

Risky Borrowers or Risky Mortgages?

Innovative Financial Services for the Underserved:
Opportunities and Outcomes
2009 Community Affairs Research Conference

Research Funded by the Ford Foundation

Center for Community Capital
*Research and analysis on the
transformative power of capital*





Findings: Mortgage Matters

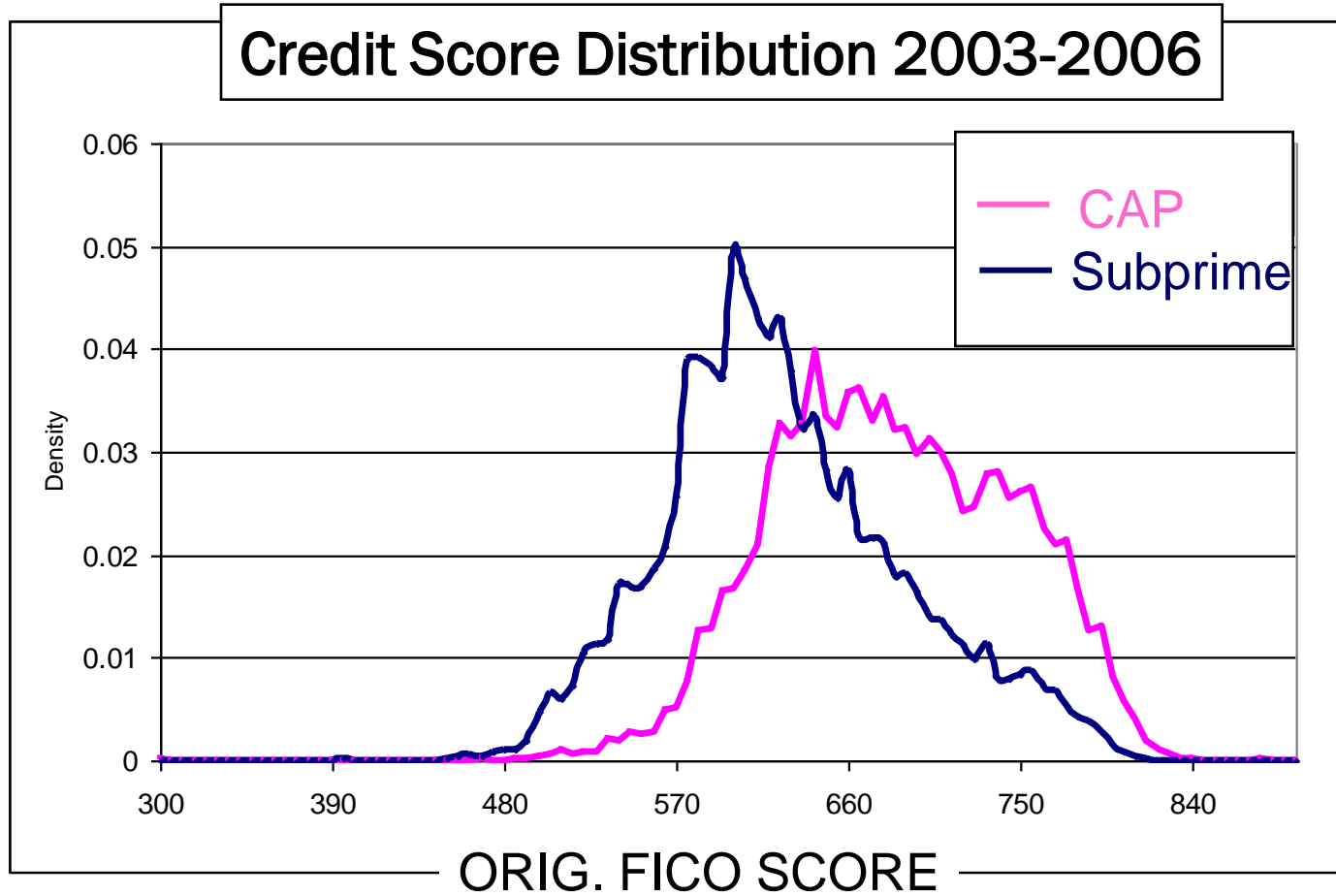
- *For borrowers with similar characteristics, the estimated default risk is much lower with a prime, CRA-type loan than with a subprime mortgage.*
- *Variable interest rates, repayment penalties, and broker origination help explain why subprime loans are more likely to fail.*

CAP Program Overview

- **Partnership between Self-Help, Ford Foundation, Fannie Mae**
 - Secondary market outlet for CRA/Affordable Housing loans
 - Fixed rate, 30-year, prime mortgages
 - 50,000 loans funded; \$4.5 Billion
- **Who is served?**
 - Low down-payments
 - More than half had original LTV of 97% or above
 - Flexibility on credit and income
 - More than 40% minorities; more than 40% female-headed
 - Average income \$32,600 (62% of Area Median Income)₃



CAP Borrowers & Subprime Borrowers





Propensity Score Match:

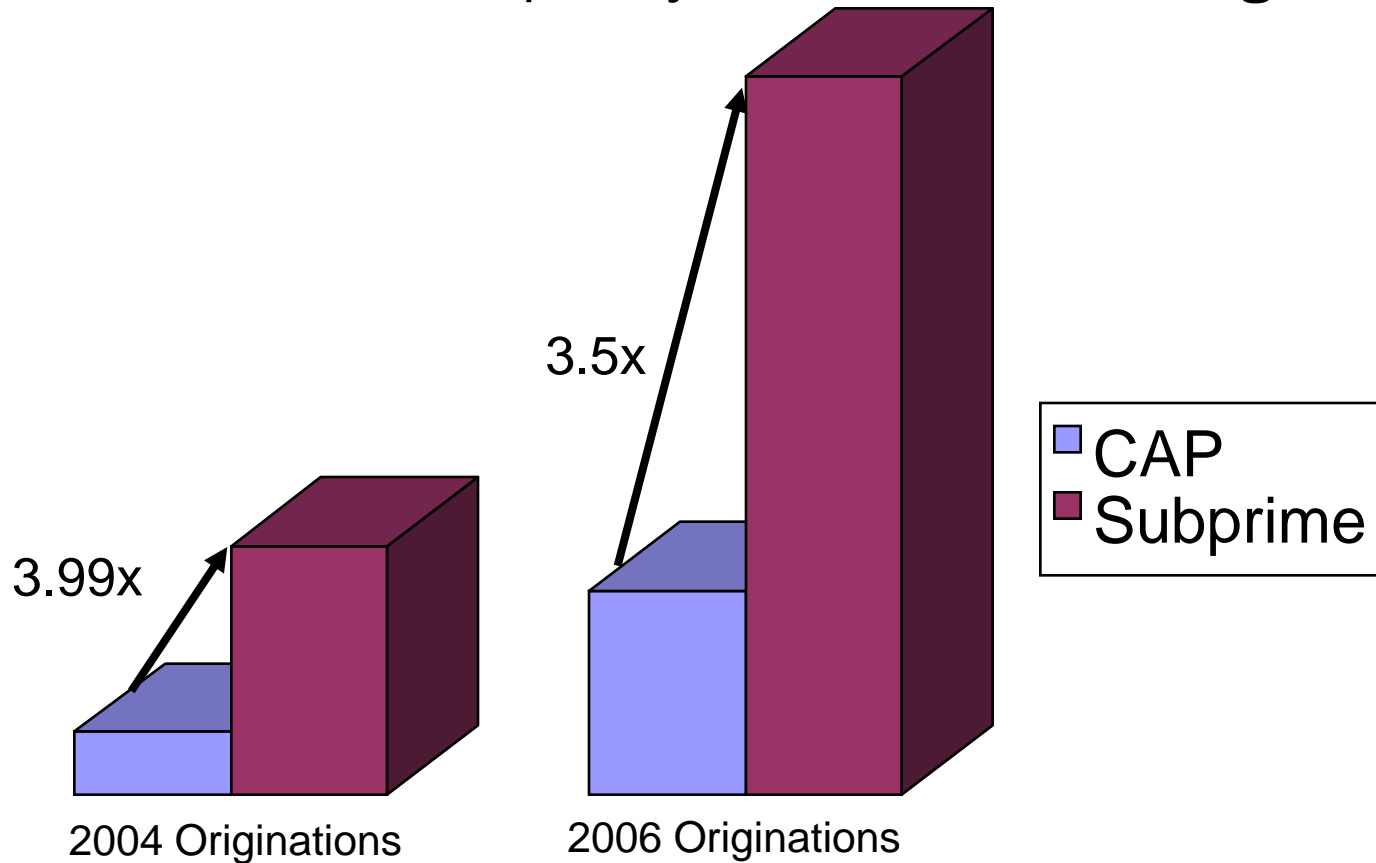
Focus on borrowers with similar risk characteristics but holding different products.

	Prime Loans	Subprime Loans
Prime Borrowers		
Subprime Borrowers	CA P	Sub- prime



For Similar Borrowers – Subprime Loans Do Worse

Predicted Serious Delinquency 24 Months after Origination



Note: Estimation is based on a borrower with a FICO score between 580-620 with the mean value of other regressors. Controlling variables include borrower DTI, FICO score, home equity, loan age, loan size, area credit risk, area unemployment rate, and interest rate environment.



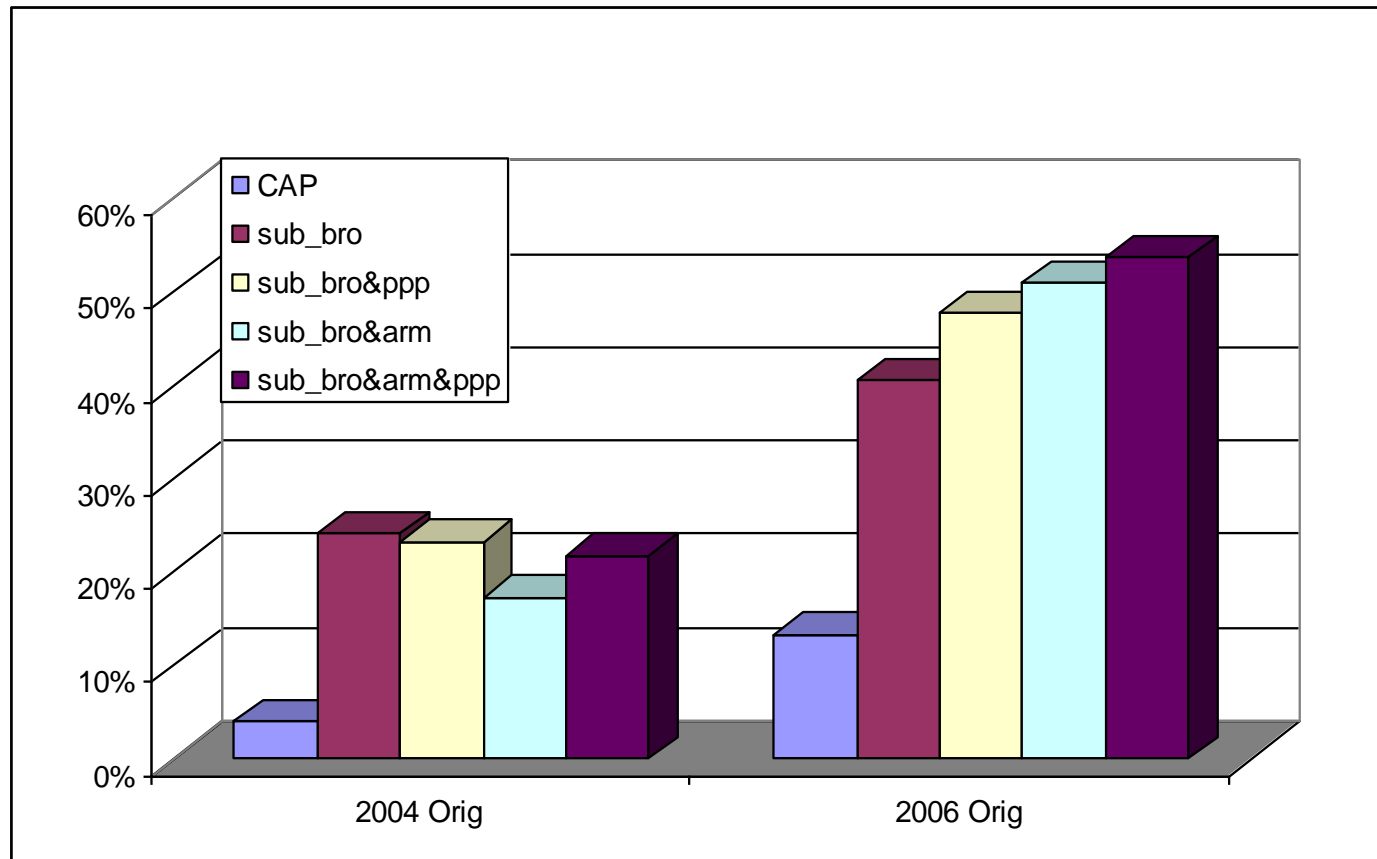
Subprime Features are Linked to Elevated Default Risk:

Subprime Loan Feature			Default Rate of subprime vs CAP	
ARM	Prepay Penalty	Broker	2004 Loans	2006 Loan
●	○	○	1.6 x	1.26 x
●	●	○	3.3 x	3.3 x
○	○	●	5.9 x	3.04 x
○	●	●	5.7 x	3.6 x

^[1] The predicted cumulative default rate is defined as 90-day delinquency as of 24 months after origination for a borrower with a FICO score between 580-620 and holding a mortgage originated in 2004 or 2006, with the mean value of other regressors. The estimation is based on regression results to be found in the full paper. The subprime default is compared to the level of default for CAP loans, which are retail originated, fixed-rate loans without prepayment penalty.

Predicted Serious Delinquency 24 Months After Origination

Community Lending (CAP) and Broker Originated Subprime Loans



Note: Estimation is based on a borrower with a FICO score between 580-620 with the mean value of other regressors. sub_bro&ppp and sub_bro represent broker-originated subprime FRMs with and without prepayment penalties respectively; sub_bro&arm&ppp and sub_bro&arm represent broker-originated subprime ARMs with and without prepayment penalties respectively.



Findings

- For low-income/low-wealth households, mortgage default risk can be significantly mitigated by product and origination process.
- Subprime features (Variable interest rates, repayment penalties, and broker origination) increase likelihood of mortgage default.

Implications

- Subprime products/broker channel are root causes.
- Given an opportunity to access fair mortgages, many foreclosed families would still be in their homes.



UNC
COLLEGE OF
ARTS & SCIENCES

CENTER for COMMUNITY CAPITAL
Research and analysis on the transformative power of capital

UNC Center for Community Capital
University of North Carolina at Chapel Hill
919-843-2140
www.ccc.unc.edu