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Introduction

Good afternoon, Mr. Chairman and members of the Committee. My name is Michael LaCour-Little. I am Professor of Finance at California State University – Fullerton. It is an honor to testify here today on the topic of the Home Mortgage Disclosure Act (HMDA). My recent research paper[1], which is included with my written testimony, addresses aggregate patterns in the 2004-2005 HMDA data and offers a forecast of 2006 results. Much of my testimony today will consist of highlights from that paper. In addition, I am currently editing a special issue of the *Journal of Real Estate Research* on the topic on HMDA and believe many of the papers contained in that volume will provide important information that policymakers should consider.

Patterns in the 2004-2005 HMDA Data

Last year's release of the 2005 HMDA data raised a number of questions given the increase in the number and percentage of higher-cost (or what I will refer to as HMDA spread-reportable) loans and continued differentials across racial and ethnic groups. My work specifically assesses three possible reasons for that increase, as well as proposing others. The three reasons evaluated include: (1) changes in lender business practices; (2) changes in borrower credit profile; and (3) changes in the interest rate environment.

Since the incidence of HMDA spread-reportable loans increased during 2005, it is tempting to infer that subprime lending must have increased proportionately. Indeed, the media and some commentators tend to equate HMDA spread-reportable loans with subprime. My research indicates, however, that the relationship is not so simple.

It is also important to remember that the new HMDA data does not contain information on many of the factors that affect credit risk and the economics of mortgage lending. As a result, the new HMDA data is sufficient neither to explain the pricing of loans nor to draw conclusions about pricing fairness. At best, the bank regulatory agencies can use HMDA data as a preliminary screening tool to identify markets or institutions for further scrutiny.

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[1] LaCour-Little, Michael. 2007. Economic Factors Affecting Home Mortgage Disclosure Act Reporting. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=992815

Let me highlight several major conclusions of my research for you. First, I do not find an increase in average borrower risk in 2005, though there does appear to be an increase in the use of riskier products in 2005 (such as loans that allow negative amortization) and the average loan-to-value ratio (LTV) did appear to increase for home purchase loans during 2006. Second, the yield curve accounted for a significant part of the growth in HMDA spread-reportable loans in 2005. Third, wholesale originations played a major role in explaining the overall growth in HMDA spread-reportable lending. Results reported in my paper suggest that after controlling for the mix of loan types, credit risk factors, and the yield curve, there was no statistically significant increase in reportable volume for loans originated directly by lenders during 2005, though wholesale originations did increase.

My research identifies nine major factors that explain why a loan is HMDA spread-reportable: loan size; term; purpose; property type; whether the loan is an ARM; credit score; LTV; origination channel; and the yield curve slope. In addition, I find that the market price of risk increased by approximately 15 basis points during both 2005 and 2006, implying that rates were higher for all borrowers on a risk-adjusted basis.

Finally, let me offer a forecast for the 2006 results when they are released later this year. Given the change in interest rates, the likely mix of ARM versus FRM, the increase in average LTV, and other factors, I predict that approximately 28% of loans will be HMDA spread-reportable.

Special Issue of the Journal of Real Estate Research

I mentioned earlier the special issue on HMDA that will be published later this year. Included in that volume will be an article that examines the differential in Annual Percentage Rate (APR) paid by minority versus white borrowers, controlling for the segment of the market through which the loan is obtained, credit risk variables, and other economic factors. The paper utilizes a unique proprietary data set that includes over one million individual loan records from multiple lenders and many of the pricing related variables not included in HMDA. The authors find that raw disparities in the APR, which are on the order of 50-100 basis points, decline to roughly 5-10 basis points when appropriate controls for market segment and credit risk are included. The authors remark

"… public policies aimed at remediating APR differentials would achieve a far greater return through the elimination of race/ethnicity differentials in FICO scores, income, wealth used to lower LTV ratios, and, arguably, financial literacy, than they would through the elimination of any possible disparate treatment." [2]

Mr. Chairman, I thank you for the opportunity to share these thought today and would be happy to answer any questions.

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[2] Courchane, Marsha and Peter Zorn. 2007. The Pricing of Home Mortgage Loans to Minority Borrowers: How Much of the APR Differential Can We Explain? *Journal of Real Estate Research*, forthcoming.