

Does Mortgage Deregulation Increase Foreclosures? Evidence From Cleveland

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Anti-predatory Lending Laws

- **Federal:**
 - Home Ownership and Equity Protection Act (HOEPA)
- **State:**
 - 31 states laws in effect (as of January 2007)
- **Local:**
 - 8 city laws had been repealed
- **Intensity: local > state > federal**

Loan and Foreclosure Data

- Loan originations *matched* to foreclosure filings
- Constructed *longitudinal* panel
 - 458 census tracts
 - 5496 monthly observations
- *Foreclosures* within 30 months

A Natural Experiment

- Treatment group:
 - Census tracts in Cleveland
- Control group:
 - Census tracts in the suburbs
- Difference-in-difference
 - At the month-tract level
- Robustness cases:
 - Excluding federal preemption
 - Narrower window of time
 - Narrower areas on city border
 - Foreclosures within 24 months

Ohio Law vs. Cleveland Law

- **Covered Loan Types:**
 - Ohio: home equity loans
 - Cleveland: all home loans, including home-purchase loans
- **Interest rate triggers** (first-lien loans):
 - Ohio: 8 percentage points above the treasury rate
 - Cleveland: 4.5-8 percentage points above the treasury rate
- **Lending Restrictions:**
 - Cleveland's restrictions in addition to Ohio's: increased interest rates after default, prepayment penalties, etc.

Cleveland Deregulation

- **Cleveland Home Mortgage Ordinance** (“Anti-predatory lending law”)
 - **Passed** on *April 23, 2002*
 - **Challenged** *immediately* by American Financial Services Association (AFSA)
 - **Repealed** by the Ohio Supreme Court’s ruling on *November 20, 2006*
- Repeal affected **only** loans secured by home properties within the city limits of Cleveland

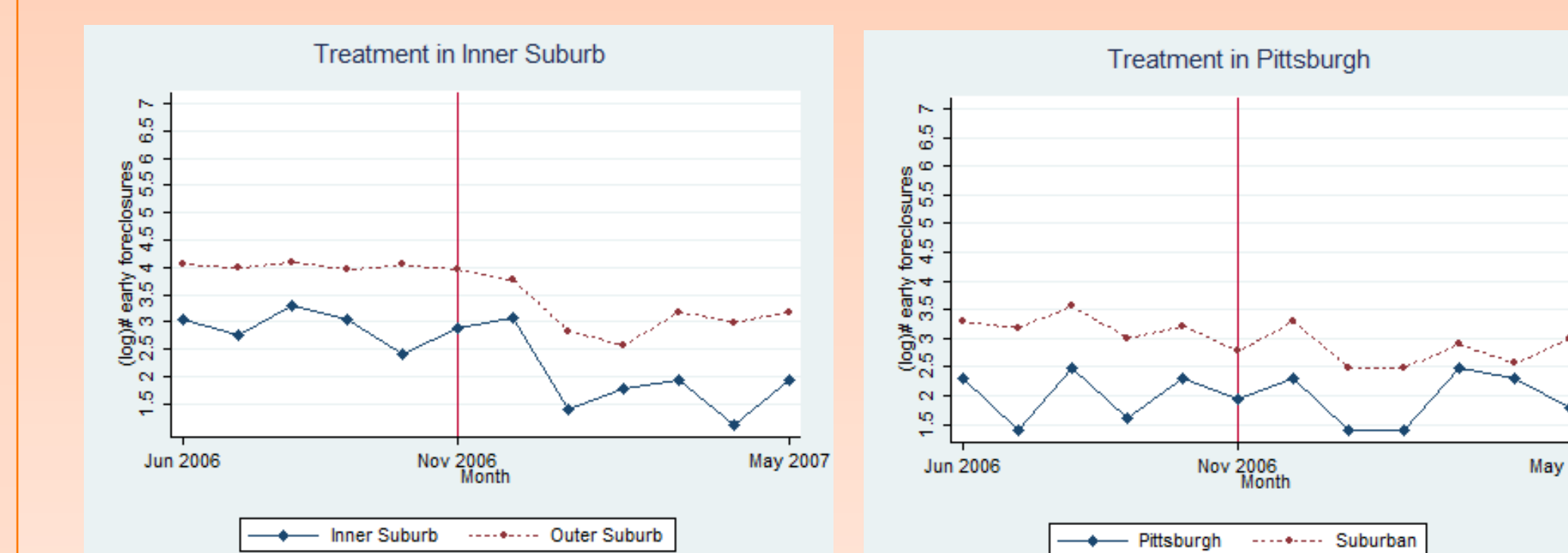
Falsifications

The following alternatives *fail* to explain the increased foreclosures in Cleveland after deregulation

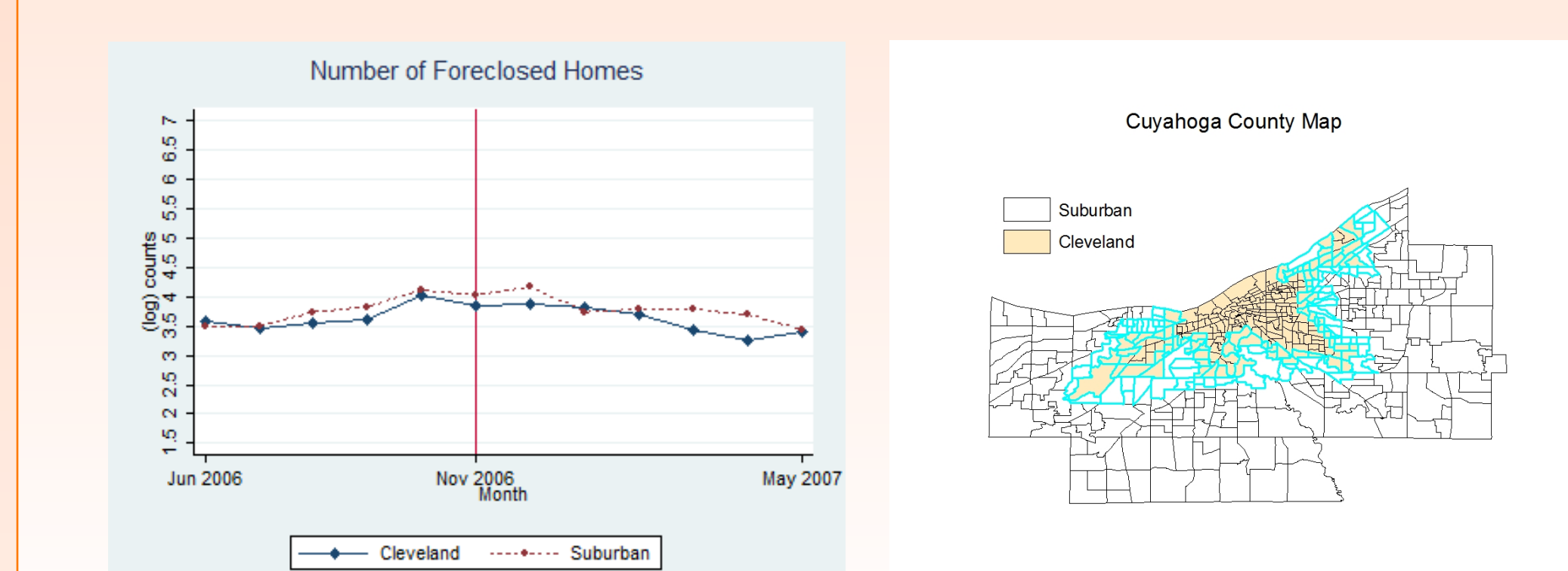
❖ Seasonal Pattern



❖ City Effect

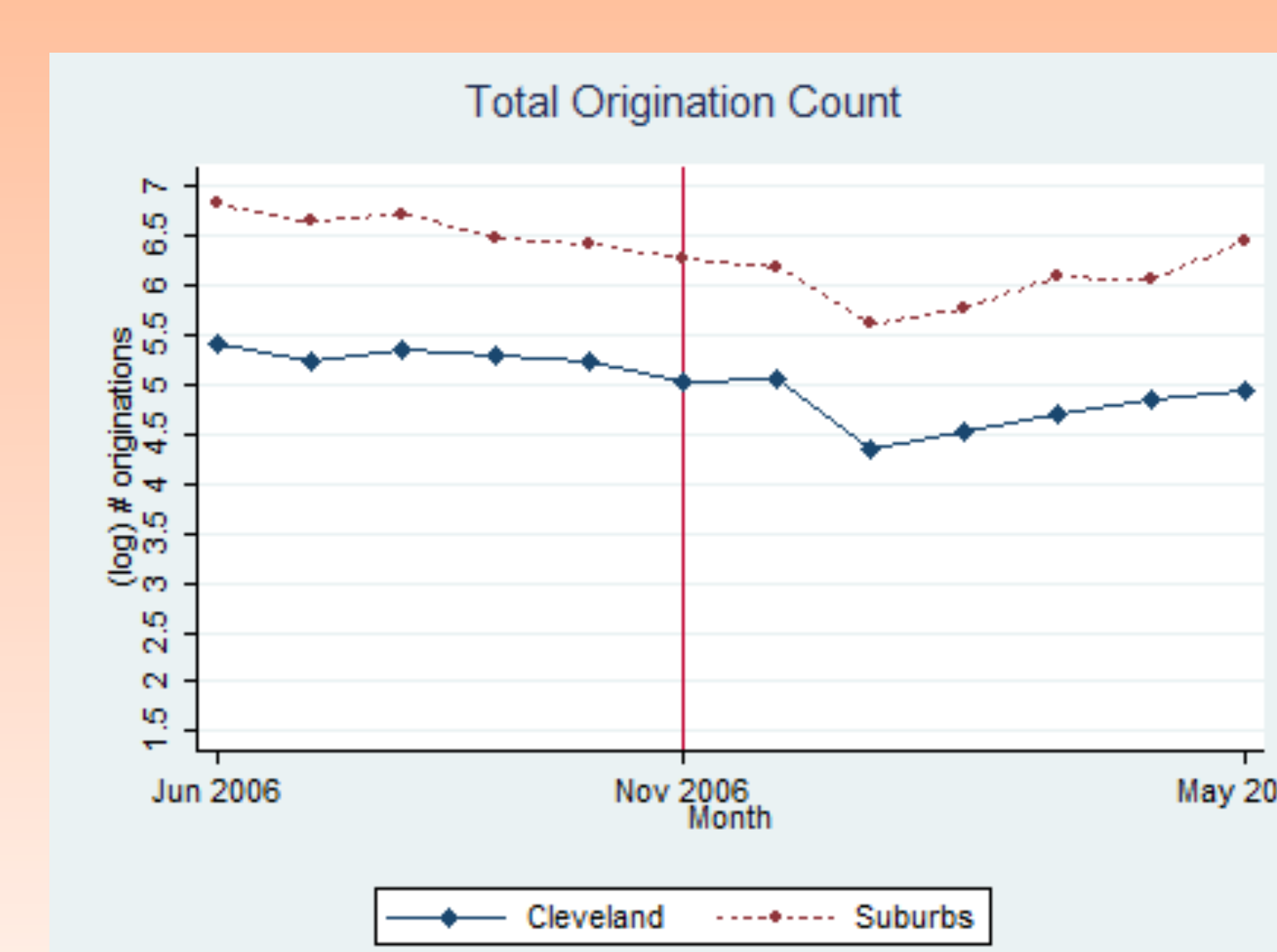


❖ Financial Crisis



Quality and Quantity Effects of Deregulation

- Following the deregulation,
- **Quality:** 49% increase in loan foreclosures
- **Quantity:** no change in loan originations



- Robust to multiple alternative explanations
- Suggestive of predatory lending arising from deregulation

Conclusions

- ❖ Lack of regulation led to a substantial increase in foreclosures
- ❖ Regulation may foster healthy loans without impeding credit flow