Consumer Financial Education and Homeownership

Consumer Information and the Mortgage Market

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Overview

- Illinois anti-predatory lending pilot program (HB-4050)
  - We intend to study if counseling was helpful for 10 zip-codes and compare them to the neighboring zip-codes
  - Study credit supply, pricing, and default behavior
- Indianapolis Neighborhood Housing Partnership (INHP)
  - We intend to study the impact of credit counseling and financial management classes on homeownership experience of its clients
  - Study the dropouts
  - Tracks the loan performance of the graduates
  - Conduct randomized trials and surveys

Illinois HB-4050: mandated loan counseling

- Low-credit-score borrowers in select ZIP codes have to go through HUD-accredited loan counseling prior to closing
  - Applies regardless of the loan product they selected
  - If FICO < 620 mandatory counseling
  - If 620 < FICO < 650, then get counseling only for certain loans
    - Interest only,
    - low- doc,
    - exploding ARMs,
    - Refi within 12 months
    - Loans with prepayment penalties
    - Points/fees > 5% of loan amount
  - FICO > 650, no counseling regardless of the loan product
- Stark contrast with *statewide* legislation based on *loan* characteristics (North Carolina, 1999; 30+ states since)

Illinois HB-4050: mandated loan counseling

- Also, messy implementation
  - ZIP code selection: a contiguous block on the South Side of Chicago
  - Contract enforceability: no “good faith” provision
  - Asymmetric treatment of lenders: applies *only* to state-licensed mortgage brokers and bankers, but not to national banks, credit unions, or thrifts!
- Counselor recommendation include (One hour sessions)
  - Loan should not be approved due to indication of fraud
  - Borrower cannot afford loan
  - Loan rate in above the market rate
  - Borrower should seek alternative bids
  - Borrower does not understand cost
  - Borrower does not understand transaction
  - Borrower needs credit card discipline

Predictable consequences

- Supply dries out (highly publicized withdrawals)
  - Lenders claim higher costs from ensuring compliance
  - Legal uncertainty (a data entry error can invalidate a contract)
  - Preliminary evidence suggest supply shrinks by 28%.
- Mobilization of aggrieved groups
  - Borrowers and sellers in affected ZIPs – why us!!?
    - higher locking costs, fewer lenders
  - Mortgage brokers and real estate groups – why us???
  - Outside parties (NAACP, Operation Rainbow) – discrimination
- House prices and sales volume decline disproportionately

What do we want to do?

- Look beyond summary stats to gauge welfare effects
- Detailed data on loan characteristics and performance
  - Assess changes in features of accepted loans contracts
    - Interest rate, resets, prepayment penalties, etc.
  - Evaluate ex post performance of loans that went through counseling
    - Foreclosure and delinquency rates
  - Look at changes in the borrower pool
    - Creditworthiness, refinancing/purchase
  - Transaction characteristics
    - time on the market, discount to list price
  - Measure shifts in lender composition
- Possible data on loan counselling and outcomes
  - Frequency of loan offer rejection (features of rejected loans)

Preliminary results HB-4050

Dif-in-Dif Analysis:

- Interest rates are lower for borrowers below 80% leverage
- Leverage is slightly lower in treatment ZIP codes
- Less borrowers at high leverage (above 80%)
- Transaction prices relative lower by 0.5% relative to listing prices
- There is stronger response to cashback offers from high-leverage borrowers (i.e., borrowers try to circumvent rules)
- Low leverage buyers buy more expensive properties;
  High leverage buyers buy cheaper properties (t = 1).
  This could mean that high leverage borrowers "pay the price" for regulation

A polar opposite: INHP counseling

- Indianapolis Neighborhood Housing Partnership (INHP) is a non-profit providing financial education to underprivileged households
- Unlike Illinois HB4050, participation is voluntary and long-term
- Collect extensive data on participants
  - Credit history, financial and socioeconomic data upon enrollment
  - Performance and outcome in the counseling program
  - Credit history and financial statement upon graduation

Details of the Program

- At enrollment, the homebuyers education program offers a series of individual appointments to develop a plan to improve personal finances. The main components of such plans are budgeting, debt reduction, and credit scores improvement with the eventual goal of homeownership.

- At the end of the program, they attend an 8 hour class that teaches how to navigate home buying.

- In between, the homebuyers attend 2 hour classes on a monthly basis for up to 2 years.

Details of the Program

- Predominantly minority, low-to-moderate income families.
  - 59% African American
  - 71% females
  - 22% below age 29, 55% between ages 30-50, 23% above age 50
  - 32% high school of less, 7% post graduate
  - 43% had annual income below $24,000
- For example, in 2007 the program graduated 1160 families
- 303 closed on a home loan.

Questions to study

- Measure the magnitude and longevity of the effects of financial education for this self-selected group
  - Improvement in credit scores over the course of the program
  - Loan terms relative to a matching sample
  - Longer term metrics from
    - Loan performance data (McDash)
    - Resold loans (yet another reading on credit histories)
    - Follow up survey of all program participants

- Individual data and follow-up survey information should allow
  - Controls for household-level shocks (income, health, demographics)
  - Precise identification of matching sample