JOINT CENTER FOR HOUSING STUDIES
of Harvard University

Community Reinvestment Lending: A Description and Contrast of Loan Products and Their Performance

LIHO-01.11

Roberto G. Quercia, Michael A. Stegman, Walter R. Davis and Eric Stein

September 2001

Low-Income Homeownership
Working Paper Series

Joint Center for Housing Studies

Harvard University

Community Reinvestment Lending: A Description and Contrast of Loan Products and Their Performance

Roberto G. Quercia, Michael A. Stegman, Walter R. Davis
and Eric Stein

LIHO-01.11

September 2001

Spencer Cowan co-authored an earlier version of this paper.

This paper was prepared for the Joint Center for Housing Studies' *Symposium on Low-Income Homeownership as an Asset-Building Strategy* and an earlier version was presented at the symposium held November 14-15, 2000, at Harvard University. The Symposium was funded by the Ford Foundation, Freddie Mac, and the Research Institute for Housing America.

This paper, along with others prepared for the Symposium, will be published as a forthcoming book by the Brookings Institution and its Center for Urban and Metropolitan Policy.

All opinions expressed are those of the authors and not those of the University of North Carolina, Self-Help, Joint Center for Housing Studies, Harvard University, the Ford Foundation, Freddie Mac, and the Research Institute for Housing America.

Table of Contents

I. Introduction

The 1977 Community Reinvestment Act (CRA) was enacted to encourage banking institutions to meet the credit needs of their entire communities. In response, lenders have expanded their lending activities in low-income, minority, and other traditionally underserved markets. New loan products have become increasingly more affordable and flexible, allowing for little or no downpayment (sometimes without requiring mortgage insurance), high debt burdens, and nontraditional proofs of creditworthiness.

Since the early 1990s, there has been a rapid increase in community lending to traditionally underserved borrowers and areas. For instance, the number of mortgage loans to minorities and low- and moderate-income borrowers increased by 24 percent between 1998 and 1999 alone (NCRC 2000). Hispanic borrowers received 35,000 more loans in 1999 than in 1998, or 21 percent more loans while whites received only 1.5 percent more loans (NCRC 2000).

These loans are typically held in portfolio because many nontraditional borrowers meet neither the underwriting guidelines used by secondary mortgage market institutions in their standard or affordable loan purchases nor the underwriting guidelines for Federal Housing Administration (FHA)-insured loans. This has limited the amount of capital (or hindered the growth of capital) available for community reinvestment lending. Self-Help's Community Advantage ™ Home Loan Secondary Market Program (SHCA) is intended to address this problem. SHCA is the result of a partnership between the Ford Foundation, the Center for Community Self-Help, a North Carolina community-based organization, and the Federal National Mortgage Association (Fannie Mae). Under the program, lenders can sell their nonstandard community reinvestment loans in the secondary market. By demonstrating that these community lending products perform at acceptable levels of risk, the Ford Foundation hopes to encourage mainstream lenders, secondary market institutions, and housing policymakers to incorporate loan products that feature more flexible underwriting into their core lending business, federal regulations, and national housing policies.

In this paper, we examine three aspects of affordable lending. First, we compare and contrast community lending with other affordable products. Second, we examine the extent to which underwriting flexibility in community lending products expands homeownership opportunities to underserved populations. Finally, we undertake a preliminary analysis of

performance in community lending products that have been purchased by Self-Help as part of its Community Advantage effort.

More narrowly, in the first section, we identify barriers to the promotion of homeownership opportunities to underserved populations (financial and otherwise). Next, we describe the way the mortgage industry participants have addressed these barriers by developing affordable lending efforts that include targeting, outreach, homeownership education and counseling, and the use of flexible underwriting guidelines. In this section, we compare and contrast community lending and other affordable lending products with regard to the way they address these barriers. Next, we describe the impacts that these efforts have had on the homeownership propensities of underserved populations and the large and increasing lending volume going to these populations. Next, we examine what we know of the performance of affordable loans and identify key limitations in existing studies, including a lack of adequate loan level data. (We note that the analysis in this study starts addressing this limitation by relying on loan level data.) We provide a general overview of SHCA in the methodology and data section. Next, we examine the way the underwriting flexibility in community lending loans expands the homeownership market and we examine the performance of these loans with regards to their 30-, 60-, and 90-day delinquency by individual risk factor and layering of risk factors. Finally, we summarize the findings, emphasize the limitations of the study, and describe future steps.

II. Background

For many Americans, especially low- and moderate-income households, the equity in a home represents the most important form of accumulated wealth (NAHB 1998). Thus, homeownership represents a unique opportunity for families to build economic security. Unfortunately, homeownership is an unfulfilled dream for many Americans. The national homeownership rate reached an all time high of 67.7 percent, surpassing the end-of-administration goal set by President Clinton in 1995. There are now 71.6 million homeowners in the United States. Yet, while 72 percent of white households own their homes, only 48.2 percent of minority households and 51.9 percent of central city residents do so. Similarly, only 53.3 percent of households headed by females, 52.2 percent of households

earning less than the median family income, and 61 percent of young married couples (age 35 or younger) own a home (U.S. Department of Housing and Urban Development 2000).

Reasons for these differences are complex, including household, financial, and supply considerations. First, many underserved renters lack a relationship with mainstream financial and other institutions. For instance, 44 percent of all black renters with incomes below $40,000 in 1997 were unbanked.[1] Without a relationship with a financial institution, it is probably difficult for many underserved borrowers to even consider purchasing a home. In addition, many renter households may feel apprehension and/or may lack information about the possibility of owning a home (Ratner 1996). Even with the financial resources, apprehension and lack of knowledge are likely to discourage many renters from believing that they can purchase a home. To make matters worse, many low-income and minority loan applicants are unable to meet standard mortgage underwriting guidelines. The inability to meet underwriting guidelines may be the result of blemished or no credit; insufficient cash for a downpayment, closing costs, reserves and other borrower contributions; or high housing- and debt-burden ratios due to a low income.

Data from the 1999 Home Mortgage Disclosure Act (HMDA) support this last contention. HMDA indicates that the conventional home purchase loan denials rate among white loan applicants (15.1 percent) was less than half that of African American applicants (37.1 percent), and about three-fifths that of Hispanic applicants (24.9 percent). Key reasons for loan denial are consistent across groups. High debt-to-income burdens and blemished credit histories are the two most important reasons for mortgage application denials. However, incidence of these reasons differed greatly across groups. Among conventional loan applicants, only 5.2 percent of white applicants were rejected because of credit problems, while almost half of all African American applicants were rejected for such problems (46 percent).

1 Authors' calculations using data from the 1997 Survey of Consumer Finances.

Finally, there is evidence that a lack of appropriately priced homes may prevent many renter households who could qualify for a loan from purchasing a home (Stegman, Quercia, and McCarthy 2000). For instance, in 17 metropolitan areas for which data were available in 1997 and 1998, Stegman et al. estimate that 200,000 working renter families could afford to purchase a three-plus bedroom house priced between $50,000 and $75,000, yet, only 30,000 homes in that price range were available in the market.[2] As expected, the lack of adequately priced supply varies greatly from place to place. In San Francisco, about 2,500 working renter families could purchase a $75,000 to $100,000 home, but, when the 1998 American housing survey was conducted in that city, there were no houses for sale in this price range. In Boston, this potential demand was more than 13 times larger than the number of houses available for sale in early 1998. Thus, many renters face the prospect of a lifetime of renting because there are no homes to buy that they can afford. Unfortunately, typical efforts to expand homeownership opportunities to underserved populations have focused on addressing household and financial barriers almost exclusively.

Addressing Barriers to Homeownership

To expand lending to minority, low-income and other nontraditional borrowers, mortgage industry participants have put in place a number of strategies. These include targeting and outreach, requiring homeownership education and counseling, and the use of flexible underwriting guidelines. Targeting focuses lending activity on the basis of some defined criteria, such as borrower characteristics and neighborhood income, location, and racial composition. Special marketing activities commonly include outreach to community and religious organizations that are active in targeted markets, and homebuyers education fairs or seminars to reach targeted groups (Quercia 1999).

As a rule, homeownership education and counseling (HEC) is required for all affordable products. HEC is believed to fulfill several roles in the promotion of affordable homeownership. First, although empirical evidence is unavailable to date, HEC is believed to compensate for the potentially higher risk inherent in the use of nontraditional or flexible underwriting guidelines. Prior to purchase, lenders require borrowers to complete a homebuyer education program and to undergo individualized credit counseling (pre-purchase counseling). After purchase, lenders may also use enhanced servicing techniques on

[2] These families were assumed to qualify under an affordable mortgage product such as Fannie Mae's Alt 97 or Freddie Mac's Flex 97.

affordable loans, such as phone contact with delinquent borrowers, to determine the cause of the delinquency and to establish a plan to rectify the situation. Finally, the lenders may establish default prevention targeted to borrowers with serious delinquency problems (post-purchase counseling) (Quercia 1999).

Many of the benefits of HEC, ironically, do not arise from the actual education and counseling. They arise from the partnerships formed between lenders and the nonprofit organizations offering HEC. HEC agencies provide a low-cost marketing strategy for lenders and secondary market institutions. This fills the existing information gap caused by a lack of lending experience and presence in underserved markets. HEC also reaches a client base that is beyond the reach of most conventional lenders. They help lenders to cross cultural and linguistic barriers at a low cost. HEC providers sort through potential homebuyers to find the creditworthy and send them to lenders mortgage-ready. Lenders therefore avoid the difficult process of deciding which applicants qualify for a loan. This, in turn, helps the lenders to satisfy CRA requirements and secondary market institutions to meet their affordable lending mandates (McCarthy and Quercia 2000).

The use of non-traditional, flexible underwriting guidelines is the most distinguishing characteristic of affordable lending efforts (Figure 1). Affordable lending products allow for high loan-to-value ratios, high debt burden limits, little or no cash reserves, low credit scores, and alternative evidence of creditworthiness. Flexible underwriting guidelines are important because they help address barriers to homeownership among non-traditional borrowers. For instance, high loan-to-value products allow cash poor borrowers to meet underwriting guidelines without the need for a large downpayment.

Mortgage industry participants have developed many flexibly underwritten products. However, none of these loans reflect flexibility in all the underwriting criteria. A loan product may allow for higher debt-to-income ratios but it is likely to require standard credit scores. Thus, the extent to which affordable loan products allow the layering of risk factors is a distinguishing characteristic. For instance, secondary market institutions are more reluctant to allow for layering of risk factors than portfolio lenders (Temkin, Quercia, and Galster 2000). This is due to the belief that loans underwritten using multiple nontraditional guidelines are at significantly greater risk of delinquency and default (Quercia 1999).

Figure 1: Standard and Affordable Underwriting Guidelines

Guideline	Standard	Affordable
Percent downpayment	20	3
Percent back-end ratio (ratio of mortgage principal and interest payment, property taxes, insurance, and other non-housing debt to household income)	33	Greater than 38
Credit history	High credit scores (unlikely to allow less than 620)	Low or no credit scores
Cash reserves	Two months	Waived or reduced
Mortgage insurance	Required if downpayment less than 20 percent	Waived or reduced
Layering of risk factors	Not allowed	Allowed

A word on the use of credit scores is warranted. Because of its predictive power, the industry has embraced the use of credit scores as a powerful underwriting tool. Until recently, both GSEs relied on credit scores derived by formula, such as the one developed by Fair, Isaac, and Company, known as FICO. Recently, Fannie Mae announced it would stop using (third party) borrower credit scores and rely instead on credit characteristics when loans are processed with automated underwriting (AU).[3] Freddie Mac continues to rely on credit scores, even if AU is used. In any case, neither uses the score as an absolute criterion. That is, loan purchases were not denied solely on the basis of a borrower's score. Instead, the scores are used to define the extent of review accorded the application and the amount of risk layering permitted. Better scoring applications are considered "low risk" or "probably acceptable," while the lowest scores are "very high risk, no layering permitted" or "probably unacceptable, cautious review." In general, although these institutions have stated that loan applications should not be denied only on the basis of low credit scores, there is a perception among some portfolio lenders that the GSEs will not purchase loans with credit scores below 620 (Temkin, Quercia, and Galster 2000).[4]

More broadly, the use of credit scores in underwriting has been subject of intense debate. Credit scores evaluate previous credit performance, current level of indebtedness, the length of credit history, the types of credit in use, and the pursuit of new credits (Roche 2000). Credit scoring can assess risks without considering age, race/ethnicity or marital status of the loan applicant. Credit scoring is a very important part of computer-based underwriting (automated underwriting). Automated underwriting is considered by some to be fairer and faster than manual underwriting and to provide a more precise evaluation of risk (Roche

[3] For manually underwritten loans, Fannie Mae still recommends lenders to use FICO scores in their underwriting decisions (http://www.fanniemae.com/news/media/faqs/faqs.html, 8/10/00).

[4] Fannie Mae does not specify minimum credit scores for its CHBP 5 and 3/2 and Fannie 97 products. In contrast, Fannie Mae's Community 100 emerging affordable product requires a minimum score of 660. See Berry (2000) for perspectives on potential disparate impacts that may result from the reliance on credit scores.

2000). Supporters of credit scoring contend that credit scoring gives greater access to mortgage credit rather than creating new barriers for minority mortgage applicants (Smith 2000).

In contrast, critics of credit scoring contend that, although credit scoring is able to predict the percentage of applicants at or below any score who are likely to go into default, it is not able to precisely identify which specific individuals will default (Bradford 2000). For instance, even if 100 percent of loans predicted to default may have credit scores below, say 620, not all loans with scores below 620 will default. In fact, most will not. Credit scoring cannot identify those with scores below 620 not predicted to default. This fact raises disparate impact concerns among critics of credit scoring. If minorities are more likely to have lower scores, as evidence suggests they do, then rejecting low credit scoring applications will result in rejecting low scoring minority applicants who are in fact a good risk. Unfortunately, data to empirically test these contentions are proprietary and have not been made available to researchers.

Increasing Reliance on Eve- More Flexible Underwriting

Historically, lenders relied almost exclusively on government-backed mortgage products, such as those insured by FHA, to reach low-income, minority. and other nontraditional borrowers. This changed with the enactment of (and subsequent reforms to) the 1977 Community Reinvestment Act (CRA) and the 1992 Federal Housing Enterprises Financial Safety and Soundness Act (FHEFSSA).

Enacted in 1977, the CRA made explicit the affirmative obligation of banking institutions to meet the credit needs of their entire communities, including low-income and minority borrowers and neighborhoods.[5] The CRA requires federal regulators to take an institution's CRA record into account in determining whether to approve applications for federal charter or FDIC insurance, relocations of main offices and branches, mergers, consolidations, and other such actions. Similarly, FHEFSSA required HUD to establish three affordable goals for GSE mortgage purchases: a low- and moderate-income goal, a geographic goal, and a special affordable goal. For the 2001-2003 period, these goals are set at 50, 31.and 20 percent of GSE purchases respectively.

Combined with these primary and secondary affordable lending requirements, the federal government stepped up enforcement of fair housing and equal credit laws. Institutions

[5] The CRA complemented the Home Mortgage Disclosure Act (HMDA) enacted in 1975 and amended in 1989. HMDA required all federally regulated depository institutions to report annually on mortgage lending by census tract for all metropolitan areas by location, and by race, ethnicity, gender and income level of all loan applicants, along with the disposition (and reason for disposition) of each loan application (approved, denied, or withdrawn).

became more concerned about their community lending obligations, the appearance of discrimination and other such practices (Listokin et al. 1999). As a result of these regulatory and enforcement changes, institutions became more aggressive in extending credit to underserved populations and areas.

Initially, institutions made marginal changes to one or more of their standard underwriting guidelines to offer somewhat more flexible and affordable loans. For instance, in the early-1990s, the GSEs started offering mortgage products that allowed for lower downpayments (higher LTV ratios) than products prior to the early 1990s. These new mortgage products became standardized and replaced the earlier (pre-early 990s) less flexible products. Currently, these products are referred to as GSE standard mortgages. Over time, industry participants have introduced a number of even more flexible and affordable products than the now standard mortgages (Listokin et al. 2000). These mortgages are often referred to as affordable or community lending products (Quercia 1999). For instance, these include the Fannie Mae's Community Home Buyers products (CHBP).

In addition to expanding standard underwriting guidelines, institutions have developed a number of unique programs that are specifically designed for nontraditional borrowers. These untested pilot products offer the most flexible guidelines but have limited availability. For instance, they may allow borrowers to make no downpayment (100 percent LTV) but are available only in the Chicago market. The GSEs have introduced a number of such pilot products. Fannie Mae's Community 100 Program offers loans with no downpayment, with three percent closing costs required from the borrowers or other sources (the maximum and 28/36 percent front-end/back end ratios. Pilot products, such as the Community 100, are referred to as GSE emerging affordable mortgages.[6] The expectation is that the GSEs will bring these pilot products into mainstream lending efforts once the risk of the products is known. A description of the underwriting guidelines in selected Fannie Mae community lending products is presented in Figure 2.

Figure 2: Selected Fannie Mae Community Lending Guidelines

	CHBP	CHBP 3/2	Fannie 97	Community 100
Minimum percent down from borrower's own funds	5	3	3	0, but 3 closing costs required from borrower or other sources
Maximum LTV percent	95	95	97	100
Maximum CLTV percent	105	105	105	105
Minimum credit score	None	None	None	660
Reserves	None	None	1 month	2 months
Ratios	33/38	33/38	28/36	28/36
Geographic	National	National	National	Pilot program

Similarly, primary lenders have developed a number of unique mortgage products (pilots) to reach nontraditional borrowers. Often, lenders serve low- and moderate-income

[6] These pilot products are not sold in capital markets as part of mortgage related mortgages.

borrowers by offering mortgage products that have been developed by their institutions and remain in portfolio because they contain features that fall outside of the GSEs' purchasing guidelines. These products may allow for lower downpayments (with no mortgage insurance), and higher front- and back-end ratios than do the GSEs' affordable guidelines. In addition, many of these affordable portfolio products allow underwriters to qualify borrowers who would not meet the GSEs' guidelines for defining an acceptable credit history (Temkin, Quercia, and Galster 2000). In many instances, the inability to sell these portfolio products in capital markets limits the amount of community lending that primary institutions offer. A description of the underwriting guidelines in selected portfolio products is presented in Figure 3.

Figure 3: Selected Community Lending Guidelines

	Lender 1	Lender 2	Lender 3	Lender 4	Lender 5
Minimum down from borrower's own funds	The greater of 1%or $500	$500	1%	$0	$500
Maximum LTV percent	97	97	97	100	100
Maximum CLTV percent	103 for ½ of deliveries; 100 for others	100; 103 on case-by-case-basis	105	105	103
Minimum credit Score	600	580 unless there is no layering of risk	580	640	None
Reserves	None	None	None	2 months	1 month
Ratios	33/42	33/42	30/45	40/40	38/38, but up to 45/45 with offsets
Geographic	National	National	National	National	North Carolina flood counties

The impacts of all these affordable products cannot be denied. A recent study estimates that almost $60 billion has been originated in community lending products for home purchase and refinance in 1999 alone (Board of Governors of the Federal Reserve System 2000).

A key policy question is raised by the continued affordable lending goals that primary and secondary mortgage market institutions are required to meet, combined with the large volume of outstanding community lending obligations. How risky are affordable, community lending products?

Evidence on the Riskiness of Affordable Lending Products

In theory, the use of flexible underwriting guidelines need not pose greater risks than the use of traditional or standard guidelines if risk-mitigating mechanisms (such as HEC) are also used. Unfortunately, we know nothing conclusive about the performance of affordable loans in general or the effectiveness of HEC as a risk mitigating mechanism in particular.

With regard to the performance of affordable lending products, the evidence is mixed at best. Several studies have reported positive experiences, others have reported negative experiences, while some have reported both positive and negative experience depending on the institution examined.[7] There may be several reasons for the conflicting evidence, including differences across institutions in composition and management of both affordable and standard portfolios and differences in the way risks are assessed and managed (Board of Governors of the Federal Reserve System 1993). On this basis alone, it would be reasonable to expect differences in risks associated with the affordable and standard products serviced, held, insured or purchased by different institutions. To make matters more difficult, the data needed to assess the riskiness of affordable loans are proprietary and thus not available to researchers. In general, researchers have been forced to rely on qualitative information, proxy measures and/or statistical techniques to fill in the data void.

Yet, the accurate measurement of the performance of affordable lending efforts may be the key to their long-term viability. An event such as a downturn in the economy is likely to increase the incidence of default in affordable products and thereby reinforce the belief that affordable products are risky when in reality broader economic considerations are at play. More importantly, only the accurate assessment of the risk inherent in affordable lending products can increase the likelihood of their securitization and inclusion in mortgage-related securities and thus bring them into the mainstream of the mortgage lending system (Quercia 1999).

III. Methodology and Data

In this study, we examine three aspects of community lending. First, we compare and contrast the flexibility of community lending products with those of other affordable products. Second, we examine the extent to which the underwriting flexibility in community lending products expands homeownership opportunities to underserved populations. Finally, we address the data limitations of prior work and undertake a preliminary analysis of the performance of affordable, community lending products with loan level data from loans purchased by Self-Help as part of the Community Advantage demonstration. We examine the

[7] See Quercia (1999) for a review of the literature and evidence and Board of Governors of the Federal Reserve System (2000) on the performance and profitability of CRA lending for a recent study.

performance of these loans by risk factors, and the extent to which layering of risks contributes to performance.

Under Community Advantage (SHCA), Self-Help purchases non-conforming, CRA-type mortgages from selected mortgage lenders, and then securitizes these loans with Fannie Mae.[8] Because Self-Help retains full recourse for any credit losses, Fannie Mae can accept loans that are outside its standard guidelines. Fannie Mae and Self-Help have committed to purchase and securitize $2 billion of such loans over a five-year period. The Ford Foundation provided capital to support Self-Help's recourse obligations. In addition to generating an expected 35,000 loans to underserved markets, this effort will enable Fannie Mae to measure and better understand the risks associated with non-traditional mortgages. In the long term, this could increase the liquidity of nonstandard community lending loans by permanently expanding the secondary mortgage market.

To date, Self-Help has established partnerships with about two dozen lending institutions. Through these partnerships, Self-Help has already purchased over $377 million in loans and secured commitments totaling over $400 million per year. A summary of the partnerships is presented in Figure 4.

Figure 4: Self-Help Community Advantage Partnerships*

Lender	Commitment $MM	Actual $MM
Bank of America	500 (100/yr)	102.0
Bank One	250 (50/yr)	8.5
BB&T	N/A	102.2
Cambridgeport	N/A	0
Cendant	N/A	0
Centura	50	53.5
Charter One	N/A	0
Chase	250 (50/yr)	7.7
Chevy Chase	N/A	0
Citizens Bank	15 (5/yr)	0
Countrywide	250	0
Family Savings Bank	N/A	0
First Citizens	N/A	45.3
First Nationwide	N/A	0
First South	5	0.2
FirstMerit	75 (25/yr)	2.7
Flagstar Bank	N/A	0
GMAC	200 (67/yr)	7.7

[8] The SHCA demonstration relies on the participating lenders to design loan programs and to market, originate, underwrite, and service the loans. Self-Help acquires seasoned portfolios of loans as well as newly originated mortgages on a "flow" basis. When a lender sells a portfolio of previously originated loans to Self-Help, the lender commits to re-lend the same amount to similar borrowers under similar loan programs. When Self-Help acquires seasoned loans, the loans must have a record of on-time payments for the prior nine months (or 12 months depending on CLTV). Similarly, when selling new originations to Self-Help on a flow basis, the lenders indemnify Self-Help against any defaults occurring in the first nine months (or 12 months depending on CLTV). Other than the early term defaults, Self-Help bears the full risk of loss for 10 years.

Lender	Commitment $MM	Actual $MM
Huntington Bank	N/A	0
Indy Mac	N/A	0
Irwin Mortgage	N/A	0
Key Bank	N/A	0
Local Gov't Employees FCU	N/A	0.9
National City Bank	500 (100/yr)	10.8
PNC Bank	N/A	0
Sky Financial Group	N/A	0.1
State Employees' Credit Union	N/A	33.8
Trustmark Bank	N/A	0
Union Planters	N/A	0
Total		**$376.7**

*As of 9/30/00

Self-Help's Community Advantage™ Products

Self-Help's Community Advantage™ program enables Fannie Mae to measure and better understand the risks in mortgages underwritten with guidelines that are more flexible and aggressive than those used in its affordable products (Figures 2 and 3 above). [9] The SHCA product guidelines, considered individually, consistently meet or go beyond those of Fannie Mae's affordable products.[10] SHCA products allow for higher LTVs, CLTV, and front-end and back-end ratios, and less stringent or alternative evidence of creditworthiness, such as a good rent payment record for 12 months prior to mortgage application.

When layering of risk is considered, the differences appear even greater. For Fannie Mae Community Home Buyers Program products, all adhere to two of the four quantitative standards for its standard products (LTV, debt ratios, credit scores, reserves). For instance, for loan products with LTVs above 95 percent, the borrower must meet the housing expense- and debt-to-income ratios of standard Fannie Mae loans, 28 percent/36 percent (front-end/back-end). For higher ratios, up to 33 percent/38 percent, the maximum allowable LTV is 95 percent for a 30-year mortgage term.

Of Fannie Mae's products, the ones that clearly are most aggressive in attempting to reach the nontraditional market are the emerging affordable products, such as Community 100. These products may exceed guidelines on more underwriting criteria. For instance, they

[9] Figure 3 shows only selected SHCA flow products. SHCA flow products are the central focus of the program and will constitute eventually the bulk of transactions. However, the descriptions and comparisons below are based on information on both flow and portfolio products to date.

may require no borrower cash for downpayment or closing. However, the credit scores required generally are higher (660) than those deemed "acceptable" for other affordable products.

SHCA products clearly exceed the flexibility of the Fannie Mae's affordable counterparts. The typical SHCA product allows maximum LTV of 97 percent, CLTV of 103 percent, front-end/back-end ratios of 33 percent/40 percent, approximately $500 to $1000 of borrower cash contribution, and nontraditional credit and employment standards. Some of the more aggressive SHCA products combine high LTVs and high front-end/back-end ratios with low up-front buyer cash and less stringent credit reputation and employment history requirements. One such product has a maximum LTV of 100%, CLTV of 105%, front-end/back-end ratios of 40 percent/40 percent, requires only one month's reserves from the borrower, allows a soft second, and has relatively lenient credit and employment history requirements.

A main goal of affordable lending efforts is to reach traditionally underserved populations. In the next section, we examine borrower characteristics by risk factors. Ideally, we would see that as underwriting becomes more flexible, more nontraditional borrowers are served.

Borrower Characteristics by Risk Factors in Self-Help's Community Advantage™

As a result of underwriting flexibility, SHCA loans have reach underserved populations more effectively than the GSEs. As of September 30, 2000, Self-Help has purchased 5,512 loans with a combined principle of $377 million under the SHCA program. A large proportion of these loans was originated to traditionally underserved borrowers. About 42 percent of the loans were originated to minority borrowers, including almost 28 percent to blacks and 11 percent to Hispanic borrowers. Almost 42 percent of the loans were originated to borrowers with a female head of household, and about 41 percent were originated to rural borrowers. The typical borrower was relatively young. Only about one in every four borrowers was over 40 years of age. The median gross income for all borrowers was $2,245 per month of about $26,940 a year. Borrower credit scores at the time of loan origination appeared to be evenly distributed across credit scores ranges. About one in every five borrowers have credit scores below 620 (21.1 percent) and another one in four have scores between 621-660 (24.8

[10] Both SHCA products and Fannie Mae affordable products require borrowers to receive homeownership counseling. Also, both have in place an enhanced servicing component. Finally, both product types also allow for the consideration of factors

percent). About three in every four borrowers were first-time homebuyers. More than half the SHCA borrowers put a downpayment of less than five percent (compared with 2.2 percent or less for the GSEs). Borrower characteristics are summarized in Figure 5.

Figure 5: Characteristics of Self-Help CAP Borrowers

Characteristics	Self-Help's Community Advantage %(N=5,498)	Fannie Mae 1997 (N=945,181)	Freddie Mac 1997 (N=603,383)	FHA 1996	Conforming Market 1996
Race/Ethnicity					
White	57.8	83.0	86.6	--	--
Black	27.5	4.1	2.7	14.3	5.4
Hispanic	10.9	5.0	3.9	15.5	6.7
Other	3.8	7.9	6.8	--	--
Gender					
Women	42.0	15.7	14.6		
Age					
Under 30	40.2	13.8	13.4		
30-39	31.5	35.4	35.6		
40 & over	28.3	50.8	51.0		
Income					
≤ 60 AMI	48.9	10.1	7.5	20.1	16.4
61-100 AMI	48.1	27.2	26.1	47.0	39.0
> 100% AMI	3.0	62.7	66.4	32.9	44.6
Other characteristics					
Urban borrower	59.0	--	--		
Metro (vs. non-metro)	--	87.3	85.1		
First time homebuyers	70.6	34.5	28.4		
Loan-to-Value					
LTV over 95%	56.8	2.2	.6		
Mortgage insurance	22.4	--	--		
LTV>80%	(94)	31.1	29.8		
Borrower credit score					
<= 620	21.1	NA	NA		
621-660	24.8	NA	NA		
661-720	30.6	NA	NA		
>= 720	23.5	NA	NA		

Note: Self-Help data are as of 9/15/00. Fannie Mae and Freddie Mac data are from Tables 5 and 6B of "Characteristics of Mortgages Purchased by Fannie Mae and Freddie Mac: 1996-1997 update" by Paul B. Manchester, Housing Finance Working Paper Series, no. HF-006 (HUD: Washington, DC). Age and LTV are reported for home purchase and refinance loans combined, other variables are for home purchase loans only. The Fannie Mae and Freddie Mac data separate loans into "men only," "women only," and "both men and women." The reported number is the percentage of "women only" loans. The number for Self-Help is the percentage of loans to women with no co-borrower. FHA and conforming market data are from Table 2 of "The GSE's Funding of Affordable Loans: 1996 update" by Harold L. Bunce and Randall M. Scheessele, Housing Finance Working Paper Series, no. HF-005 (HUD: Washington, DC). The conforming market consists of loans below the 1997 conforming loan limit of $214,600.

Credit scores are important in mortgage underwriting. Borrower characteristics by credit score are presented in Figure 6. Race and ethnicity exhibit the strongest relationship with credit scores. White and black borrowers are about equally represented among loans with scores less or equal to 620 (42.7 and 45.9 percent respectively). As scores go up, whites become increasingly more represented in the population. More than three in every four borrowers with scores above 720 were white, compared with about one in 10 for black borrowers. We also find a relationship (though weaker) between borrower income (as a

to compensate deficiencies in one or more underwriting criteria.

percentage of AMI) and urban/rural location. Lower income borrowers and rural borrowers are more likely to have lower scores. Finally, we find no substantively important relationship between genders, age of borrower, whether the borrower is a first-time homebuyer and credit scores.[11]

Figure 6: Borrower Characteristics by Credit Scores

Characteristics	<=620	621-660	661-720	> 720	No Score	Total
Race/Ethnicity						
White	441 (42.7)	603 (49.4)	985 (65.1)	895 (77.2)	239 (43.9)	3,163 (57.8)
Black	475 (45.9)	460 (37.6)	306 (20.2)	137 (11.8)	131 (24.1)	1,509 (27.6)
Hispanic	89 (8.6)	110 (9.0)	162 (10.7)	91 (7.9)	145 (26.7)	597 (10.9)
Other	29 (2.8)	49 (4.0)	60 (4.0)	36 (3.1)	29 (5.3)	203 (3.7)
Total	1,034 (100)	1,222 (100)	1,513 (100)	1,159 (100)	544 (100)	5,472 (100)
Gender						
Men	514 (49.7)	644 (53.0)	876 (58.1)	636 (54.8)	325 (59.9)	2,995 (54.8)
Women	520 (50.3)	572 (47.0)	633 (41.9)	524 (45.2)	218 (40.1)	2,467 (45.2)
Total	1,034 (100)	1,216 (100)	1,509 (100)	1,160 (100)	543 (100)	5,462 (100)
Age						
Under 30	372 (37.8)	437 (37.8)	613 (45.2)	399 (42.8)	169 (32.1)	1,990 (40.1)
30-39	321 (32.7)	394 (34.1)	398 (29.3)	268 (28.7)	179 (34.0)	1,560 (31.5)
40 and over	290 (29.5)	325 (28.1)	346 (25.5)	266 (28.5)	178 (33.9)	1405 (28.4)
Total	983 (100)	1,156 (100)	1,357 (100)	933 (100)	526 (100)	4,955 (100)
Income						
60% AMI	521 (54.0)	604 (52.5)	656 (45.6)	473 (43.2)	257 (52.7)	2,511 (48.9)
61-100% AMI	422 (43.8)	514 (44.7)	743 (51.7)	569 (51.9)	222 (45.5)	2,470 (48.1)
>100% AMI	21 (2.2)	33 (2.9)	39 (2.7)	54 (4.9)	9 (1.8)	156 (3.0)
Total	964 (100)	1,151 (100)	1,438 (100)	1,096 (100)	488 (100)	5,137 (100)
Urban/Rural						
Urban	635 (62.7)	736 (61.3)	825 (55.6)	621 (54.8)	343 (66.3)	3,160 (59.1)
Rural	378 (37.3)	464 (38.7)	658 (44.4)	512 (45.2)	174 (33.7)	2,186 (40.9)
Total	1,013 (100)	1,200 (100)	1,483 (100)	1,133 (100)	517 (100)	5,346 (100)
First time homebuyers						
Yes	694 (72.3)	802 (72.1)	932 (70.5)	707 (76.3)	288 (54.7)	3,423 (70.6)
No	266 (27.7)	310 (27.9)	389 (29.5)	220 (23.7)	238 (45.3)	1,423 (29.4)
Total	960 (100)	1,112 (100)	1,321 (100)	927 (100)	526 (100)	4,846 (100)

Numbers in parentheses are column percentages. All characteristics are statistically significantly different across credit score categories (p<.05).

Borrower characteristics by loan-to-value ratios are presented in Figure 7. Although not strong, we find relationships between some demographic characteristics and low LTV loans (<=89 percent). We find a higher presence of minority, women, older, and lower-income borrowers among low LTV loans than among higher LTV loans. Also, we find a higher presence of older, higher income, and not-first-time homebuyers among high LTV loans (>=100 percent) than among low LTV loans. It is interesting to note that only one of four high LTV loans was made to first-time homebuyers.

[11] Most of these and other differences reported elsewhere are statistically significant in bivariate tests of association due to the relatively large sample size and the power of the chi-square and similar tests. Thus, in our presentation we focus on substantively important differences.

Figure 7: Borrower Characteristics by Loan-to-Value

Characteristics	≤89	90-95	96-97	98-99	100+	Total
Race/Ethnicity						
White	317 (46.8)	1,010 (59.7)	1,177 (57.9)	408 (60.7)	243 (62.2)	3,155 (57.7)
Black	302 (44.6)	428 (25.3)	399 (19.6)	243 (36.2)	129 (33.0)	1,501 (27.5)
Hispanic	39 (5.8)	176 (10.4)	363 (17.9)	13 (1.9)	6 (1.5)	597 (10.9)
Other	19 (2.8)	78 (4.6)	93 (4.6)	8 (1.2)	13 (3.3)	211 (3.9)
Total	677 (100)	1,692 (100)	2,032 (100)	672 (100)	391 (100)	5,464 (100)
Gender						
Men	283 (41.7)	925 (54.9)	1,170 (57.8)	394 (58.7)	220 (56.8)	2,992 (54.9)
Women	395 (58.3)	759 (45.1)	855 (41.2)	277 (41.3)	167 (43.2)	2,453 (45.1)
Total	678 (100)	1,684 (100)	2,025 (100)	671 (100)	387 (100)	5,445 (100)
Age						
Under 30	170 (28.7)	590 (40.3)	845 (41.7)	302 (46.0)	83 (38.8)	1,990 (40.1)
30-39	214 (36.1)	447 (30.6)	634 (31.2)	204 (31.1)	61 (28.5)	1,560 (31.5)
40 and over	209 (35.2)	426 (29.1)	550 (27.1)	150 (22.9)	70 (32.7)	1,405 (28.4)
Total	593 (100)	1,463 (100)	2,029 (100)	656 (100)	214 (100)	4,955 (100)
Income						
60% AMI	387 (64.1)	772 (48.1)	941 (50.7)	292 (43.8)	116 (29.7)	2,508 (49.0)
61-100% AMI	186 (30.8)	766 (47.8)	907 (48.9)	358 (53.8)	243 (62.1)	2,460 (48.0)
>100% AMI	31 (5.1)	66 (4.1)	8 (.4)	16 (2.4)	32 (8.2)	153 (3.0)
Total	604 (100)	1,604 (100)	1,856 (100)	666 (100)	391 (100)	5,121 (100)
Urban/Rural						
Urban	387 (59.9)	1,002 (59.8)	1,325 (68.1)	278 (41.2)	162 (41.9)	3,154 (59.2)
Rural	259 (40.1)	674 (40.2)	620 (31.9)	397 (58.8)	225 (58.1)	2,175 (40.8)
Total	646 (100)	1,676 (100)	1,945 (100)	675 (100)	387 (100)	5,329 (100)
First time homebuyers						
Yes	387 (66.4)	1,046 (76.8)	1,364 (67.2)	574 (87.4)	52 (24.3)	3,423 (70.6)
No	196 (33.6)	316 (23.2)	666 (32.8)	83 (12.6)	162 (75.7)	1,423 (29.4)
Total	583 (100)	1,362 (100)	2,030 (100)	657 (100)	214 (100)	4,846 (100)

Numbers in parentheses are column percentages. All characteristics are statistically significantly different across LTV categories ($p<.05$).

Borrower characteristics by total debt burdens (back-end ratios) are presented in Figure 8. We find no clear relationship between most borrower characteristics and whether a loan had high back-end ratio (>= 39 percent).[12] We find a weak relationship between urban/rural location and first-time homebuyers and high back end ratios. Urban borrowers are more likely to have high ratios. About 64 percent of all loans with back-end ratios equal or greater than 39 percent were made to urban borrowers. About three of four loans with ratios less than 39 percent were made to first-time homebuyers (73.3 percent).

Borrower characteristics by level of cash reserves are presented in Figure 9. We find a strong relationship between two borrower characteristics and the level of cash reserves required. Urban borrowers and first-time homebuyers were more likely to be required to have at least one-month reserve at closing than other borrowers. About 68 percent of all loans made with at least one-month reserves were made to urban borrowers. Similarly, about four in five loans that required at least one-month reserves were made to first-time homebuyers (82.9 percent).

[12] The cutoff for back-end ratios was chosen based on guidelines for GSE affordable products. The highest allowable back-end ratio in a GSE affordable product is 38 percent.

Figure 8: Borrower Characteristics by Back-End Ratios

Characteristics	<39	>=39	Total
Race/Ethnicity			
White	2,047 (60.5)	1,098 (53.0)	3, 145 (57.7)
Black	905 (26.8)	595 (28.7)	1,500 (27.5)
Hispanic	310 (9.2)	287 (13.9)	597 (11.0)
Other	119 (3.5)	91 (4.4)	210 (3.8)
Total	3,381 (100)	2,071 (100)	5,452 (100)
Gender			
Men	1,900 (56.5)	1,082 (52.5)	2,982 (54.9)
Women	1,465 (43.5)	980 (47.5)	2,445 (45.1)
Total	3,365 (100)	2,062 (100)	5,427 (100)
Age			
Under 30	1,221 (41.3)	768 (38.6)	1,989 (40.2)
30-39	901 (30.4)	657 (33.0)	1,558 (31.5)
40 and over	838 (28.3)	566 (28.4)	1,404 (28.3)
Total	2,960 (100)	1,991 (100)	4,951 (100)
Income			
60% AMI	1,469 (46.3)	1,031 (53.2)	2,500 (48.9)
61-100% AMI	1,569 (49.5)	889 (45.8)	2,458 (48.1)
>100% AMI	133 (4.2)	20 (1.0)	153 (3.0)
Total	3,171 (100)	1,940 (100)	5,111 (100)
Urban/Rural			
Urban	1,862 (56.6)	1,281 (63.7)	2,158 (40.7)
Rural	1,427 (43.4)	731 (36.3)	3,143 (59.3)
Total	3,289 (100)	2,012 (100)	5,301 (100)
First time homebuyers			
Yes	2,136 (73.3)	1,281 (66.7)	3,417 (70.6)
No	780 (26.7)	640 (33.3)	1,420 (29.4)
Total	2.916 (100)	1,921 (100)	4,837 (100)

Numbers in parentheses are column percentages. All characteristics, except age, are statistically significantly different across back-end ratio categories ($p<.05$).

Figure 9: Borrower Characteristics by Reserves

Characteristics	At least 1 Month	No Reserves	Total
Race/Ethnicity			
White	1,520 (56.9)	1,523 (58.0)	3, 043 (57.5)
Black	597 (22.4)	893 (34.0)	1,490 (28.1)
Hispanic	436 (16.3)	142 (5.4)	578 (10.9)
Other	117 (4.4)	69 (2.6)	186 (3.5)
Total	2,670 (100)	2,627 (100)	5,297 (100)
Gender			
Men	1,496 (55.9)	1,397 (53.4)	2,893 (54.7)
Women	1,180 (44.1)	1,218 (46.6)	2,398 (45.3)
Total	2,676 (100)	2,615 (100)	5,291 (100)
Age			
Under 30	1,054 (39.5)	856 (40.7)	1,910 (40.0)
30-39	810 (30.4)	683 (32.5)	1,493 (31.3)
40 and over	804 (30.1)	564 (26.8)	1.368 (28.7)
Total	2,668 (100)	2,103 (100)	4,771 (100)
Income			
60% AMI	1,322 (52.8)	1,078 (43.6)	2,400 (48.2)
61-100% AMI	1,177 (47.0)	1,245 (50.4)	2,422 (48.7)
>100% AMI	5 (.2)	149 (6.0)	154 (3.1)
Total	2,504 (100)	2,472 (100)	4,976 (100)
Urban/Rural			
Urban	1,813 (68.0)	1,218 (47.8)	2,186 (41.9)
Rural	854 (32.0)	1,332 (52.2)	3,031 (58.1)
Total	2,667 (100)	2,550 (100)	5,217 (100)
First time homebuyers			
Yes	2,214 (82.9)	1,155 (57.9)	3,369 (72.3)
No	455 (17.1)	838 (42.1)	1,293 (27.7)
Total	2.669 (100)	1,993 (100)	4,662 (100)

Numbers in parentheses are column percentages. All characteristics are statistically significantly different across reserves categories ($p<.05$).

If the above analysis is typical of community lending in general, the use of flexible underwriting guidelines will not result necessarily in an expansion of homeownership opportunities to nontraditional borrowers. In fact, we find that first-time homebuyers are more likely to have high credit scores (>660) than low scores (<660) and to be required to have at least one month cash reserves at closing than non-first-time homebuyers. We do find that first-time homebuyers have loans with slightly higher overall LTV than other borrowers. However, only one in four borrowers with LTVs greater or equal to 100 percent was a first-time homebuyer.

Performance of Affordable Loans in Self-Help's Community Advantage™

As stated earlier in the paper, the lack of data has been a key reason for the conflicting findings in the literature on the performance of affordable loans. In this section, we present the results of preliminary analysis of the performance of affordable loans in SHCA. Because

it is early in the demonstration, we limit our examination to the incidence of delinquency (30 days, 60 days, and 90 days over the most recent 24 month period) by four risk factors: credit scores, LTV, back-end ratios, and cash reserves.[13] Overall, except for credit scores, we find no relationship between delinquency and individual risk factors (Figure 10). Delinquencies increase only marginally when the other risk factors are layered and added to low credit scores.

Figure 10: Performance of SHCA Loans by Risk Factors

Risk Factors	No Delinquency	30-Day Delinquency Only Once	30-Day Delinquency > Once	60-Day Delinquency	90-Day Delinquency
Credit Scores					
<=620	677 (71.0)	119 (12.5)	67 (7.0)	40 (4.2)	51 (5.3)
621-660	957 (82.7)	79 (6.8)	69 (6.0)	22 (1.9)	30 (2.6)
661-720	1,345 (92.2)	57 (3.9)	25 (1.7)	10 (.7)	21 (1.5)
>720	1,106 (97.8)	16 (1.4)	4 (.3)	3 (.3)	2 (.2)
LTV					
<=95 %	2,007 (87.2)	136 (5.9)	78 (3.4)	37 (1.6)	44 (1.9)
96-97 %	1,587 (87.0)	105 (5.7)	59 (3.2)	34 (1.9)	40 (2.2)
>=98%	916 (87.2)	53 (5.0)	42 (4.0)	11 (1.0)	29 (2.8)
Back-end ratio					
<39 %	2,815 (87.8)	174 (5.4)	108 (3.4)	44 (1.4)	66 (2.0)
>=39%	1,669 (85.9)	118 (6.1)	71 (3.6)	38 (2.0)	47 (2.4)
Cash Reserves					
>= 1 Months	2,306 (87.0)	162 (6.1)	88 (3.3)	46 (1.8)	48 (1.8)
No reserves	2,221 (87.3)	132 (5.2)	91 (3.6)	36 (1.4)	65 (2.5)

Numbers in parentheses are column percentages. All characteristics, except age and urban/rural, are statistically significantly different across delinquency categories (p<.05).

We find a significant inverse correlation between borrower credit scores and delinquencies. As scores go up, delinquencies decline. More than seven of 10 borrowers with scores below 620 were never delinquent over the most recent 24-month period; over eight of 10 borrowers with scores between 621-660 were never delinquent; and almost 10 in 10 borrowers with scores over 720 were never delinquent. Despite a clear pattern of higher delinquencies with lower scores, we find that fewer than three of 10 borrowers with the lowest scores were delinquent within the last 24 months and that an additional 12.5 percent experienced a single 30-day delinquency. This says that the vast majority of low-score borrowers appear to be good risks.

Obviously, the incidence of loan delinquencies is affected by loan maturity. The direction of the effect, however, is not clear in advance. Older loans are more seasoned and may be less likely to have experienced delinquencies over the most recent 24-month period.

[13] We coded loans with regard to the worst delinquency they had suffered, meaning that the categories do not overlap. Thus "30-day delinquency only once" includes only loans which were never more than 30 days delinquent and had only one instance of being 30 days delinquent. If a loan went 60 days delinquent at any time, that loan was coded as a "60-day delinquency" and is not included in the 30-day delinquency categories.

In contrast, more recent loans are not seasoned enough to experience delinquency problems. Loan delinquencies by credit scores and loan maturity are presented in Figure 11.

Figure 11: Performance of SHCA Loans by Credit Scores and Maturity

	No Delinquency	30-Day Delinquency Only Once	30-Day Delinquency > Once	60-Day Delinquency	90-Day Delinquency
<=620 credit scores					
Originated 0-24 months ago	285 (77.0)	25 (6.7)	18 (4.9)	18 (4.9)	24 (6.5)
Originated 25-48 months ago	301 (68.5)	67 (15.3)	36 (8.2)	17 (3.9)	18 (4.1)
Originated 49+ months ago	91 (62.8)	27 (18.6)	13 (9.0)	5 (3.4)	9 (6.2)
621-660 credit scores					
0riginated 0-24 months ago	358 (84.4)	31 (7.3)	21 (5.0)	10 (2.4)	4 (.9)
Originated 25-48 months ago	520 (81.6)	42 (6.6)	46 (7.2)	10 (1.6)	19 (3.0)
Originated 49+ months ago	79 (82.3)	6 (6.2)	2 (2.1)	2 (2.1)	7 (7.3)
>660 credit scores					
0riginated 0-24 months ago	946 (95.2)	29 (2.9)	8 (.8)	6 (.6)	5 (.5)
Originated 25-48 months ago	1,251 (93.8)	41 (3.1)	19 (1.4)	7 (.5)	16 (1.2)
Originated 49+ months ago	254 (97.3)	3 (1.1)	2 (.8)	0 (0)	2 (.8)

Numbers in parentheses are row percentages. Differences among seasons within each credit category are statistically significant ($p<.05$), except for credit scores >660.

In relative terms, loans with lower scores are more likely to have experience delinquencies at least once, regardless of seasoning. Among loans with scores less or equal to 620, seasoning is associated with higher delinquencies. Loans with higher scores do not present this pattern regardless of seasoning. While almost eight in 10 borrowers with low score loans originated within the last 24 months never had a delinquency, only about six in 10 borrowers with low score loans originated more than 48 months ago had none. This compared unfavorably with loans with intermediate scores (621–660) and with higher sores (>660). About 8 of 10 borrowers with loans with scores between 621–660 originated more than 48 months ago had no delinquencies, and almost 10 in 10 borrowers with similarly seasoned loans with scores greater than 660 had no delinquencies.

A different picture emerges when we look at the performance of low-scored loans in absolute terms. Regardless of maturity, approximately 90 percent of loans with scores at or below 620 and 95 percent of loans with scores between 620 and 660 were never delinquent either 60 or 90 days over the most recent two-year period. This suggests that the vast majority of borrowers with low credit scores are in fact good credit risks.

Layering of Risks. To examine the belief that layering of risk factors makes affordable products particularly risky, we examine delinquencies by layering of risk factors (Figure

12).[14] When we examine delinquencies for borrowers with credit scores less than or equal to 620, we find that about three in four borrowers have never been delinquent (70.1 percent). When the other three risk factors are layered, presumably, we have the highest risk loans. These are loans with scores less than or equal to 620, LTVs equal to or greater than 98 percent, back end ratios greater than or equal to 39 percent, and no reserves. These loans are only marginally riskier than low credit score only loans. About 66 percent of these highest risk loans have never been delinquent over the most recent 24-month period. We find similar patterns when we examine delinquencies by layering of risk for loans with scores between 621–660. Additional analyses were undertaken to assess the marginal impact on delinquencies of the layering of different combinations of risk factors (not presented here). Tests of statistical significance show that none of the other three risk factors adds to the power of credit scores in predicting delinquencies.

Figure 12: Performance of SHCA Loans by Layering of Risks

Risk Factors	No Delinquency	30-Day Delinquency Only Once	Other
<=620 credit scores only	220 (70.1)	48 (15.3)	46 (14.6)
<=620 credit scores plus no reserves plus back-end >=39%	94 (65.7)	17 (11.9)	32 (22.4)
<=620 credit scores plus LTV > 98% plus no reserves plus back-end >=39%	35 (66.0)	9 (17.0)	9 (17.0)
621-660 credit scores only	288 (83.7)	19 (5.5)	37 (10.8)
621-660 credit scores plus no reserves plus back-end >=39%	108 (81.2)	11 (8.3)	14 (10.5)
621-660 credit scores plus LTV >= 98% plus no reserves plus back-end >= 39%	83 (80.7)	6 (5.8)	14 (13.5)

Numbers in parentheses are row percentages. Based on the results of ordered and polytomous logistic regression models (not reported), after controlling for credit scores, no risk factors, including their interactions, were statistically significantly associated with delinquency ($p<.05$).

IV. Conclusion

In this paper, we compared and contrasted community lending products. Because of their stated goal, we also examined whether these products are likely to expand homeownership opportunities to underserved populations and we undertook a preliminary analysis of the

[14] We examined different combinations of layering of risk factors and, after controlling for credit score, we found no substantive differences with regard to delinquencies. In Figure 12, we present a couple of representative examples.

performance of these affordable loans. We used loan level data from a sample of community lending products purchased by Self-Help as part of its Community Advantage program (a joint effort between Self-Help, the Ford Foundation, and Fannie Mae), that aims at providing a secondary market outlet for CRA products. The use of loan level data addressed a key limitation of prior work.

It should be noted that the loans purchased by Self-Help as part of its Community Advantage demonstration are not a random sample of all affordable loans made by portfolio lenders. Loans must meet certain requirements (seasoning and otherwise) to qualify for purchase. This limits the generality of the findings. The generality of the analysis will be augmented when performance information from a control group is added in the future.

Consistent with prior work (Listokin et al. 2000), we find that community lending products permit housing expense-to-income (front-end) and debt service-to-income (back-end) ratios exceeding GSE's (Fannie Mae's) affordable guidelines. SHCA products allow non-traditional credit and employment histories, avoiding reliance on the formulaic credit scores used to underwrite conventional loan products. While each of those factors, considered individually, may address the needs of a specific borrower, layering of risk factors may be necessary to help those with multiple deficiencies. In general, Fannie Mae products avoid risk layering (liberalizing few underwriting guidelines at a time), while SHCA products are more likely to allow such layering (liberalizing more guidelines at a time).

With regard to expansion of homeownership opportunities to underserved populations, the results suggest that more could be done to liberalize underwriting. Within the universe of SHCA loans to date, we find that first-time homebuyers are more likely to have high credit scores and to be required to have r0eserved than non-first-time homebuyers. We do find that first-time homebuyers have loans with slightly higher LTVs than other borrowers. However, only one in four loans with LTV >= 100 percent was made to a first-time homebuyer. If the relationships uncovered in the study hold for the broader affordable market, industry participants may be focusing their homeownership promotion efforts based on flexible underwriting only on a narrow portion of the underserved market.

With regard to performance, except for credit scores, we find no clear association between the presence of risk factors and delinquencies. High LTV loans (>=98 percent), high back end ratio loans (>=39 percent), and loans with no cash reserves show no significantly different patterns of delinquency than loans without these risk factors. With regard to credit scores, we find a statistically significant pattern: the lower the credit scores, the higher the likelihood of a delinquency occurring. However, even for loans with scores at or below 620, more than seven in 10 borrowers were never delinquent over the most recent 24-month

period. Moreover, an additional 12.5 percent of borrower (more than one in 10) were 30-day delinquent only once over the same period.

When risk factors are layered, we find that the presence of the other three risk factors does not add substantively or significantly to the predictive power of credit powers in identifying future delinquencies. This is the case for loans with scores less than or equal to 620 and for scores between 621 and 660. To date, the performance of SHCA loans counters the belief in the industry that the layering of risk factors increases delinquency significantly.

We caution the reader against using the results for lending decision purposes. This is a preliminary analysis of information from a data collection effort that won't be completed for a few years. Most of the information used comes from portfolio loan purchases and not from the flow purchases that are expected to constitute the bulk of SHCA transactions. Thus, it is too early in the evaluation to conduct a definite analysis.

Finally, the findings are open to interpretation without the additional information to be generated in the course of the study. Some may read in the findings that the use of credit scores for underwriting purposes is warranted because its significant inverse relationship with delinquencies. Credit scores can predict that almost three of 10 borrowers with scores below 620 will have at least one 30-day delinquency over a 24-month period while nearly 0 in 10 borrowers with scores above 720 will have such a delinquency.. Others may say that despite the predictive power of credit scores, more than seven of 10 borrowers with the lowest credit scores were never delinquent, and yet credit scores cannot identify them. Still others may state that delinquency is not a real problem, that the real problem is default and foreclosures.

Future activities will address these issues. A central goal of the study is to develop a mechanism to identify the three of 10 likely to experience delinquency. This will be done by combining loan-servicing data with data from a longitudinal survey of mortgage borrowers (treatment and control groups). In addition, we will do case studies of servicers, lenders, and others to understand the true costs of delinquencies and defaults.

The GSEs' affordable products are widely available. The GSEs have been very successful in extending credit to nontraditional borrowers using technology, homeownership education and outreach. However, if the GSE affordable market is to continue to expand, the GSEs need to expand the definition of who qualifies for a loan. This requires the development and mainstreaming of new affordable and more flexible products. These products must offer a different mixed of underwriting requirements than is currently available from the GSEs. The GSEs are pilot testing emerging products with the hope to mainstream them one day. However, these products are limited in number and not as aggressive as many community lending portfolio products. Self-Help's Community

Advantage ™ (SHCA) allows Fannie Mae to test the performance of several very aggressive portfolio products by sharing the risk with Self-Help. Future research will examine whether loans underwritten with such flexible guidelines can be made prudently.

Although outside the scope of our long-term study, the almost exclusive reliance on financial innovation to expand homeownership opportunities to nontraditional homebuyers needs to be re-examined. Without an adequate supply of appropriately priced homes in viable neighborhoods, the full promise of affordable lending is likely to remain unfulfilled.

References

Board of Governors of the Federal Reserve System. "Report to the Congress on Community Development Lending by Depository Institutions." Washington, DC: Government Printing Office, 1993.

Listokin, David; Elvin Wyly, Larry Keating, Khristopher M. Rengert, and Barbara Listokin. "Innovative Strategies to Expand Lending to Traditionally Underserved Populations. Approaches and Case Studies." Rutgers—The State University of New Jersey: Center for Urban Policy Research, March 2000.

Litan, Robert E.; Nicolas P. Retsinas; Eric S. Belsky; Susan White Haag. "The Community Reinvestment Act After Financial Modernization: A Baseline Report." Joint Center for Housing Studies of Harvard University, April 2000.

McCarthy, George W., and Roberto G. Quercia. "Bridging the Gap Between Supply and Demand: The Evolution of the Homeownership Counseling Industry." Washington, DC: Research Institute for Housing America, 2000.

National Community Reinvestment Coalition (NCRC). "Home Mortgage Data Reveals Growth in Lending to Minorities and Lower Income, but More Data Needed on Subprime Lending." Press Release, 2000.

"The Performance and Profitability of CRA-Related Lending." Board of Governors of the Federal Reserve System, mimeographed, July 17, 2000.

Quercia, Roberto G. "Assessing the Performance of Affordable Loans: Implications for Research and Policy," *Journal of Planning Literature* 14, no.1 (1999): 16-26.

Stegman, Michael A., Roberto G. Quercia, and George W. McCarthy. "Housing America's Working Families." *New Century Housing* 1, no.1 (2000). Washington, DC: The Center for Housing Policy.

Stein, Eric and Martin Eackes. "Achieving the American Dream: Increasing Homeownership Through a No-Interest Second Mortgage Tax Credit." *Backgrounder*, Progressive Policy Institute, April 1, 2000.

Temkin, Kenneth, Roberto G. Quercia, and George C. Galster. "The Impacts of Secondary Mortgage Market Guidelines on Affordable and Fair Lending." *Review of Black Political Economy* 11, no. 2 (2000).

U.S. Department of Housing and Urban Development. 2000. http://www.hud.gov/pressrel/pr00-311.html. Access 10/31/00.