

Consumer Financial Education and Homeownership

Consumer Information and the Mortgage Market

Federal Trade Commission, Bureau of Economics Conference

May 29, 2008

Sumit Agarwal, Federal Reserve Bank of Chicago

joint with Gene Amromin, FRB-Chicago; Zahi Ben-David, University of Chicago; and Doug Evanoff, FRB-Chicago

The views expressed in this presentation are not necessarily those of the FRS.

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

§ 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???

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 or 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.

