CRL Response to September 15, 2004 NHEMA Report "Analysis of 1st Quarter 2004 Mortgage Lending in New Jersey and Pennsylvania"

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On September 15th, 2004, the National Home Equity Mortgage Association (NHEMA) released a report by Professors Richard DeMong and Richard Netemeyer of the University of Virginia that asserts that New Jersey's Homeownership Protection Act of 2002 has decreased access to credit for non-prime borrowers in the state. The authors assert that non-prime lending was lower and comprised a smaller share of the total mortgage market in New Jersey than in Pennsylvania. In addition, the authors claim that borrowers in New Jersey had, on average, higher incomes and FICO scores than Pennsylvania borrowers. Based on these findings, the authors conclude that the Homeownership Protection Act impaired access to credit for New Jersey borrowers.

This research is seriously flawed. Like other industry-sponsored research on the impact of state anti-predatory lending laws, the findings from NHEMA's latest report are based on questionable data and a deficient research methodology. Specifically, The NHEMA study relies on a small (and potentially biased) sample of lenders and inexplicably limits the analysis to one comparison state, Pennsylvania. In addition, the authors attribute all observed differences between Pennsylvania and New Jersey to the New Jersey Law, disregarding any differences in baseline lending activity, the demographic characteristics of the two states, or trends in other economic or market conditions. Finally, the study provides no information on changes in the terms of credit in New Jersey since the enactment of the Homeownership Protection Act and, therefore, does not address whether the law has in fact decreased abusive lending practices.

These problems are examined in greater detail, below.

Data

NHEMA's findings are based on the lending activity of six mortgage lenders in New Jersey and Pennsylvania. However, although the authors assert that these six lenders account for more than 34 percent of the subprime market nationally and are "very active in the New Jersey and Pennsylvania market", they provide no information on: 1) why the analysis was limited to such a small sample of lenders; 2) how these lenders were chosen; or 3) the market share of these lenders in these two states. As a result of the exclusion of such information, independent verification of the study's results (or identification of potential biases) is impossible.

Methodology

Even if the data were comprehensive and verifiable, the research methodology used in the report is seriously impaired, due to a limited comparison group, omission of pre-law analysis, questionable units of analysis and lack of appropriate market controls. These flaws are discussed below.

Comparison Group

The study limits its analysis to a comparison of lending in New Jersey to lending in Pennsylvania. However, the authors give no justification for why the comparison was limited to just one state or why Pennsylvania was deemed the most appropriate state to serve as a benchmark for New Jersey.

Time Frame

Perhaps the biggest problem with the study's methodology is its sole reliance on data from the first quarter of 2004 to evaluate the impact of the New Jersey law. Specifically, the study cites the higher market share of prime loan originations in New Jersey (79 percent of all 1st mortgages in the first quarter of 2004) than in Pennsylvania (72 percent), the higher average incomes of New Jersey borrowers ($71,934 vs. $56,755) and the higher average FICO scores of New Jersey borrowers (621 vs 614) as evidence that the New Jersey anti-predatory lending law has constrained credit access to non-prime borrowers. Merely comparing post-law lending activity is entirely insufficient for estimating the impact of a law because it disregards conditions prior to the law's enactment. For example, suppose prior to the law prime loans comprised 79 percent of all first mortgage originations in New Jersey while prime loans comprised 72 percent of all originations in Pennsylvania—shares identical to the post-law period observed in the study. If this were the case, the relative nonprime market shares would have been unaffected by the state law. The same criticism holds true for the authors' analysis of borrower characteristics, namely FICO scores and income levels. Without having comparable baseline data on New Jersey and Pennsylvania prior to the law's effective date, it is impossible to assess the law's impact on credit access.

Units of Analysis

The report uses nonprime market share, first mortgage originations, and average income and FICO scores to evaluate the impact of the New Jersey Law. These units of analyses are inadequate for the reasons listed below.

Nonprime Market Share

The authors rely heavily on the subprime market share of the total mortgage market to compare access to credit across the two states. However, it is unclear why this unit of analysis appropriately measures the impact of the New Jersey law. The lower subprime share of the total mortgage market in New Jersey could be the result of restricted access to subprime credit, as the authors assert, or it could be the result of fewer prime credit-worthy borrowers being steered into subprime prime loans, which would be evidence of the New Jersey law's effectiveness.

First Mortgage Originations

The authors point to the fact that, during the first quarter of 2004, there were more than three times as many first mortgages originated in Pennsylvania as in New Jersey. Aside from the fact that, as stated earlier, such measures are virtually meaningless without pre-law benchmarks or a sense of the market share of the sample lenders, there is no explanation of why the authors only looked at first mortgages, since the New Jersey law applies to all mortgage loans.

Average Income and FICO Scores

The study also cites higher average income levels and FICO scores of New Jersey borrowers than those of Pennsylvania borrowers as evidence that it is more difficult to secure credit in New Jersey since the passage of the law. However, even if pre-law levels were included in the analysis, average FICO scores and incomes for all first mortgage borrowers are poor units of analysis from which to draw such a conclusion. As the authors note, New Jersey has a higher share of prime borrowers than Pennsylvania. Consequently, we would expect average incomes and FICO scores of borrowers to be higher in New Jersey. Secondly, New Jersey residents have higher average incomes than Pennsylvania residents and we would expect this to be reflected in the average incomes of borrowers. Therefore, at a minimum, comparisons of the demographics of borrowers between two states should be analyzed separately for prime and subprime borrowers, should be normalized based on statewide demographics, and should be analyzed both pre- and post-law enactment.

Lack of Control Data

The study attributes all differences between New Jersey and Pennsylvania to the New Jersey Home Ownership Security Act without even attempting to control for differences economic or other market conditions. As mentioned above, analyzing post-law data without any regard for pre-law conditions renders any conclusions about the law's impact meaningless. However, even "difference-in-difference" analyses where changes in variables (such as subprime originations, average subprime FICO scores and/or average subprime income levels) in New Jersey pre- vs. post-law are compared to the changes in Pennsylvania over the same time period, would probably be an inadequate methodology for measuring the impact of the New Jersey law because such analyses assume that all other factors either remained constant or changed to the same degree across the two states. This assumption is probably invalid, as New Jersey and Pennsylvania likely experienced different trends in factors such as unemployment and housing prices.

Conclusion

DeMong and Netemeyer, on behalf of NHEMA, claim their findings "confirm the drop in lending in New Jersey" resulting from the Homeownership Protection Act. However, they never actually show a decrease in the amount of lending in New Jersey since the law's enactment. Their report simply compares the lending activity of a handful of lenders in New Jersey to their lending in Pennsylvania during one quarter after the law's enactment. Even with this limited data, they do not provide any compelling evidence that the New Jersey law impaired access to credit in that state.