The Role of Lending Practices on the 2007 Foreclosure Crisis: Evidence from Indiana and Ohio

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Abstract: The goal of this paper is to understand the role of loan approval decisions and interest rates on mortgage defaults. Our analysis also attempts to understand the characteristics of "unqualified borrowers" that were extended credit before the foreclosure crisis. We identify the effect of lending practices of mortgage lenders on mortgage defaults by exploiting the variation in foreclosure rates across counties in Indiana and Ohio. The foreclosure rates are calculated using data from different sources of foreclosure listings. We obtain the loan approval/denial decisions and loan characteristics from the 2006 Home Mortgage Disclosure Act (HMDA) data. Our findings show that the counties that have higher loan approvals and positive interest rate spread have higher foreclosure rates. However, high loan-to-income ratio and the magnitude of the interest rate spread do not affect foreclosure rates.

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