgage default decisions, the implicit identification assumption is that there is no unobservable that explains the similar default decisions of neighbors after controlling for spatial fixed effects. Furthermore, Campbell et al. (2011) include census-tract-by-year fixed effects in their panel data model, while we cannot incorporate time-varying fixed effects as

¹²People who work together tend to live very close to one another. This means that when a company has layoffs, this tends to affect particular neighborhoods — the regional layoffs.

we have cross-sectional data.

Despite these limitations, including spatial fixed effects is still an effective way to account for the correlated effect. To show this, we conduct Moran I tests (see [Kelejian & Prucha 2001](#), Section 4.1) based on the NPL-2 estimates of our model with and without block group fixed effects.¹³ Without fixed effects, the Moran I test statistic is 9.23 (with a p value of 0.00), suggesting a strong spatial correlation in the estimation residuals. With fixed effects, the Moran I test statistic is 0.17 (with a p value of 0.87), suggesting no spatial correlation in the estimation residuals conditionally on block groups. This result provides some reassurance of our identification strategy.

Table 3: Estimation Results

	Logit	NPL-1	NPL-2
delinquency spillover effect		1.1210*	2.3226***
		(0.6459)	(0.4629)
foreclosure contagion effect	0.0063***	0.0058***	0.0048***
	(0.0013)	(0.0012)	(0.0011)
square footage	-0.3104***	-0.3084***	-0.3061***
	(0.0260)	(0.0266)	(0.0257)
bedrooms	0.0268	0.0261	0.0246
	(0.0197)	(0.0194)	(0.0189)
owner	0.0586**	0.0585**	0.0593**
	(0.0274)	(0.0270)	(0.0270)
log property value	0.8200***	0.8149***	0.8062***
	(0.0289)	(0.0325)	(0.0325)
LTV_60to80	0.4499***	0.4499***	0.4487***
	(0.0496)	(0.0495)	(0.0494)
LTV_80to100	0.8105***	0.8103***	0.8080***
	(0.0479)	(0.0479)	(0.0479)
LTV_gt100	0.6670***	0.6659***	0.6630***
	(0.0613)	(0.0617)	(0.0617)
block group dummies	included	included	included
log-likelihood	-27352.78	-27351.48	-27345.05

Standard errors in parentheses. Statistical significance: ***p<0.01; **p<0.05; *p<0.1.

For the logit model, all the coefficient estimates are statistically significant at the 5%

¹³A block group is a subdivision of a census tract or block numbering area. It is the smallest geographic entity for which the decennial census tabulates and publishes sample data.

level with the expected signs (except that the estimated coefficient of *bedroom* is statistically insignificant). In particular, a borrower’s delinquency risk increases with more neighboring foreclosures in the previous time period, giving evidence to the contagion effect (Towe & Lawley 2013). The delinquency risk also increases with a higher property value and LTV ratio. After controlling for the other covariates (including the property value), larger houses have lower delinquency risks. The positive sign of the coefficient estimate of *owner* is not surprising since occupancy fraud is found to be common in various mortgage markets, including government-sponsored-enterprise-guaranteed, private-securitized, and portfolio-held mortgage markets (Haughwout et al. 2011, Elul & Tilson 2015, Piskorski et al. 2015, Griffin & Maturana 2016). Both Haughwout et al. (2011) and Griffin & Maturana (2016) suggest loans with fraud occupancy status perform much worse than otherwise comparable loans.

In both the NPL-1 and NPL-2 estimations, we find a positive and significant delinquency spillover effect, while the coefficient estimates for other covariates remain largely the same as the logit estimates. The NPL-2 estimate of the delinquency spillover effect is more than twice the NPL-1 estimate. This is consistent with our finding in the Monte Carlo simulations that ignoring the missing data issue in the MM data leads to a substantial downward bias of the estimated spillover effect. To see how sensitive the NPL-2 estimate of the delinquency spillover effect is to the model specification, we report the estimation results with different sets of regressors in Table 4. The estimated spillover effect using the NPL-2 algorithm is relatively stable across different model specifications.

As we observe in the Monte Carlo simulations reported in Section 2.3, the NPL-2 estimates are quite stable across different sampling rates. Hence, we expect to obtain similar NPL-2 estimates if we use sub-samples of the MM data to re-estimate.¹⁴ More specifically, we randomly draw a sub-sample of y_i from the MM data, and combine it with the information on X_i for all $i \in \mathcal{N}$ in the RRP data to obtain a new dataset for the NPL-2 estimation. We repeat this process for 500 times for each of the following sampling rates: 90%, 80%,

¹⁴We thank an anonymous referee for suggesting this robustness check.

Table 4: NPL-2 Estimation Results with Different Sets of Control Variables

delinquency spillover effect	2.3226*** (0.4629)	1.9228*** (0.7581)	2.1805*** (0.7295)	2.2136*** (0.7265)
foreclosure contagion effect	0.0048*** (0.0011)	0.0048*** (0.0012)	0.0045*** (0.0012)	0.0045*** (0.0012)
square footage	-0.3061*** (0.0257)	-0.0651*** (0.0230)	-0.0601*** (0.0227)	-0.0443*** (0.0174)
bedrooms	0.0246 (0.0189)	0.0198 (0.0188)	0.0201 (0.0187)	
owner	0.0593** (0.0270)	0.0758*** (0.0262)		
log property value	0.8062*** (0.0325)			
LTV_60to80	0.4487*** (0.0494)			
LTV_80to100	0.8080*** (0.0479)			
LTV_gt100	0.6630*** (0.0617)			
block group dummies	included	included	included	included
log-likelihood	-27345.05	-27857.84	-27861.15	-27861.69

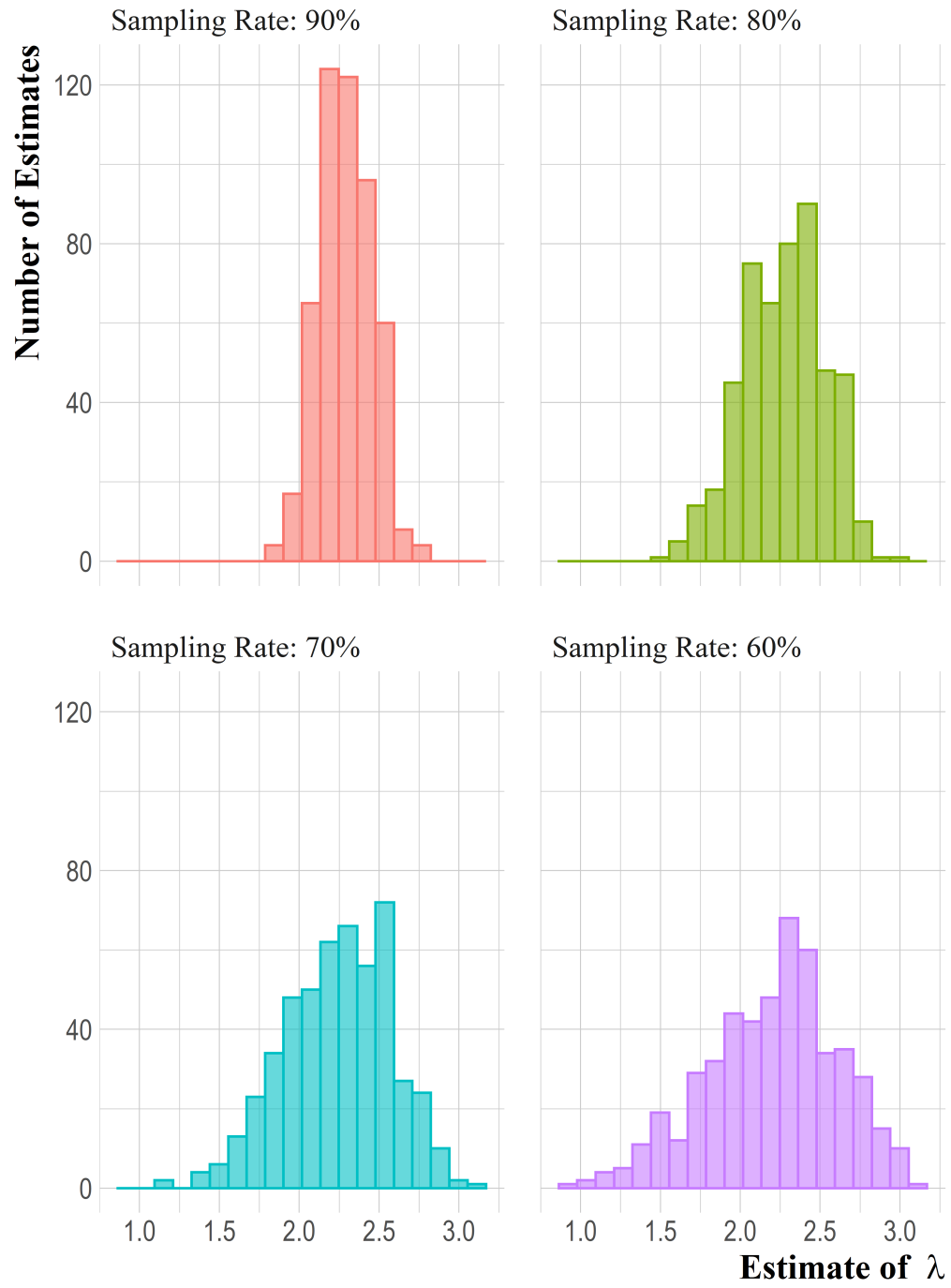
Standard errors in parentheses. Statistical significance: *** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$.

70%, and 60%,¹⁵ and plot the distributions of the estimated spillover effects under different sampling rates in Figure 8. For all sampling rates considered, the estimated spillover effects are centered around the NPL-2 estimate reported in Table 3. The distribution spreads out more as the sampling rate decreases. This exercise provides additional empirical evidence for the credibility of the NPL-2 estimator in the presence of missing outcome data.

Finally, we conduct some robustness checks regarding our specification of spatial networks and spatial weights. For the main estimation results reported in Table 3, we treat a census tract as a spatial network. As a robustness check, Table 5 reports the NPL estimates with block groups as spatial networks. We find that the NPL-2 estimate of the delinquency spillover effect is robust to the scope of spatial networks while the bias of the NPL-1 estimate is more prominent as the network gets smaller. This result is sensible because the discrepancy between the expected neighborhood delinquency rate calculated based on the MM sample and the one calculated based on the population increases as the scope of the network gets smaller. We also conduct a robustness check for the specification of spatial weights. In our specification of the spatial weight w_{ij} , we assume $w_{ij} = 0$ if the geographical distance between homeowners i and j is greater than a cutoff distance. For the main estimation results reported in Table 3, the cutoff distance is set to 0.5 miles. As a robustness check, Table 6 reports the NPL estimates with a cutoff distance of 0.1, 0.25, and 0.5 miles respectively. The results from this sensitivity analysis are reasonable and consistent with our main findings. For most covariates, the estimated coefficients are very similar with different cutoff distances. For the delinquency spillover effect, as the cutoff distance decreases, the NPL-1 estimate decreases significantly (e.g., 1.12 for 0.5 miles and 0.38 for 0.1 miles, with a drop of 66%) whereas the NPL-2 estimate is considerably stable across different cutoffs (e.g., 2.32 for 0.5 miles and 2.12 for 0.1 mile, with a drop of less than 10%). As the spatial network becomes more sparse with a shorter cutoff distance, this empirical result is in line with our finding in the Monte

¹⁵As the MM sample only has 58,526 records while the RRP transaction data contains 221,947 records, the sampling rate of the MM data is about $n^*/n = 58,526/221,947 \approx 26\%$. With a sampling rate of 60% to draw a sub-sample from the MM data, the actual sampling rate would be about $26\% \times 60\% \approx 16\%$.

Figure 8: Estimates of the Spillover Effect Using Sub-samples of the MM Data



Carlo simulations that the bias of the estimated spillover effect by the NPL-1 algorithm is larger with a more sparse network (under the rook contiguity).

Table 5: Estimation Results with Block Groups as Networks

	NPL-1	NPL-2
delinquency spillover effect	0.3211 (0.7565)	2.2844*** (0.4962)
foreclosure contagion effect	0.0076*** (0.0014)	0.0058*** (0.0012)
square footage	-0.3072*** (0.0270)	-0.3029*** (0.0253)
bedrooms	0.0262 (0.0196)	0.0240 (0.0187)
owner	0.0599** (0.0270)	0.0602** (0.0270)
log property value	0.8198*** (0.0326)	0.8056*** (0.0327)
LTV_60to80	0.4489*** (0.0495)	0.4475*** (0.0494)
LTV_80to100	0.8095*** (0.0479)	0.8068*** (0.0479)
LTV_gt100	0.6662*** (0.0618)	0.6623*** (0.0617)
block group dummies	included	included
log-likelihood	-27348.45	-27342.19

Standard errors in parentheses.

Statistical significance: ***p<0.01; **p<0.05; *p<0.1.

Table 6: NPL Estimation Results with Different Cutoff Distances

	Cutoff dist. = 0.5 mi		Cutoff dist. = 0.25 mi		Cutoff dist. = 0.1 mi	
	NPL-1	NPL-2	NPL-1	NPL-2	NPL-1	NPL-2
delinquency spillover effect	1.1210*	2.3226***	0.7677	2.1307***	0.3796	2.1194***
	(0.6459)	(0.4629)	(0.5698)	(0.3942)	(0.4732)	(0.3217)
foreclosure contagion effect	0.0058***	0.0048***	0.0058***	0.0044***	0.0059***	0.0037***
	(0.0012)	(0.0011)	(0.0013)	(0.0011)	(0.0013)	(0.0010)
square footage	-0.3084***	-0.3061***	-0.3088***	-0.3054***	-0.3088***	-0.2998***
	(0.0266)	(0.0257)	(0.0266)	(0.0253)	(0.0268)	(0.0241)
bedrooms	0.0261	0.0246	0.0263	0.0245	0.0263	0.0233
	(0.0194)	(0.0189)	(0.0194)	(0.0187)	(0.0195)	(0.0180)
owner	0.0585**	0.0593**	0.0585**	0.0594**	0.0584**	0.0591**
	(0.0270)	(0.0270)	(0.0270)	(0.0269)	(0.0270)	(0.0268)
log property value	0.8149***	0.8062***	0.8157***	0.8033***	0.8169***	0.7930***
	(0.0325)	(0.0325)	(0.0326)	(0.0325)	(0.0327)	(0.0328)
LTV_60to80	0.4499***	0.4487***	0.4499***	0.4485***	0.4498***	0.4472***
	(0.0495)	(0.0494)	(0.0495)	(0.0494)	(0.0495)	(0.0494)
LTV_80to100	0.8103***	0.8080***	0.8104***	0.8078***	0.8104***	0.8058***
	(0.0479)	(0.0479)	(0.0479)	(0.0479)	(0.0479)	(0.0478)
LTV_gt100	0.6659***	0.6630***	0.6661***	0.6626***	0.6664***	0.6605***
	(0.0617)	(0.0617)	(0.0617)	(0.0617)	(0.0617)	(0.0616)
block group dummies	included	included	included	included	included	included
log-likelihood	-27351.48	-27345.05	-27351.97	-27344.11	-27352.47	-27341.00

Standard errors in parentheses. Statistical significance: ***p<0.01; **p<0.05; *p<0.1.

3.3 Counterfactual studies

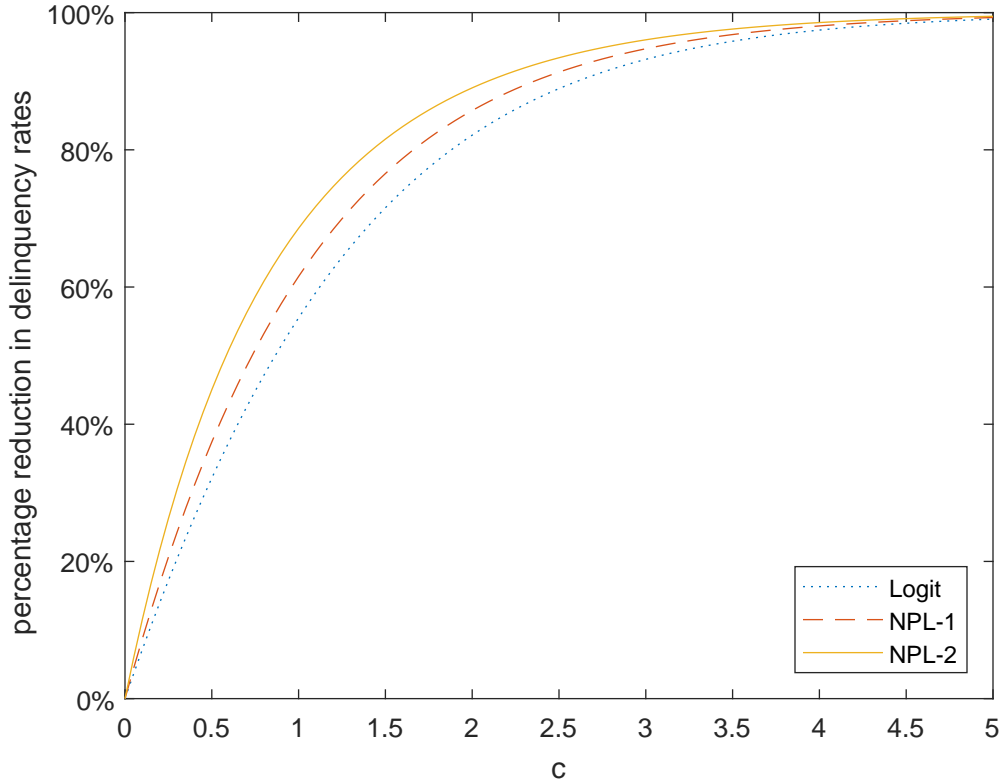
To illustrate the policy relevance of our empirical model and estimation strategy, we carry out two counterfactual studies. In the first study, we hypothetically remove properties in foreclosure, one at a time, from the data, and calculate the corresponding reduction in the aggregate delinquency level. More specifically, we first calculate the predicted delinquency probability for every borrower in the study region and add the probabilities up to obtain the initial aggregate delinquency level. Then, we remove a foreclosure from the study region, re-calculate the predicted delinquency probability for every borrower, and then add them up to get the new aggregate delinquency level. Taking the difference between the two aggregate delinquency levels (before and after the removal of a foreclosure) gives the reduction in the aggregate delinquency level from removing that foreclosure. We then repeat this exercise for every foreclosure in the study region to obtain the corresponding reduction in the aggregate delinquency level. Table 7 reports the summary statistics of the reductions based on the logit, NPL-1 and NPL-2 estimates in Table 3. From the table, we can see that the marginal effect of removing a property in foreclosure tends to be understated when the spillover effect is ignored (logit) or inconsistently estimated due to the missing data problem (NPL-1). This exercise sheds light on the importance of correctly estimating the delinquency spillover effect in evaluating the effectiveness of a foreclosure prevention program.

Table 7: Aggregate Delinquency Reduction from the Removal of a Neighboring Foreclosure

	Mean	SD	Min	Max
Logit	0.16	0.09	0	0.63
NPL-1	0.19	0.12	0	0.81
NPL-2	0.22	0.15	0	1.14

In the second study, we add a constant c , which can be interpreted as a mortgage payment reduction, to the utility function (2) of all mortgage borrowers in the study region. The dotted, dashed, and solid lines in Figure 9 represent, respectively, the predicted percentage reduction in delinquency rates as c increases, based on the logit, NPL-1 and NPL-2 estimates

Figure 9: Reduction in Delinquency Rates with a Utility Shock c



in Table 3. Similar to the first study, we can see that the marginal effect of loan payment reduction is understated when the spillover effect is ignore (logit) or inconsistently estimated due to the missing data problem (NPL-1).

4 Conclusion

This paper proposes a modified NPL algorithm for the missing data problem in the dependent variable of a discrete choice network model. We carry out Monte Carlo simulations to show that the proposed estimator works well in finite samples and ignoring this missing data issue leads to a downward bias of the estimated spillover effect. We provide an empirical illustration of our method and conduct some counterfactual experiments to demonstrate the

importance of consistently estimating the spillover effect in policy analysis.

Although the motivation of this paper comes from the missing data issue in home mortgage delinquencies, the applicability of the proposed method is not limited to this specific setting. As the econometric model described in Section 2.1 is very general, this method can be applied to many other data sets. For example, in the Add Health survey, every student attending the sampled schools on the interview day was asked to identify their friends from the school roster and complete a questionnaire (in-school survey) on basic socio-demographic characteristics. Then, a subset of students selected from the rosters of the sampled schools was asked to complete a longer questionnaire containing more sensitive individual and household information (in-home survey). Using the notations in Section 2.2, the students that participated in the in-school survey can be considered as \mathcal{N} , and those that participated in the in-home survey can be considered as \mathcal{N}^* . Suppose the outcome variable of a study is from the in-home survey, while the covariates are from the in-school survey. Then, the researcher would encounter the same missing data problem as in this paper. When the outcome variable is continuous, Liu et al. (2017) find that the spillover effect in a linear network model is also likely to be underestimated neglecting this missing data problem. They propose a nonlinear least squares estimator to address this missing data problem and provide an empirical illustration using the Add Health data. On the other hand, when the outcome variable is binary, the modified NPL method in this paper can be adopted to consistently estimate the spillover effect.

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Online Appendix for “Estimation of Discrete Choice Network Models with Missing Outcome Data”

A Asymptotic Distribution of the NPL Estimator

Let W_i denote the i th row of W . When the NPL algorithm converges, the NPL estimator $\hat{\theta} = (\hat{\lambda}, \hat{\beta}')'$ for $\theta = (\lambda, \beta')$ is given by $\hat{\theta} = \arg \max \ln L(\theta; \hat{p})$, where

$$\begin{aligned} \ln L(\theta; \hat{p}) &= \sum_{i \in \mathcal{N}^*} \{y_i \ln F(X_i \beta + \lambda W_i \hat{p}) \\ &\quad + (1 - y_i) \ln [1 - F(X_i \beta + \lambda W_i \hat{p})]\}, \end{aligned}$$

and $\hat{p} = (\hat{p}_1, \dots, \hat{p}_n)'$ is the solution of the system of equations

$$\hat{p}_i = F(X_i \hat{\beta} + \hat{\lambda} W_i \hat{p}),$$

for $i \in \mathcal{N}$.

Let $f(x) = \partial F(x)/\partial x$. From the first order condition $\frac{\partial \ln L(\theta; \hat{p})}{\partial \theta} \Big|_{\theta = \hat{\theta}} = 0$, we have

$$\sum_{i \in \mathcal{N}^*} [y_i - F(X_i \hat{\beta} + \hat{\lambda} W_i \hat{p})] \frac{f(X_i \hat{\beta} + \hat{\lambda} W_i \hat{p})}{F(X_i \hat{\beta} + \hat{\lambda} W_i \hat{p}) [1 - F(X_i \hat{\beta} + \hat{\lambda} W_i \hat{p})]} [W_i \hat{p}, X_i]' = 0.$$

By the Taylor expansion,

$$\begin{aligned} \sqrt{n^*}(\hat{\theta} - \theta) &\stackrel{a}{=} \left\{ \frac{1}{n^*} \sum_{i \in \mathcal{N}^*} \frac{f_i^2}{F_i(1 - F_i)} [W_i p, X_i]' ([W_i p, X_i] + \lambda W_i \frac{\partial p}{\partial \theta'}) \right\}^{-1} \\ &\quad \times \frac{1}{\sqrt{n^*}} \sum_{i \in \mathcal{N}^*} (y_i - F_i) \frac{f_i}{F_i(1 - F_i)} [W_i p, X_i]', \end{aligned}$$

where $F_i = F(X_i \beta + \lambda W_i p)$, $f_i = f(X_i \beta + \lambda W_i p)$, and $\stackrel{a}{=}$ denotes asymptotic equivalence as $n^* \rightarrow \infty$. As

$$\frac{\partial p_i}{\partial \theta'} = f_i \cdot ([W_i p, X_i] + \lambda W_i \frac{\partial p}{\partial \theta'}),$$

we have

$$\frac{\partial p}{\partial \theta'} = \text{diag}\{f_i\}([Wp, X] + \lambda W \frac{\partial p}{\partial \theta'}),$$

which implies

$$\frac{\partial p}{\partial \theta'} = (I_n - \lambda \text{diag}\{f_i\}W)^{-1} \text{diag}\{f_i\}[Wp, X].$$

Let J be a $n^* \times n$ selector matrix such that JX collects elements in $X = (X'_1, \dots, X'_n)'$ corresponding to $i \in \mathcal{N}^*$. Then,

$$\begin{aligned} & \frac{1}{n^*} \sum_{i \in \mathcal{N}^*} \frac{f_i^2}{F_i(1-F_i)} [W_i p, X_i]' ([W_i p, X_i] + \lambda W_i \frac{\partial p}{\partial \theta'}) \\ = & \frac{1}{n^*} \sum_{i \in \mathcal{N}^*} \left\{ \frac{f_i^2}{F_i(1-F_i)} [W_i p, X_i]' [W_i p, X_i] + \lambda \frac{f_i^2}{F_i(1-F_i)} [W_i p, X_i]' W_i \frac{\partial p}{\partial \theta'} \right\} \\ = & \frac{1}{n^*} \sum_{i \in \mathcal{N}^*} \left\{ \frac{f_i^2}{F_i(1-F_i)} [W_i p, X_i]' [W_i p, X_i] \right. \\ & \left. + \lambda \frac{f_i^2}{F_i(1-F_i)} [W_i p, X_i]' W_i (I_n - \lambda \text{diag}\{f_i\}W)^{-1} \text{diag}\{f_i\} [Wp, X] \right\} \\ = & \frac{1}{n^*} (\Sigma_1 + \lambda \Sigma_2), \end{aligned}$$

where

$$\begin{aligned} \Sigma_1 &= [Wp, X]' J' J \Omega J' J [Wp, X], \\ \Sigma_2 &= [Wp, X]' J' J \Omega J' J W (I_n - \lambda \text{diag}\{f_i\}W)^{-1} \text{diag}\{f_i\} [Wp, X], \end{aligned}$$

and $\Omega = \text{diag}\{f_i^2/[F_i(1-F_i)]\}$. On the other hand, under standard regularity conditions,

$$\frac{1}{\sqrt{n^*}} \sum_{i \in \mathcal{N}^*} (y_i - F_i) \frac{f_i}{F_i(1-F_i)} [W_i p, X_i]' \stackrel{a}{\sim} N(0, \lim_{n^* \rightarrow \infty} \frac{1}{n^*} \Sigma_1).$$

Hence,

$$\sqrt{n^*}(\hat{\theta} - \theta) \stackrel{a}{\sim} N(0, \lim_{n^* \rightarrow \infty} n^* (\Sigma_1 + \lambda \Sigma_2')^{-1} \Sigma_1 (\Sigma_1 + \lambda \Sigma_2)^{-1}).$$

B Marginal Effects

In the rational expectation equilibrium, the probability $p_i = \Pr(y_i = 1)$ is given by

$$p_i = F(X_i\beta + \lambda \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} p_j) = F(X_i\beta + \lambda e'_i W p),$$

where e_i denotes the i th column of the identity matrix I_n . Let $f(x) = \partial F(x)/\partial x$. The derivatives with respect to x_{ik} , the k th covariate in X_i , are

$$\frac{\partial p_i}{\partial x_{ik}} = f_i \cdot (\beta_k + \lambda e'_i W \frac{\partial p}{\partial x_{ik}}), \quad (8)$$

$$\frac{\partial p_j}{\partial x_{ik}} = f_j \cdot \lambda e'_j W \frac{\partial p}{\partial x_{ik}}, \quad \text{for } j \neq i, \quad (9)$$

where $f_i = f(X_i\beta + \lambda \sum_{j \in \mathcal{N} \setminus \{i\}} w_{ij} p_j)$ and β_k is the k th element of β . In matrix form, Equations (8) and (9) can be written more compactly as

$$\frac{\partial p}{\partial x_{ik}} = \text{diag}\{f_i\} (e_i \beta_k + \lambda W \frac{\partial p}{\partial x_{ik}}),$$

which implies

$$\frac{\partial p}{\partial x_{ik}} = (I_n - \lambda \text{diag}\{f_i\} W)^{-1} \text{diag}\{f_i\} e_i \beta_k. \quad (10)$$

Substitution of Equation (10) into Equations (8) and (9) gives

$$\frac{\partial p_i}{\partial x_{ik}} = f_i \cdot [\beta_k + \lambda e'_i W (I_n - \lambda \text{diag}\{f_i\} W)^{-1} \text{diag}\{f_i\} e_i \beta_k] = (1 + \lambda \psi_{ii}) f_i \beta_k, \quad (11)$$

$$\frac{\partial p_j}{\partial x_{ik}} = f_j \cdot \lambda e'_j W (I_n - \lambda \text{diag}\{f_i\} W)^{-1} \text{diag}\{f_i\} e_i \beta_k = \lambda \psi_{ji} f_j \beta_k, \quad \text{for } j \neq i, \quad (12)$$

where ψ_{ij} denotes the (i, j) th element of the matrix

$$\Psi = W (I_n - \lambda \text{diag}\{f_i\} W)^{-1} \text{diag}\{f_i\}.$$

C Additional Monte Carlo Simulations

In this appendix, we conduct additional Monte Carlo simulations to investigate the robustness of the proposed estimator with respect to misspecification of $F(\cdot)$ in Equation (1). More specifically, we consider the situation where the true $F(\cdot)$ is the standard normal distribution function in the data generating process but is misspecified as the standard logistic function in the NPL-2 estimation. We follow the same setup as in Section 2.3. We adopt the generated rook and queen networks and the empirical friendship network. We set $X_i = (1, x_{i2})$, where x_{i2} is a scalar that is generated from a uniform distribution on $[-1, 1]$. The true values of the parameters are $\lambda = 1$ and $\beta = (\beta_1, \beta_2)' = (-1, 2)'$. We experiment with different sampling rates $n^*/n \in \{0.75, 0.5, 0.25\}$, and assume that X_i is observable for all $i \in \mathcal{N}$ while y_i is observable only for $i \in \mathcal{N}^*$.

As a direct comparison between the parameters in the true model (with $F(\cdot)$ being the standard normal distribution function) and in the misspecified model (with $F(\cdot)$ being the standard logistic function) is not meaningful, we compare the marginal effects of x_{i2} in these two models. The marginal effect of x_{i2} on the aggregate delinquency level of all agents in the network (i.e., $\sum_{j=1}^n p_j$) is given by $\sum_{j=1}^n \partial p_j / \partial x_{i2}$, where $\partial p_j / \partial x_{i2}$ is defined in Equation (11) if $j = i$ and defined in Equation (12) if $j \neq i$. Then, we take an average of the marginal effect across i to obtain the average marginal effect (AME) of x_{i2} given by $n^{-1} \sum_{i=1}^n \sum_{j=1}^n \partial p_j / \partial x_{i2}$. We calculate both the true AME, with $F(\cdot)$ being the standard normal distribution function and $(\lambda, \beta_1, \beta_2)$ being their true values, and the estimated AME of the misspecified model, with $F(\cdot)$ being the standard logistic function and $(\lambda, \beta_1, \beta_2)$ being their estimates by the NPL-2 algorithm. We conduct 1000 simulation repetitions and obtain the difference between the true and estimated AMEs in each repetition. We report the mean and standard deviation (SD) of the differences between the true and estimated AMEs in Table 8. Although $F(\cdot)$ in Equation (1) is misspecified, the estimated AMEs are essentially unbiased for all cases considered, suggesting the proposed NPL-2 algorithm is robust with respect to model misspecification. It is worth pointing out that the two counterfactual studies

in Section 3.3 are based on marginal effects. Hence, the conclusions of those counterfactual studies are likely to be robust with respect to misspecification of $F(\cdot)$.

Table 8: Monte Carlo Simulation Results on Model Misspecification

	$n^*/n = 0.75$	$n^*/n = 0.50$	$n^*/n = 0.25$
Rook contiguity	0.046(0.031)	0.047(0.037)	0.045(0.054)
Queen contiguity	0.046(0.040)	0.047(0.049)	0.041(0.071)
Friendship network	0.026(0.032)	0.026(0.038)	0.024(0.054)
Mean(SD)			