

Study Blames Brokers, Not Borrowers

Delinquency Intervention May Halve Defaults

New research by the Center for Community Capital at the University of North Carolina, Chapel Hill presented at a New America Foundation seminar last week suggests that, given an opportunity to access fair mortgages, most families who foreclosed under the burden of loan products that were not appropriate for their financial situation would still be in their homes. The study also found that borrowers are three to five times more likely to default if they obtained their mortgages through brokers.

The study looked at large groups of borrowers with similar risk profiles, the kind that would have prevented them from getting prime loans from traditional lenders. The first group wound up with subprime loans, while the second group received prime fixed-rate loans through a program seeded by the Ford Foundation to help banks serve low-income families. Both groups had the same financial background and the same ability to pay.

The study did not measure the effect of other factors believed to contribute to defaults—unemployment, marginal credit, falling property values, and poorly documented loan applications. Not surprisingly, the study shows that the loans with prepayment penalties, variable interest rates and other subprime features were four times more likely to fail than the prime mortgages.

Brokered loans defaulted at a significantly higher rate. One possible explanation is that, loans originated through brokers have significantly higher closing costs and prices, which increases borrowers' costs and can

lead to elevated default risk. It is also possible that borrowers obtaining loans through brokers are more likely to receive products with features that may increase the default risk. Researchers suggested it is very likely that the broker-origination channel has a looser underwriting standard that has not been fully captured by the model, which allows unqualified borrowers to receive unsustainable risky products. Stopping short of blaming brokers for higher default rates, the researchers said additional research is needed to examine this issue in more detail.

In an editorial citing the study, the New York Times said on October 15, "subprime lending was not driven by banks, which are covered by the act. Rather, most subprime lending was driven by independent mortgage lending companies, which the (Community Reinvestment) act does not cover, and, to a lesser extent, by bank affiliates and subsidiaries that are not fully covered by the act. By some estimates, nonbank lenders and bank affiliates and subsidiaries may have originated 75 percent or more of the riskiest subprime loans."

At the New America Foundation seminar, researchers said the study indicated that delinquency intervention can be effective, with the odds of preventing defaults more than two times higher for borrowers who receive counseling. "Even over the phone, counseling effectively increases the probability of cure. Even when received after borrowers enter a 60-day delinquency, the probability of curing is 18% higher than for uncounseled borrowers," according to Center for Community Capital analysts