Some banks help keep mortgage holders out of default, studies find

January 3 2011, by Jeff Grabmeier

While the nation's foreclosure crisis has focused blame on bad loan practices by some lenders, new research shows how some banks may have actually reduced the default risk of their homebuyers.

Researchers found that low-income homeowners who received a mortgage from a local lender were less likely to default on their loans than are those who borrowed from a more distant bank or mortgage company.

Even if two similar homeowners received the same home loan, with the same interest rate, the one who got the loan at the local lender might be better off in the long run.

"The door you walk into when you're looking for a loan matters a lot," said Stephanie Moulton, assistant professor in the John Glenn School of Public Affairs at Ohio State University.

"Local banks seem to offer some protection to homebuyers, particularly those with low incomes who may be seen as risky borrowers."

A few other studies have found that borrowers who get mortgages from banks rather than mortgage brokers are less likely to default on their loans. But Moulton said this new research is among the first to find that not all banks are equal, and that bank location is a key.

Moulton's research looks at homebuyers who have participated in state administered Mortgage Revenue Bond (MRB) programs. MRB programs are funded through tax-exempt mortgage revenue bonds, and help lower-income, first-time home buyers by offering affordable mortgages. In contrast to the subprime mortgage product that offered high-interest rate loans, the MRB loan product provides market or below-market interest rate loans to similar borrowers.

Moulton previously studied Indiana's program, and is now researching Ohio's program.

Overall, her findings from both studies show that delinquency and default rates for state MRB programs are much lower than the rates for subprime or even other conventional loans to similar borrowers.

However, Moulton finds that there are significant differences by lender. For some lenders, fewer than 9 percent of their MRB borrowers were ever 60 days late in making a payment. However, for other lenders, up to 37 percent of their borrowers were similarly late in making payments.

"I was trying to find out why there was such a wide variation in default rates, even though they were all offering the same loan product," Moulton said.

Both studies show that for higher-risk borrowers (those with credit scores below 660), delinquency and foreclosure rates are significantly lower if they got their mortgage from a local lender.

Moulton emphasized that this effect is not due to the loan product, as all borrowers receive the same type of mortgage (including interest rate) through the program. And personal characteristics of the borrowers, such as credit score, debt and income, are controlled for in the analysis. In other words, the effect truly seems to be related to the localness of the bank, and not other hidden factors.

In the Indiana study, recently published in *Housing Policy Debate*, Moulton examined the loan performance (as of March 2008) of more than 5,000 homebuyers who purchased homes between 2004 and 2006. Higher-risk borrowers with loans from lenders with a lot of local loan activity (a high concentration of loans in the county where the homebuyer bought their home) were much less likely to be late on their mortgage or enter foreclosure, than homebuyers with loans from non-local lenders.

In the Ohio analysis, presented recently at the Association for Public Policy Analysis and Management conference in Boston, Moulton is studying the loan performance (as of June 2010) of more than 20,000 homebuyers who purchased homes between 2005 and 2008. Rather than focusing on the location of the lender's loan activity (as in the Indiana study), this study examines the location of bank branches relative to where the homebuyers purchased their homes. Again, Moulton finds that higher-risk homebuyers with loans from banks with branches close to their new homes (less than 10 miles) were significantly less likely to default on their mortgages.

But what is it about local banks that make them better choices for many low-income borrowers?

Moulton said she believes it has to do with the type of information banks collect on potential borrowers, and the support they offer to their borrowers.

Many mortgage brokers base their decisions on whether to offer a mortgage on one or more key numbers, such as a credit score. In other words, if your credit score is above a certain level, and you meet other criteria, the broker will offer the loan. The same may be true of large, non-local banks, Moulton said.

But local lenders may place more weight on other factors, such as how long you've been working for your current employer, and whether you make regular deposits in a savings account.

"This kind of information may give a more complete picture of whether a person can really afford a mortgage, particularly for higher-risk borrowers," Moulton said.

"Some of the local bankers told me they won't even look at a credit score until they have talked to an individual and determined if they think he or she can make the payments."

In addition, local bankers are more likely to have a continuing relationship with the borrower, through the checking and savings accounts held by the customer.

"If there's a relationship, the borrower may feel more obligated to make their payments. And the banks may provide more education and information to the borrowers, equipping them to be better homeowners," she said.

The results of these studies suggest that policies aimed at making homeownership affordable may need to expand their focus, Moulton said.

"A lot of policies concentrate on the loan itself, and that's definitely important. But for higher-risk, lower-income borrowers, mortgage institutions also matter quite a bit," she said.

"These borrowers need to work with lenders that will properly evaluate their application and give them support after they receive the mortgage."

Provided by The Ohio State University