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  - 8 city laws had been repealed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

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  - Repealed by the Ohio Supreme Court’s ruling on November 20, 2006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

Loan and Foreclosure Data

- Loan originations matched to foreclosure filings
- Constructed longitudinal panel
  - 458 census tracts
  - 5,496 monthly observations
- Foreclosures within 30 months

Quality and Quantity Effects of Deregulation

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

Falsifications

- The following alternatives fail to explain the increased foreclosures in Cleveland after deregulation
  - Seasonal Pattern
  - City Effect
  - Financial Crisis

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

Conclusions

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