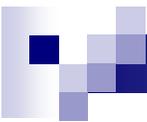


Understanding Underwriting Factors

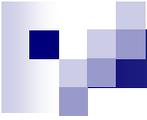
Marsha J Courchane
Principal, ERS Group
mcourchane@ersgroup.com
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Imminent Disclosure: APRs by Race, Gender, and Income

- 2005 will be the first year in which HMDA data contains any kind of “pricing” information. APR must now be reported for loans above a threshold Treasury rate.

What will that mean for fair lending compliance?

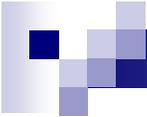


Amendments to Reg. C:

(see 67 FR 7222, February 15, 2002, and 67 FR 43217, June 27, 2002)

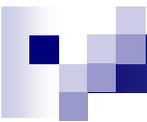
New items to be reported:

- the rate spread between the annual percentage rate (APR) on the loan and the yield on Treasury securities of comparable maturity
- whether the loan is subject to the Home Ownership and Equity Protection Act (HOEPA)
 - Rates above Treasuries at least 8% for 1st's, 10% for 2nd's
- whether manufactured housing is involved
- the type of lien on the property (first, subordinate, or none)
- certain information about requests for pre-approval



Importance of HMDA Data

- HMDA remains an important data source for measuring mortgage activity by geography, by product type, by secondary mortgage market involvement
- HMDA remains the only database that allows for the collection of race and ethnicity from borrowers during a loan transaction and has proved useful for regulatory agencies charged with enforcement of the fair lending laws
- HMDA remains flawed as a tool that allows for comparisons of origination or pricing decisions based on the full spectrum of underwriting factors



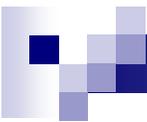
Questions that Might be Addressed

Researchers, regulators and community activists are all interested in using HMDA data to determine whether or not minorities and those of other protected classes are treated fairly with respect to a lending decision of great individual and social importance.

Questions:

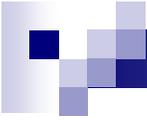
Can the HMDA data be used to help inform the public about how different groups are treated?

Can the HMDA data alone determine whether or not banks and other lenders engaged in discriminatory practices?



The Lending Process

- Selection of Institution (location, product offerings)
- Selection of product (FRM, ARM, Govt, Prime or Not)
- Selection of terms (point vs rate tradeoffs, lock periods, closing costs, yield spread premiums (no cost refi))
- Borrower credit worthiness
 - LTV, DTI, Monthly Payment, Reserves, Credit History, Co-borrower information, employment status, verification process (or choice of no or low doc)
- Sale to the secondary market
 - Conventional loan? Conforming loan?



Academic Research Has Often Addressed Lending Decisions

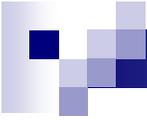
M. Cary Collins, Keith D. Harvey and Peter J. Nigro, The Influence of Bureau Scores, Customized Scores and Judgmental Review on the Bank Underwriting Decision-Making Process, *Journal of Real Estate Research*, Vol. 24 No. 2, 2002.

Ambrose, Brent and Sanders, Anthony, High LTV Loans and Credit Risk, *Journal of Real Estate, Finance, and Economics*, Forthcoming.

Ambrose, Brent, LaCour-Little, Michael, and Sanders, Anthony, The Effect of Conforming Loan Status on Mortgage Yield Spreads: A Loan Level Analysis. Working Paper No. 2001-1

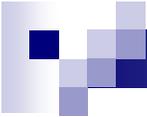
Courchane, Marsha, David Nebhut and David Nickerson, Lessons Learned: Statistical Techniques and Fair Lending, *Journal of Housing Research* · Volume 11, Issue 2.

Glennon, Dennis and Stengel, Mitchell, Evaluating Statistical Models of Mortgage Lending Discrimination: A Bank Specific Analysis, *Real Estate Economics*, Vol 27-2, 1999.



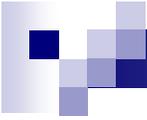
Collins, Harvey, Nigro, 2002

- Credit Bureau Score
- Time at Current Address
- No. of Bank Trade Lines
- No. of Finance Company Inquiries
- No. of Overall Inquiries
- Age of Trade File
- No. of Times 30-60 days Late
- Applicant Income
- Revolving Credit Limit
- No. of Trade Lines Opened in Past Year
- No. of Satisfactory Trade Lines



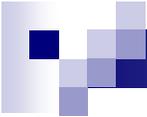
Ambrose, LaCour-Little, and Sanders, 2002

- Slope of Yield Curve
- Loan to Value Ratio
- FICO
- Borrower Age
- Borrower Income
- Loan Amount
- Conforming Status
- House Price Index Volatility
- Credit Spread (AAA-BBB Bond Spread)



Ambrose and Sanders, 2002

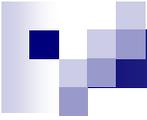
- Loan Amount
- Term
- FICO
- Purpose (debt consolidation, cash out refi, home improvement...)
- Loan-to-Value Ratio (LTV)
- Loan Amount of First Mortgage
- House Value
- Treasury Yield



Courchane, Nebhut, and Nickerson, 2000

Several banks (11) used for analysis— all national charters, all large enough for conducting statistical analysis. We found that at each different factors were used to determine loan decisions. For example,

- Bank 1: Excess DTI, LTV, Credit Score, “Bad Credit”, Gift Funds, Public Record Items, Credit Explanations
- Bank 2: DTI, LTV, Credit Score, Relationship with Bank, Gift Funds, Public Record Items , Front Ratio, Denied PMI , Insufficient Funds to Close, Credit Explanations
- Bank 3: LTV, DTI, “Bad Credit”, Insufficient Funds to Close, Credit Score, Bank Relationship



Summary of the Research

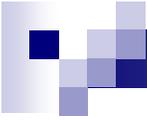
- Many common factors
- Many ways to combine those factors when determining pricing for risk
- Prices will vary from one mortgage product to another, and from one channel to another.
- APR alone may reflect the final decision, but cannot explain why the decisions were made.

To summarize the complexity of the process, we can look at an example from a secondary market tool used to help lenders underwrite their loans.

Major Categories of Factors:

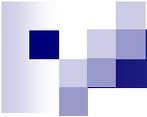
Example from Freddie Mac's Loan Prospector

<i>Collateral</i>	<ul style="list-style-type: none">• Borrower's total equity or downpayment• Property type: 1-unit house, 2-unit or duplex house, etc.• Property use: investment property or owner-occupied home	Relative Importance of These Factors High
<i>Credit</i>	<ul style="list-style-type: none">• Credit bureau score• Credit delinquencies, collections and charge-offs• Credit accounts: type, age, limits, usage and status of credit cards, store charge cards, etc.• Borrower applications for new credit in last 12 months• Foreclosures and bankruptcies• Liens or judgments	Relative Importance of These Factors High
<i>Capacity</i>	<ul style="list-style-type: none">• Debt ratios: total monthly payments-to-income and housing payment-to-income ratios• Salaried or self-employed borrower• Cash reserves	Relative Importance of These Factors Low
<i>Loan</i>	<ul style="list-style-type: none">• Loan product: 30-year fixed-rate mortgage, 1-year adjustable-rate mortgage, etc.• Loan purpose: purchase, rate and term refinance or cash-out refinance	Relative Importance of These Factors Medium



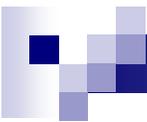
Additional Issues to be Considered

- Bank specific pricing decisions may reflect several factors – credit risk, prepayment risk, costs of production and competitiveness.
 - Overages used by banks to encourage employees to generate loan volume – often involves a compensation structure that allows for origination fee income to be split between loan officer and institution
 - Overages reflect deviations from ‘mean’ or suggested rate spreads on any given day
 - May be easy to measure at a single institution – but reflects competitiveness in the market broadly



Additional Issues to Consider

- Broker originated loans
 - Yield spread premiums
 - Advantages – no cost refi
 - Disadvantages – complexity of consumer costs
 - Can affect total points/fees paid (with deviations of up to a few thousand dollars) – this will clearly impact observed APR
 - Cannot observe borrower “choice” about tradeoffs made between rates and fees or even borrower “choice” about channel



Conclusions

- HMDA can be very useful for directing regulatory agency efforts to particular lenders/products for detailed fair lending examinations
- Each additional data element included in HMDA helps us better understand the borrowing process and the impacts on different types of borrowers
- The addition of APR information into the public domain will not be sufficient to understand the underwriting decisions made by institutions