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The Use of Social Capital in Borrower Decision-Making

Cassi L. Pittman

Fellowship Program for Emerging Leaders in Community and Economic Development

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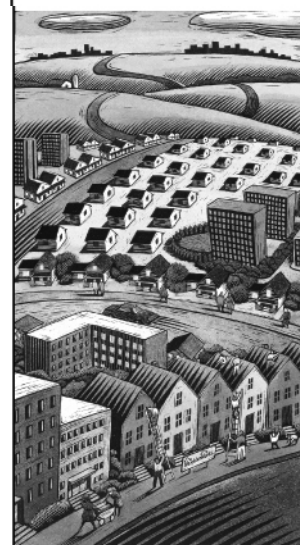
Joint Center for Housing Studies
of Harvard University



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Harvard Joint Center for Housing Studies
Harvard University
1033 Massachusetts Avenue, 5th Floor
Cambridge, MA 02138
(617) 495-7908
www.jchs.harvard.edu

NeighborWorks® America
1325 G Street, NW, Suite 800
Washington, DC 20005
(202) 220-2300
www.nw.org

About the Author

Cassi Pittman is a doctoral student at Harvard University in the Multidisciplinary program in Inequality and Social Policy, working toward a Ph.D. in Sociology and Social Policy. She is a graduate of University of Pennsylvania, with a Bachelors of Arts in Sociology and Urban Studies. Her research interests include housing, racial residential patterns, and racial inequality using both qualitative and quantitative methods.

Abstract

By looking beyond the financial characteristics of borrowers, this research brings to light the social factors that influence a borrower's choice of a lender and mortgage product. Previous research has indicated that distinct channels exist that funnel borrowers into lower or higher cost loan products (Apgar, Bendimerad, and Essene 2007). But little is known as to how borrowers seek out or are directed to such channels. A particular concern that this paper hopes to address is why black borrowers disproportionately have higher priced products. Some research indicates that even when credit worthiness is controlled for, blacks are overrepresented in the subprime sector and in higher-cost products (Bocian, Ernst, and Li 2006). Through in-depth interviews with 32 borrowers, this research (1) highlights how borrowers seek mortgage credit and evaluate their mortgage options, and (2) demonstrates how borrowers make use of their social networks (friends and family) when making their decisions.

The preliminary findings indicate that borrowers' preferences and subsequent demands for mortgage products were shaped by the informal and formal advice they received. Those borrowers who consulted the most diverse sources of information had loans with lower interest rates. Those borrowers who received advice only from family and friends did not fare as well as those who received help from credit counselors. Thus, arguably, their loan outcomes varied not just based on if they consulted others, but especially whom they consulted. When given the right advice, potential homebuyers make better decisions in choosing both a lender and a loan.

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1.0 Executive Summary

For consumers, the purchase of a home represents the single largest purchase they will make in their lives. For most Americans, their home is their largest asset and can only be acquired by using a 30-year fixed-rate mortgage. Consequently, how consumers seek and obtain mortgage credit has tremendous implications for their ability to sustain homeownership and generate wealth. When borrowers make poor decisions regarding to their mortgages, it can cost them thousands of additional dollars in interest while exposing them to an elevated risk of foreclosure, thereby reducing the economic and social benefits associated with home-ownership. Yet virtually no empirical research has examined how individuals reach a decision about the appropriateness of a mortgage product given their financial circumstances.

This paper examines the demand side of the mortgage market. Through in-depth interviews with a small sample of borrowers, I test and further expand on hypotheses drawn from social capital theory, investigating the process that homebuyers undergo when purchasing a home and examining the influential factors that affect their decision and subsequent loan outcomes. In concurrence with previous research that suggests that some borrowers end up in the sub-prime sector not because of the risk they present but because of their "demographic characteristics, knowledge, and financial sophistication" (Lax *et al.* 2004), this research additionally explores how social networks influence borrowers' choice of lender and loan product.

The paper is organized in five sections. In the first section, social capital theory is applied and discussed in reference to previous research on borrower behavior in the mortgage market. In the second section, the transactional environment borrowers face is discussed and an overview of previous research on borrower behavior is presented. Previous research on the significance of the channel of mortgage origination to loan outcomes, how borrowers shop for a mortgage, and the usefulness of federally mandated disclosure forms is reviewed. In the third section, the study design and preliminary results, as well as the study's limitations, are presented. The economic and social context of the mortgage marketplace in Atlanta, the site where the research was conducted, is described. In the fourth section, the implications of this research for policy and suggestions for future research are discussed. The last section presents concluding thoughts.

Arguably, access and mobilization of social capital in the search for mortgage credit can prove beneficial for borrowers seeking mortgage financing in three ways.

(1) Informing borrowers of their options and guiding their decision.
(2) Distilling complex information presented by mortgage industry professionals.
(3) Directly determining their course of action.

Borrowers do not choose a mortgage in a marketplace where there is perfect information. Most borrowers are not rational actors, deciding on a mortgage product only on the basis of cost. Rather access to and use of social capital, defined as resources "embedded in a social structure" utilized in "purposive action" (Lin 2001), play a role in borrowers' decisions.

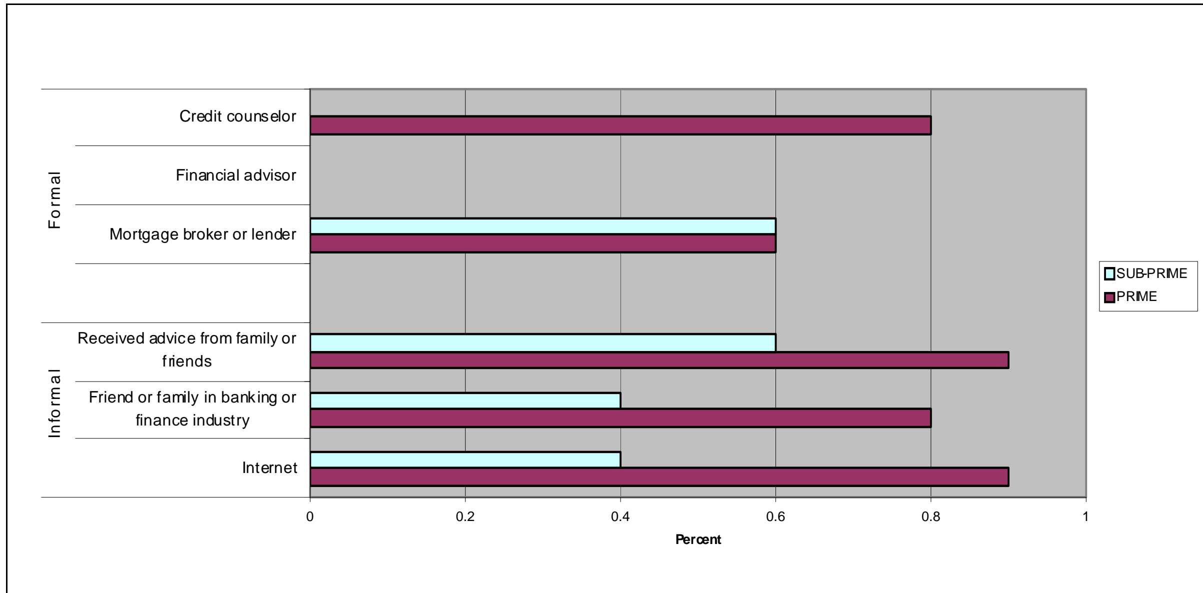
Obtaining a mortgage in today's mortgage market is a complicated process. When reaching a decision on a home loan, borrowers might feel compelled to use their social networks for information and guidance. Loan products have become increasingly complex. Federally mandated mortgage disclosure forms, instituted to display the cost of the mortgage transaction and to prevent "the uninformed use of credit," have been found to poorly convey the true cost of borrowing. Even with the help of a mortgage professional, finding a mortgage can be an overwhelming ordeal as "many consumers experience information overload"(Lee and Hogarth 1999). Given the amount of time and energy required to adequately understand and evaluate various loan options, it can be expected that borrowers will make use of others in their social networks for recommendations (Chang 2005).

For black borrowers, equipping oneself with the knowledge of the mortgage lending process may safeguard one against the chance of being wrongly relegated to the subprime sector. A well-informed consumer not only is aware of available loans, but may pursue an alternative course of action such as waiting on the purchase of a home until he or she qualifies for a better rate or negotiating better loan terms. Access to and use of social capital influences the degree to which borrowers make informed decisions.

This research focuses exclusively on black borrowers' search for and obtaining of mortgage financing. An examination of the experiences of black borrowers is particularly important because previous quantitative research has not been successful in identifying the causes of racially divergent lending patterns. In cities across the country, black borrowers account for a disproportionately larger share of high-cost, subprime loans. Research has consistently found that race remains a significant predictor of an individual's likelihood of receiving a subprime loan, even when other variables such as debt burden, credit history, employment stability, housing market conditions and neighborhood factors are controlled (NCRC 2003; Wyly et al. 2006; Bocian, Ernst and Li 2006). Audit studies have also found that white prospective borrowers "received more advice, recommendations, and follow-up contacts from the loan officers" (Williams et al. 2005).

While additional research on the pervasiveness of discrimination and its implications for the final price black borrowers pay for a mortgage loan is sorely needed, this paper takes a different approach. By comparing experiences within the black population, it examines how use of social capital plays a role in those instances when black borrowers secure mortgage credit at differing rates. Audit studies have demonstrated that the information loan officers provide informally to whites gives them an advantage in the mortgage marketplace (Williams et al. 2005). This supports the hypothesis presented in this paper that underlying social interactions affect the transactional environment borrowers face, including borrowers' decisions on both their lender and their loan. Personal narratives reveal how blacks navigate the mortgage marketplace. A qualitative analysis allows for theory testing and further theoretical development.

Figure 1. Sources and Uses of Information by Black Borrowers Seeking Mortgage Credit (by lender type: subprime or prime)



This research suggests that borrowers do in fact make use of their social capital to gain information when making their decision to borrow and when choosing a lender. In general, the pattern emerged indicating that prime borrowers had been more proactive in their search for information, consulting both members of their social networks and other sources of information, including the Internet and paid professionals. They also were more likely to have friends and family members who worked in the banking and finance industry. Borrowers with prime-rate loans also had more frequently been referred to their loan originator by someone they knew.

Housing counselors were instrumental in educating consumers about their options and what to expect throughout the process. They instructed borrowers on how to negotiate a better rate and what questions to ask their lender. Family and friends, too, helped borrowers navigate the process. When borrowers asked friends or family for advice, they often intended to ensure that the information that they were being told was accurate. If they were quoted a rate, they often asked others to verify that the rate was "good." While it is imperative for borrowers to be educated consumers, this is less important than having someone steer them in the right direction. Housing counselors often played a critical role not only in educating consumers, but also in referring them to trustworthy loan officers.

Researchers and practitioners must move beyond thinking of homebuying as a merely economic decision, and realize that important social factors play into an individual's choice of both a lender and a loan product. Often, when left to their own devices, borrowers make less-than-optimal decisions. Yet when given the right advice, potential homebuyers make better decisions, improve their financial circumstances, and are in a better position to sustain homeownership.

2.0 Applying a Social Capital Framework

Sociologists view the market in social terms and have demonstrated that social capital significantly influences economic outcomes. Social capital can be defined as the aspects of social organization that enable and improve the efficiency of both individual and collective action. Most research on social capital has been applied in a limited way to educational attainment and labor market outcomes. There is, however, some research that examines the allocation of financial credit and financial decision-making that has demonstrated that social networks and capital are consequential. In his research on capital markets, Brian Uzzi, an economic sociologist, found that firms' relationships with financial institutions influence the dispersal and pricing of financial capital (1999). Uzzi concludes that the use and maintenance of diverse social network ties produces informational benefits for both firms and lending institutions, which subsequently reduces the rates at which firms receive financial capital (1999). Similarly, economists Duflo and Saez have demonstrated that social capital and social learning affect the extent to which individuals enroll and contribute to retirement plans (2003). Using an experimental design, they show that individuals make critical financial decisions based on the actions of those around them, essentially demonstrating that social learning — when individuals learn from or mimic a behavior exhibited by others in a group — significantly affects important, long-term financial decisions. Lastly, research by Mariko Chang has demonstrated that their social networks are important conduits of financial information for most people (2005).

Social capital theory has never explicitly been applied to the domain of borrower decision-making in the mortgage market. However, research on the transactional environment suggests that there is fertile ground for asserting a social capital story. For instance, respondents in a Federal Trade Commission study were found to base their decisions on social relations rather than reviewing disclosure forms. Researchers at the FTC found that borrowers made decisions "primarily on the reputation of the lenders, their trust in the loan originators, or the recommendations of friends, rather than carefully reading and understanding their loan disclosures themselves to learn the cost and terms of their loans, and to ensure that the features of the loans fit their needs and circumstances" (Lacko and Pappalardo 2007). Similarly, a nationally representative survey of borrowers conducted by Fannie Mae under the direction of Vada Hill found that "[a] trusted advisor is extremely important to African Americans" and that "trusted advisors are more important than other factors such as the lowest APR (annual percentage rate) available for a home mortgage" (Hill 2005).

Social capital and network theory is premised on the idea that individuals maintain relationships that have an effect on the opportunity structure and transactional environment they face. For borrowers, social capital can affect the transaction environment they face both indirectly and directly, in three main ways.

Table 2. Potential Effects of Social Capital Use on Borrowers' Decision Making

Indirect Effects	Direct Effects
• Information and Guidance • Filter of Complex Information	• Loan Outcomes

Firstly, borrowers' decisions are influenced indirectly by the informational benefits supplied by their social network. Borrowers' social networks provide them with crucial and protective tools by means of information flows, which inform them of their options and enable them to thoughtfully evaluate the advantages and disadvantages of a particular loan product. Borrowers with access to social resources are able to draw upon others for informational benefits, in terms of financial advice and guidance, to ensure that they receive the best available loan terms. Additionally, they may be advised on how to improve their credit standing to qualify for financing at lower interest rates. Hence, individuals could be buffered from being inappropriately channeled into higher-cost loans or the subprime segment of the market if and when they could qualify for loans at lower or prime rates.

Secondly, borrowers' social network may serve as a filter of complex information. Social learning helps borrowers to distill information provided by loan officers or mortgage brokers when making the decision to take out a home loan. As Burt, a social network theorist, contends, "given the volume of information that anyone can process, the network is an important screening device" (1992). Even when the information provided by one's network is "fuzzy or inaccurate" it may "signal something to be looked into more carefully" (Burt 1992). In the subprime sector, it is difficult for borrowers to shop around and fully understand the terms of their mortgages, due to the complexity of loan products. This complexity, combined with information asymmetries, may increase borrowers' susceptibility to being sold disadvantageous loan products. Intermediaries, therefore, play a critical function by providing warnings of unwarranted fees and informing prospective borrowers of what costs are excessive.

Finally, borrowers' social ties may directly determine an their course of action. This occurs particularly when individuals are steered into a loan product, whether appropriate or inappropriate given their financial circumstances. When individuals rely on intermediaries, they may simply consent to mortgage product based upon the recommendation of those they trust.

In all three instances I hypothesize that the use of social capital is consequential in terms of the information borrowers have available to them, affecting not only the decision-making process that borrowers undergo but also their loan outcomes.

There are limitations, nevertheless, that might restrict the use of social networks as a source of information and guidance with regard to borrowers' decisions on a lender and mortgage product. Borrowers may fail to seek information or utilize their social network for several reasons. First, they may lack ties, or access to the type of informational resources needed. A

network that provides a tremendous amount of social support may not be helpful when it comes to financial matters. Alternatively, a borrower's social network may be ill equipped to provide the type of information sought. Similarly, if the information provided by a borrower's family and friends is suspected to be of low quality and low accuracy, then he or she might be less inclined to call upon them. For example, if a borrower is the first in his or her family to own a home, it maybe of little use consulting family members about mortgage loan options. Lastly, even if a borrower's social network could provide information that is beneficial, some people are not comfortable discussing personal financial matters with those close to them (Chang 2005). People who regard their credit score, savings, level of debt, and home purchase price as private and sensitive information are unlikely to disclose that personal information to others, regardless of whether they are family and friends. Granted these limitations, some borrowers may choose to forfeit or restrict the use of their social networks.

3.0 The Transactional Environment Borrowers Face

A myriad of factors, from borrower behavior to the transactional environment, contribute to borrowers' imperfect decision-making. Subprime borrowers in particular face a transactional environment in which it is difficult to evaluate alternative options, and information asymmetries are pervasive. As loan products in the subprime sector are more complex, federally mandated disclosures are increasingly difficult to interpret. Borrowers, especially when they have or believe they have less than perfect credit, are often relegated to the subprime segment of the mortgage market. They often make this choice rather than exercising other, less costly, financing options, such as working to improve their credit or attempting to qualify for alternative types of loans such as those insured by the Federal Housing Administration[1]. Instead of rationally evaluating all alternatives and deciding on the option that renders the optimal result, it is more accurate to assume that borrowers "search for an action that is good enough" (March 1994).

3.1 Mortgage Channel

Research suggests that the channel through which borrowers initially seek mortgage credit influences their loan outcome. The borrowers whose loans are originated by locally oriented banks are a fifth as likely to be channeled into the subprime sector (Wyly *et al.* 2006). This is largely because most local banks and retail lenders specialize in originating low-cost prime loans (Apgar and Essene 2007). Relatively few lenders in the subprime sector conduct "direct-to-the-consumer" lending. Most of the top subprime lenders, half of which are subsidiaries or affiliate companies of major banks (Carr and Schuetz 2001), drum up their business through the use of correspondent lenders or brokers (Anshasy, Elliehausen and Shimazaki 2006). In today's market, mortgage brokers issue 65 percent of all loans (Anshasy, Elliehausen and Shimazaki 2006). Yet borrowers who utilize brokers may be more susceptible to receiving a subprime product. While brokers are increasingly used as an avenue to mortgage credit, borrowers are often unaware of how brokers are compensated, how that compensation structure affects the loan terms they are offered, and the long-term costs they pay as a consequence. Borrowers are unaware that brokers are not obligated to offer them a mortgage at the best available rate. Instead, most borrowers believe that brokers work for them, a mistaken assumption that results in many borrowers who "think they do not have to price shop because they are paying a broker or loan officer to do that for them" (Willis 2006). In actuality, mortgage brokers receive a commission for charging borrowers a higher interest rate. Almost all borrowers who utilize brokers pay a yield spread premium, which can be a lucrative source of income for mortgage brokers but results in higher interest rates for borrowers (Jackson 2002). Moreover, brokers receive additional compensation by adding prepayment penalties to borrowers' loan terms.[2]

[1] Interestingly, while the number of subprime loan originations was growing from 2001 to 2005, the number of FHA loans was decreasing.

[2] While virtually nonexistent in the prime sector, where fewer than 2 percent of borrowers have prepayment penalties, these are pervasive in the subprime sector, where nearly 80 percent of borrowers have loans with prepayment penalties (Goldstein and Son 2003). Subprime loans with prepayment penalties are twice as

Because of glaring information asymmetries, brokers have a great deal of discretion that they can use to either exploit or benefit borrowers. "Broker counseling" can significantly reduce the information costs expended by borrowers (Anshasy, Elliehausen and Shimazaki 2006). Nevertheless, there exists no mechanism by which consumers can discern brokers of different quality, or whether a broker is acting in their best interest. Brokers have no fiduciary duty and are therefore not legally responsible to act in the best interest of borrowers. Competition among brokers, arguably, could reduce the likelihood of borrowers being overcharged; as Anshasy, Elliehausen and Shimazaki note, "a broker quoting a higher price to receive a little more compensation risks receiving no compensation at all if the prospective borrower chooses a mortgage from a competitor" (2006). However, the effectiveness of competition limiting the degree to which borrowers are overcharged is contingent on the extent to which borrowers shop for the best available rate.

3.2 Shopping for a Mortgage

Shopping is assumed to facilitate optimal decision-making, as individuals who engage in shopping are thought to better evaluate their alternatives before reaching a final decision. Yet research indicates that this is not always the case. For less sophisticated borrowers, searching for alternative loan products may prove costly and inefficient, and does not ensure that one will get the best available rate (Lee and Hogarth 1999). Lee and Hogarth found that consumers who were refinancing were more likely to shop (1999). However, first-time homebuyers are a large share of the market, accounting for 26 percent of those purchasing newly built homes and 40 percent of those purchasing existing homes (Ivry 2007). Even for refinancers, information searches were beneficial only for those with "knowledge and experience" to be able to decipher the information obtained by contacting multiple brokers or lenders (Lee and Hogarth 1999).

Furthermore, in comparison to prime borrowers, subprime borrowers have a more challenging time comparing loan products. Carr and Kolluri cite an Urban Institute analyst who argued that the lack of standardization in underwriting guidelines in the subprime sector creates a great deal of variation regarding prevailing rates, making it difficult for borrowers to determine and subsequently "'shop' for the most favorable rates" (2001). Willis argues that subprime borrowers are more likely to consent to disadvantageous loans in part because subprime loans are highly individualized and have more complicated structures than prime loans, making them more difficult for borrowers to compare to other loans (Willis 2006).

Despite the greater difficulty in comparing loans in the subprime sector, prime and subprime borrowers do not differ in the degree to which they search for mortgage credit. A Federal

profitable for lenders as loans without them in the secondary market. In theory, subprime borrowers are more likely to refinance because they benefit even if interests rates do not change (if their credit improves and they qualify for a lower rate). Thus investors are willing to pay more for loans with prepayment penalties. Lenders consequently provide brokers with financial incentives to tack on prepayment penalties, often unnoticed by borrowers (www.mtgprofessor.com/A%20-%20Options/prepayment_penalty.htm). Furthermore, Lehman Brothers analyzed a database of 130,000 subprime loans and reported that just over half, 52.7 percent, of borrowers with prepayment penalties do prepay (Goldstein and Son 2003).

Trade Commission study found that within both groups there is a great deal of variance in borrowers' shopping behavior. There are both prime and subprime borrowers "who did not shop at all, who shopped a little, and who shopped extensively" (Lacko and Pappalardo 2007). However, subprime borrowers' motivations when seeking multiple options may differ.

Since subprime borrowers were more likely to be denied due to blemished credit history, they are more likely to contact multiple lenders out of necessity (Lacko and Pappalardo 2007). The primary goal of shopping then shifts from getting the best rate to simply getting approved. In the end, for subprime borrowers, shopping may not increase the amount of information they receive, facilitate a better choice of lender, or improve their chances of receiving a loan at a lower rate. Moreover, it does not matter if subprime borrowers have a greater or lesser propensity to engage in shopping if the information attained does not factor into their making a better decision with regard to their mortgage product.

3.3 Utility of Federally Mandated Disclosures

Federally mandated disclosures were instituted to avoid the uninformed use of credit. In order to ensure that consumers are presented with accurate information regarding the terms of their mortgage, federally mandated disclosures were intended to display the cost of the mortgage transaction to borrowers. However, research has indicated that disclosure forms poorly convey the true cost of mortgage loans to borrowers.

A Federal Trade Commission study of the effectiveness of current mortgage disclosure forms discovered that a large share of consumers did not know how to interpret the forms correctly (Lacko and Pappalardo 2007). When tested, most were unable to recognize the costs and terms of mortgages they were presented shown. Furthermore, "many consumers experience information overload from the disclosures" (Lee and Hogarth 1999). When compared, prime and subprime borrowers did not differ significantly on this point. Both were likely to have difficulty acquiring basic information about loan terms, such as the APR, the amount financed, and the computation of discount fees. In general the FTC study found that the more complex the loan, the greater difficulty borrowers have understanding the disclosure forms (Lacko and Pappalardo 2007). The utility of such disclosures is vastly reduced when information presented to consumers is not interpretable by them.

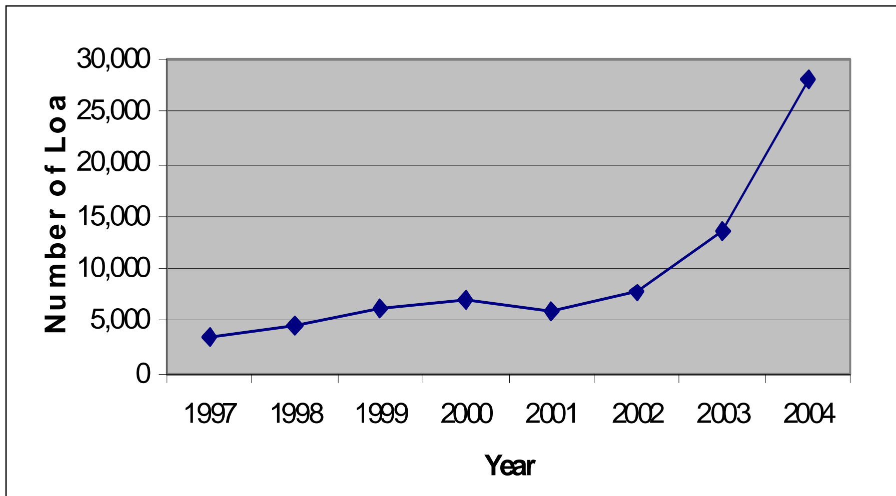
The consequences of making a poor decision are steep when it comes to choosing a mortgage. However, most borrowers, particularly in the subprime sector, face a complex and disadvantageous transactional environment. When borrowers do not understand the terms of their mortgage and the fees associated with the transaction, they are more likely to be victims of lending abuses and to be charged "fees that far exceeded what would be expected justified based on economic grounds" (U.S. Department of Housing and Urban Development and U.S. Department of Treasury Joint Report 2000).

4.0 Study Design and Findings

4.1 Setting the Stage: A Study of Mortgage Lending in Atlanta

A sprawling housing market with high levels of suburbanization, segregation, subprime lending and foreclosures make Atlanta an interesting city to study borrower behavior in the mortgage market. The city ranks fifth among all metropolitan areas in the U.S. in terms of the number of conventional home purchase loans issued by subprime lenders in 2004 (www.dataplace.org).

Figure 4.1.0. Conventional Purchase Mortgage Loans by Subprime Lenders for the Atlanta, GA, Metro Area, 1997–2004



Atlanta was the most segregated of all sunbelt cities and the fourth most segregated city in the U.S. in 1990 (Keating 2001). In addition to high levels of residential segregation, racial disparities in high-cost lending exist. High-cost loans are concentrated in predominately black neighborhoods in the Atlanta metro area.

A study conducted by HUD found that subprime loans are five times more likely to be made in black neighborhoods than in white neighborhoods in metro Atlanta (2000). Furthermore, homeowners who reside in black middle-class neighborhoods were nearly twice as likely as homeowners residing in low-income white neighborhoods to receive subprime loans (Kanell and Paul 2007). Among black moderate- to upper-income households, 44.2 percent of loans are high-cost (National Community Reinvestment Coalition 2007). According to a study released by the NCRC, moderate- to upper-income blacks are 3.14 times more likely to receive high-cost loans than moderate- to upper-income whites in Atlanta (2007).

Table 4.1.1. Racial Disparities in Rates of High-Cost Loans

MSA	% High-Cost Loans to Moderate- to Upper-Income African Americans	% High-Cost Loans to Moderate- to Upper-Income Whites	High-Cost Disparity Rate
Atlanta-Sandy Springs–Marietta, GA	44.2%	14.1%	3.14
Boston-Quincy, MA	49%	14.7%	3.33
Detroit-Livonia-Dearborn, MI	63.6%	25.3%	2.52
New York–White Plains–Wayne, NY-NJ	45.8%	19.6%	2.34

Source: "Income is No Shield Against Racial Differences in Lending." NCRC, July 2007.

When compared to other metropolitan areas, Atlanta leads the nation in the percentage of borrowers opting for adjustable-rate and interest-only mortgages loans (Downey 2006). In addition to high rates of subprime lending, Atlanta has experienced a dramatic increase in the number of foreclosures. Roughly one in ten homes with a mortgage in the Atlanta area has experienced severe delinquency, if not full foreclosure (Apgar and Duda 2005). Nearly one in five subprime mortgages in Georgia defaulted in the first quarter of 2007, a higher rate than the national rate of 13.5 percent (Kanell and Paul 2007). Unlike other areas of the country, however, Georgia has not seen as sharp a decline in house prices. In the first quarter of 2007, house prices in the Atlanta area actually increased (see Table 4.1.2).

Table 4.1.2. Freddie Mac Conventional Mortgage House Price Index

	Quarterly Change	Annualized Quarterly Change	Annual Change
	Q1 2007–Q2 2007	Q1 2007–Q2 2007	Q2 2006–Q2 2007
Atlanta-Sandy Springs–Marietta GA	0.56	2.25	3.79
Boston-Quincy MA MSAD	–1.49	–5.84	–2.38
Detroit-Livonia-Dearborn MI MSAD	–1.95	–7.57	–3.52
New York–Wayne-White Plains NY-NJ	–0.57	–2.26	2.40

Conventional Mortgage House Price Index, 2007 (all entries are in percent changes).
Note: Figure presents nominal, not real, price levels.
Source: Freddie Mac, www.freddiemac.com-finance-cmhpi-current-excel-msas.xls.

Nevertheless, when compared to the number of foreclosures in 2000, the number of foreclosures in 2006 represents a 200 percent increase (Atlanta Regional Commission 2007).

4.2 Study Design

In order to unveil the course of events that homebuyers undergo when searching for mortgage credit and to investigate how borrowers make use of social capital while engaging in the search for mortgage credit, I drew on qualitative data, collected through in-depth interviews with homeowners in the Atlanta metropolitan area. The sources of information consulted and

the sequence of interactions that prime and subprime borrowers underwent in order to procure a mortgage were analyzed.

All borrowers who participated were compensated with a $25 gift card to their choice of Target or Home Depot. In total, 33 interviews were completed with homebuyers, though two white borrowers were later dropped from the sample, for a total of 31 black households. Each interview ranged from 45 minutes to over one hour in length. Respondents were asked a series of questions that included open- and closed-ended questions. A range of subject matter was addressed in the interviews, but the questions could be organized along four major dimensions:

- Borrower Demographics
- Borrower Financial Characteristics
- Social Capital Variables
- Loan Terms and Structuring

4.2.1 Recruitment of Subjects

Homeowners were selected based on the criteria that they resided in owner-occupied homes in the Atlanta metropolitan area and were at least 18 years old. Additionally, interviewed homebuyers had to have purchased or refinanced in the last 10 years. Potential subjects were recruited in two ways. First, some respondents were sent recruitment materials in the mail. Public deed records maintained by the Georgia Superior Court Real Estate Deed Index that are available online were utilized to determine the names and addresses of potential subjects. These public deed records include the date the loan was issued, the company or bank that issued the loan, and the amount of the loan. Occasionally information about the borrower's marital status and various aspects of the loan structure and terms are also detailed in the deed. Additionally, whether a foreclosure has been issued is available as well. As hundreds of thousands of records exists, several criteria were used to select records (see appendix for more information on sample selection). In general records were utilized to determine the names and addresses of potential subjects who lived in census tracts in which subprime loans constitute 25 percent or more of all conventional mortgage loan originations. Census tracts were additionally selected based on their racial and income composition. Borrowers recruited in this manner constituted approximately 10 percent of the total sample.

The second method by which respondents were recruited was through referrals from credit counseling agencies (24 borrowers were referred by three different agencies), and referrals from the housing department of an Atlanta-based legal-aid organization (five borrowers). One borrower was recruited through snowball sampling.

To ensure that my analysis was multilevel, I also conducted a series of expert interviews to develop a fuller picture of borrowers' experience searching for mortgage loans, and to get a feel for the local mortgage industry and housing policy context. I spoke with mortgage brokers and loan officers (six in total) to gain their perspective on the services they provide to borrowers, in addition to how they differentiate borrowers and what types of borrowers opt

for different mortgage products. I also spoke with housing counselors who provide both prepurchase and postpurchase counseling as well as foreclosure-prevention counseling (four counselors from three agencies) and held a focus group of local housing counselors. The focus group was held to further elucidate what practitioners felt were factors contributing to high rates of foreclosure and the challenges they experience counseling homeowners (12 to 15 counselors were in attendance). Additionally, I spoke with several housing policy specialists, including a legal scholar, a legal aid housing attorney, a state councilman, and officials at the city and county levels. Lastly, I attended a public forum for practitioners in Atlanta on preserving homeownership and several educational seminars for housing counselors on credit counseling and credit scoring. I also attended seminars for consumers on preserving homeownership and being fiscally responsible.

4.2.2 Demographics of the Sample

Table 4.2.2. Demographics of Interview Subjects

Demographics	N =	Percent
Marital status:		
Married	7	21%
Widowed	2	6%
Separated	1	3%
Divorced	14	43%
Never married	9	27%
Total household income over the past 12 months:		
Less than $24,999	9	28%
$25,000 to $49,999	10	30%
$50,000 to $74,999	12	36%
$75,000 to $99,999	1	3%
$100,000 or more	0	0%
Not reported	1	3%
Gender:		
Male	8	24%
Female	26	76%
Race:		
Black	32	93%
White	2	7%
Age:		
Youngest	28 years	
Oldest	81 years	
Mean	49 years	
Median	53 years	

Highest level of education:		
Less than high school (grade 11 or less)	3	9%
High school diploma, GED or equivalent	5	15%
Technical or trade school	1	3%
Some college	8	23%
Associates degree or two-year degree	3	9%
Bachelors degree	6	18%
Some graduate training	1	3%
Graduate or professional degree	7	20%
Households with children under the age of 18	13	39%

Note: Total sample (N = 33 households, 34 individuals).

4.3 Limitations of the Study

The small sample size does not allow for statistical projections or generalizations, but does allow for theoretical testing and provides rich accounts of borrowers' experiences. The low response rate of subjects recruited through mailers resulted in a sizable portion of the sample being referred from credit counseling agencies (24 of the 33 households originally in the study). As a result, individuals in the sample had a greater likelihood of having sought credit counseling than would be expected for the population as a whole. Not all borrowers referred by credit counseling agencies had previously received prepurchase counseling. Several borrowers had experienced a period of difficulty paying their mortgage and were receiving counseling in order to get a loan modification agreement, or were seeking advice prior to refinancing. This allows for a unique comparison of individuals who received credit counseling at various stages of the process, against those who did not, as well as an examination of the role of credit counseling in borrowers' final decisions.

Black borrowers constituted nearly the entire sample (94 percent). However there was a great deal of diversity among the sample in terms of income, age and place of residence. Almost 13 percent of the black borrowers interviewed were of Caribbean descent (either first or second generation immigrants to the United States). Many of the respondents lived in census tracts that were racially mixed. Only 9 out of the final 31 households included in the study resided in majority black census tracts (census tracts that are more than 50 percent black). Several respondents (5 of the 9) who lived in neighborhoods that were predominately black, lived in solidly black middle-class neighborhoods. These neighborhoods had high median incomes (ranging from $57,059 to $74,986) and populations in which a minimum of 30 percent of individuals 25 and older had bachelors or graduate degrees.

By focusing nearly exclusively on the experiences of black borrowers, several possible explanations for why subprime loans are disproportionably concentrated in predominately black households and in predominately black neighborhoods could be ascertained. While the demographic make-up of the sample does not allow for comparisons across racial groups in terms of the experience of borrowers, it does bring to light that there is both a great deal of

diversity of experiences and some distinguishable patterns among the experiences of black borrowers.

4.4 Types of Borrowers

When compared to subprime borrowers, prime borrowers seemed to differ not only in their use of social capital, but also in terms of the availability of experts in their social circles. In general, a pattern emerged where prime borrowers were more proactive in their search for information, consulting both their social networks and as well as other sources of information, including the Internet and paid professionals. They also were more likely to have friends and family members who worked in the banking and finance industry.

In order to determine the influence of social capital on both borrower decision-making and loan outcomes, borrowers were grouped into three categories and their loan outcomes were compared. The first category was composed of borrowers who reported receiving no advice (borrowers who did not consulted anyone when arriving at a decision with regard to their mortgage) (N = 6), combined with those borrowers who consulted *only* a mortgage broker or lender (N = 3). The second category of borrowers were those who consulted some combination or at least one of the following: a friend, family member, religious official, neighbor, contractor/builder, or other person (N = 9). The last group of borrowers reported having consulted a private financial advisor or credit counselor (N = 12). While the experiences of borrowers in each category were diverse, noticeable patterns emerged in terms of their loan structures and outcomes.

4.4.1 Going It Alone: Solitary Decision-Makers

When left to their own devices, borrowers often made less-than-optimal decisions. When asked why they had not consulted family or friends when shopping for a mortgage, these borrowers often replied that they did not want to “bother anybody.” Borrowers who fell into this category were older adults and were longtime homeowners. The average age of borrowers in this category was 64, with the youngest borrower being 43 years old. Seven (of the nine) had lived in their homes for over ten years, three such borrowers having lived in their homes for 27, 30, and 38 years.

Solitary decision-makers were the most self-reliant, and they often made costly mistakes. Except for one person, all borrowers in this group had subprime products. Their loan structuring was typical of borrowers with subprime products: over two-thirds of borrowers in this category had adjustable-rate mortgages and only 2 of the 9 borrowers reported that their property taxes and insurance were included in their monthly mortgage payment. Six of the nine had refinanced three or more times over an average period of 7.6 years, severely reducing the equity held in their homes. These borrowers refinanced into subprime products rather than transitioning to prime rate loans, consistent with evidence from a survey conducted by Freddie Mac, which found that 60 percent of subprime borrowers refinanced into subprime loans (Courchane *et al.*).

Borrowers in this category were the most disadvantaged with regard to having friends or family members with expertise in banking or finance. Only two of the nine had a friend or family member working in the banking and finance industry. In addition to failing to consult friends or family members, few borrowers in this category sought information or assistance from other sources. While similar to other types of borrowers in consulting neither a pastor, minister or other religious official, nor their neighbors, these borrowers were unique in that they also failed to use the Internet to inform their decisions.

Lastly, borrowers in this group did not compare alternatives or engage in extensive shopping. Of the nine borrowers, only one contacted more than one lender. Three borrowers, more than any other category, responded to offers received in the mail. Several were completely reliant on their mortgage broker when choosing their loan. Among all types of borrowers, solitary decision-makers were the least informed.

The interest rates of borrowers in this category are reported in the table below. In terms of loan outcomes, borrowers in this category did not fare well; several were victims of abusive lending practices.

Table 4.4.1. Loan Outcomes of Solitary Decision-Makers (N = 9)

Loan Structure	Interest Rate	Type of Loan
2–28	16%*	Subprime
2–28	8.25% to 14.25%	Subprime
2–28	7.41% to 10.41%	Subprime
2–28	7.1% to 14.1%	Subprime
2–28	6.9% to 9.9%	Subprime
30	9.63%*	Subprime
ARM	5.5% to 10.5%*	Prime
80–20	Unreported	Subprime
Unreported	Unreported	Subprime

Notes: Information reported in this and subsequent borrower loan outcome tables was self-reported (indicated by *) by borrowers or taken from property deeds. A loan was determined to be subprime based on the U.S. Department of Housing and Urban Development (HUD) lists of specialized lenders. Three borrowers were not included in tables 4.4.1, 4.4.2 and 4.4.3 as they had not yet closed on their loans; however, their demographic information is included in the sample demographics table (4.2.2).

Larry McAdams's Story

Mr. McAdams purchased his current home, his first home, 17 years ago. A high-school graduate with a good union job, working as a conductor on the metro-rail line, he brings in around $63,000 a year. While 54 and divorced, his income alone makes him middle class in Atlanta. A proud father, he is devoted to his three daughters, the youngest of whom graduated from high

school in May. For him, being a father means being there when his girls need him. His love for his daughters drove him to a custody battle that cost him over $30,000. The bitter dispute was worth every penny in his eyes because gaining custody of his daughters meant they would be safe from maltreatment by their "unfit stepfather." But lawyers cost money. The mounting expenses drove Mr. McAdams to refinance his home.

At the time Mr. McAdams refinanced he went to just one mortgage company and did not speak to anybody about his decision. He did not use the Internet to search for options or to compare rates. His idea of his creditworthiness was based on whether he was approved: if he was approved, then his credit must be good. His monthly mortgage payments did not include property taxes or insurance, though he would have preferred this.

While he knew he was getting an adjustable-rate mortgage, the broker told him explicitly that he could refinance in just two years, as long as he paid on time. When two years came, Mr. McAdams went back to the mortgage company, but the broker he worked with was nowhere to be found. The manager told him that nothing could be done about his loan. As the interest rate on his loan continued to increase, keeping up with the payment and his other financial responsibilities put him in a position of financial strain. As he stated, "it got [to] where I couldn't afford it and pay my ex support and keep on living." Fortunately the mortgage broker had signed a letter promising Mr. McAdams that he would indeed refinance the loan after a period of two years. With the help of a lawyer and this letter, Mr. McAdams, in a rare instance, was able to work out a solution with his lender. However, the consequences of this troubling transaction don't end with the loan modification agreement. As Mr. McAdams expressed with regret, "they overappraised my house, that makes it double hard for me to sell my house now."

4.4.2 With the Help of Friends, Family, and Others

The second category of borrowers made use of their social networks by consulting a family member or friend. While these borrowers consulted their social networks, only four of the nine had friends or family members who worked in banking or finance. While none of these borrowers consulted a private financial advisor or credit counselor, five of the nine sought assistance from a mortgage broker. Given the lack of expertise within their personal networks, one might have expected these borrowers to have consulted alternative sources of information in addition to their personal networks. Yet these borrowers did not employ a more expansive search strategy. Only four of the nine made use of the Internet, and just four borrowers contacted more than one lender.

What is also surprising is that this group was exclusively composed of first-time homebuyers, who might be expected to compensate for their lack of experience by employing more rigorous searches. Nearly half of the borrowers in this group were purchasing their first home later in life; they ranged in age from 42 to 57 years. Many intended this to be their first and last home. When asked if they had intentions to move, seven of the nine stated that they had planned on living in their homes "forever," or "till I die," which contradicted the fact that five of nine had adjustable-rate mortgages, generally a product appropriate for borrowers with intentions to move before the full term of the loan is reached.

How did they fare in their loan choices when compared to solitary decision-makers? Only one of the nine borrowers in this category had a prime loan. This borrower consulted friends, family members, a mortgage broker and a contractor before deciding on his fixed-rate mortgage, which he received from a large regional bank. While several borrowers in this group had considerably better loan outcomes than solitary decision-makers, overall they did not perform as well as the next category of borrowers. See table 4.4.2 for details of their loan outcomes.

Table 4.4.2. Loan Outcomes of Borrowers Who Consulted Friends, Family and Others (N = 9)

Loan Structure	Interest Rate	Prime or Subprime
2–28	8.45% to 14.45%	Subprime
ARM	Unreported	Subprime
Option ARM	3.888% to 9.9%	Subprime
2–28	9.75% to 15.75%	Subprime
30	7.8%*	Unidentified
2–28	8.5% to 14.5%	Subprime
2–28	7.65% to 14.65%	Subprime
30	6.5%*	Prime
30	6%*	Unidentified

The Cheathams's Story

The Cheathams moved into their home just under two years ago. It was their first home, and Mr. Cheatham described it as a blessing from God. Having moved down south from New York City, they reveled in the simple joys that accompanied homeownership, like having a garage and a garden.

The Cheathams first found a house, then sought financing. They spent quite a bit of time searching for the perfect home. However, they spent considerably less time searching for a mortgage or attempting to understand the cost of obtaining mortgage credit. They used the Internet to find their home, but did not use it to search for a mortgage. Even the advice they sought from the one friend they consulted had more to do with finding a home than qualifying for financing.

Admittedly, they were "more concerned in getting approved at almost any cost" and thus they "just went along with what was available." They did not understand credit and believed their loan consultant, who told them that they qualified for only one loan option because of their credit history, despite their having a 686 FICO credit score. They felt very uncomfortable asking questions about the prospective loan, and when they did ask questions they were placed on hold, shuffled around, or told to call this person or that person, never getting a clear or direct answer. The terms of their loan were not explained to them until the closing, which is

particularly unfortunate because of the complexity of their loan product, an 80-20 ARM. They are now worried about losing their home, as the larger loan will reset in the next few months.

4.4.3 The Expert Advised/Credit Counseled

This category of borrowers consists of those who reported consulting a private financial advisor or credit counselor. While these borrowers turned to a financial expert, they also made use of their social networks. Every borrower in this category consulted a friend or family member. Eight were referred to the lender who originated their loan by a personal acquaintance. Eight of the ten had a friend or family member who worked in the banking and finance industry. Out of the three categories of borrowers, they were by far the most active in their search for information.

With regard to their loan outcomes, eight of the ten borrowers in this category had prime-rate loans (the other two lenders were not identified as either prime or subprime). All had fixed-rate products, generally with lower interest rates than the two previous categories of borrowers. See table 4.4.3 for details of their loan outcomes.

Table 4.4.3. Loan Outcomes for Expert Advised/Credit Counseled Borrowers
(N = 10)

Loan Structure	Interest Rate (percent)	Prime or Subprime
30	7.25%*	Prime
30	6.25%*	Prime
30	5.875%*	Prime
30	5.875%*	Unidentified
30	5.85%*	Prime
30	5.75%*	Prime
30	5.25%*	Prime
30	5%*	Unidentified
30	Unreported	Prime
30	Unreported	Prime

Gladys's Story

Sitting across from her, one immediately notices a sense of grace. Not a strand of hair on her head was out of place and her makeup was picture-perfect. It was hard to imagine that just a few years ago she was homeless. Having escaped an abusive marriage, Gladys lived in a homeless shelter until she got back on her feet. She unflinchingly mentions this part of her life when asked what motivated her to become a homeowner. She did not at any moment believe that homeownership was in her grasp. It was her social worker who suggested the idea of

buying a home. Considering what she was paying in rent, she could afford a monthly mortgage. Her social worker informed her of programs that would help her purchase a home. Not soon after, Gladys enrolled in a first-time homebuyer program, and with the help of counselors at a church-based housing counseling agency, she worked to improve her credit. The housing counselors directed her to a loan officer at a bank, a bank that she did not believe would lend to a "little person" like her. Even with the reassurance of the housing counselors she was still surprised to find that she was approved for a loan. The housing counselors were there every step of the way, even helping her understand the terms of her loan. In the end, homeownership has elicited a tremendous sense of personal accomplishment for Gladys.

4.5 A Tale of Two Borrowers

Achieving homeownership through the use of an inappropriate loan product not only costs borrowers thousands of additional dollars, but also undermines the social and economic benefits gained through homeownership. It is therefore important to understand the course of events that homeowners undergo when searching for mortgage credit that may lead them to either appropriate or inappropriate mortgage products. Borrowers who might otherwise be very similar may end up with vastly different mortgage products when they fail to consult others and instead make decisions based on limited information. Below I describe an instance that I encountered of just that contrast in situations: two women who were very similar when they began the search for a mortgage credit had very different loan outcomes.

4.5.1 Their Stories

Ms. Park and Ms. Smith both initially began thinking about purchasing a home because of the potential benefits owning a home would provide their children. When asked what prompted her to consider becoming a homeowner, Ms. Park stated, "Children…they need space to run, instead of me always yelling 'You know there are people underneath you' [chuckles]…To have that *space*." Similarly, Ms. Smith remarked, "Having my boys, I just wanted them to have their own space to run around in and not be all cramped up like I was when I was little."

Though comparable in many regards (both single mothers with comparable incomes, purchasing homes that were similarly priced), these women had completely different experiences searching for a mortgage. Although both initially had credit scores of 620, Ms. Park shopped around and eventually got her loan from a nationally known bank. Ms. Smith went with a mortgage broker referred to her by her real estate agent. The use of a bank versus mortgage broker was not the only difference that affected their loan outcomes.

When Ms. Park first began the process of buying a home, she meet with a broker who told her he could get her a loan. But she decided to shop around and met a with a second broker who told her if she waited and improved her credit she could qualify for a better rate. After receiving this information, she signed up for a prepurchase homebuyers class. With the help of credit counselors, she learned not only what financial cost to anticipate in becoming a homeowner, but also how to budget and improve her credit. Within seven months she had

improved her score to a 660. She took advantage of a local down-payment assistance program and qualified for a $5,000 forgivable loan to use as a down payment. In contrast, Ms. Smith did not make a down payment and received 100 percent financing. She worked with a broker who led her to believe that she could easily refinance her adjustable-rate loan in just two years. Her loan was set to adjust up in September 2007, and refinancing it has not proven as easy as her broker originally suggested. Ms. Smith felt that she had been lied to and is now seriously considering moving from her home back into an apartment.

Table 4.5.1. Two Borrowers Compared

Ms. Park • 3 children, single mother • Gradate degree • Is a behavioral scientist • Parents were homeowners		**Ms. Smith** • 2 children, single mother • Some college and trade school • Is a medical assistant • Parents were not homeowners	
Ms. Park's Loan		**Ms. Smith's Loan**	
House Value:	$135,000	House Value:	$130,000
Down Payment:	$5,000	Down Payment:	0
Loan Amount:	$130,000	Loan Amount:	$130,000
Loan Term:	30 years fixed	Loan Term:	2 years fixed, 28 years adjustable
Annual Interest Rate	6.125%	Initial Interest Rate	8.5%
Monthly Payment	$789.89	Initial Monthly Payment	$999.59
		Rate at Year Three	11.5%
		Payment at Year Three	$1,278.00
Total Finance Charge Over the Life of the Loan	**$154,364.09**	Total Finance Charge Over the Life of the Loan	**$323,395.08**

4.6 Use of Social Capital

In addition to differences in the frequency of social capital use among borrowers, the content of the information received differentiates borrowers and shapes the choices borrowers make in important ways. The assistance typically received by those borrowers who made use of their social networks, in addition to those who consulted credit counselors, had three utilities. They drew upon their social networks for information and guidance, to distill complex information, and for lender referrals. The formal and informal advice and consultation borrowers received shaped their preferences and subsequent demands for mortgage products.

4.6.1 Information and Guidance

Housing counselors were instrumental in educating consumers about their options and what to expect throughout the process. Family and friends, too, helped borrowers navigate the process. Borrowers were instructed on how to negotiate a better rate and told what questions to ask their lender. In addition to how to's, borrowers were given do's and don'ts. A young teacher's mother told her to negotiate for the best interest rate and gave her questions to ask

the loan officer with whom she was working. A 28-year-old mechanic was told by his mother "don't bite off more than you can chew" and "live within your means."

Borrowers were able to weigh their options in part by learning from the experiences of other homeowners. In many instances, more experienced homeowners helped to reassure them that they were making solid choices or moving in the right direction. As one borrower commented,

> "Because I have never owned anything before, I really want to talk to someone, people who did own something, own a home, just to get a peace of mind, I was really nervous the last 5 or 6 months. I was asking questions constantly."

Borrowers frequently depended on friends and family as sounding boards, discussing loan terms and rates with them and often adhering to their advice when making their final decision on a mortgage product.

The most proactive borrowers were concerned about making the right choices and making informed decisions. They attended homeownership education seminars, in addition to speaking with more experienced homeowners. One such young man held a "council of advisors" with whom he consulted before making the decision to purchase his home. Despite having saved in preparation for homeownership, these borrowers did not have a substantial sum to use toward a down payment. Many qualified for down-payment assistance programs and first-time homebuyer programs, which required that they attend a homebuyer education class and/or receive credit counseling. The advice and direction they received facilitated better loan outcomes in terms of lower interest rates.

4.6.2 Distilling Complex Information

Several borrowers commented on the fact that friends and family served to validate information received. As one woman stated when asked about the advice she had received from family and friends:

> "You know, if my Realtor or if the broker told me something that I may, might be unsure about, I would ask them, you know, how was it for you when you bought your house and they would, you know, tell me their experience or tell me if something sounded a little funny to them, or give me questions to go back to ask."

If they were quoted a rate, they often asked others to verify that the rate was "good." One borrower frequently sought advice from a childhood friend who worked in the mortgage industry. As she remarked:

> "Yeah, every time I talked to somebody I conferred to him to make sure that I was getting good information. Basically I would relate to him whatever was related to me by whatever individual I'd talked to. And if it didn't sound good to him, then I would go back and see what else could be done, worked out or said."

Borrowers who worked with housing counselors often discussed their loan terms with them and these housing counselors were instrumental in helping them understand the conditions of their loan. Borrowers are often at an inherent informational disadvantage, yet those who make use of their social capital often gained a filter through which they could make sense of the complex information.

4.6.3 Direct Instruction

While it is important for borrowers to be educated consumers, the importance of this education is often of less consequence than having someone who will steer them in the right direction. Often housing counselors provided an instrumental role not only in educating consumers, but also in steering them in the right direction. Many of the borrowers who worked with credit counselors did not engage in extensive loan shopping. Half (six out of 12) of these borrowers consulted only one company when searching for mortgage financing. Five of the 12 were directed to a loan officer, usually at a bank, who worked with the housing counseling agency to ensure that the borrower was presented with the best possible deal. In addition, borrowers who worked with credit counselors often discussed their loan terms with their counselors, who were instrumental in helping them understand the conditions of their loan. Thus these intermediaries often played an instrumental role in ensuring that borrowers got the best possible product.

Just as borrowers can be steered into inappropriate products when they rely completely on mortgage professionals, they can also be steered into products that fit their financial circumstances with the help of credit counselors as well as friends and family.

4.7 Reasons Borrowers Make “Bad” Decisions

Those borrowers who consulted the most diverse sources of information almost always had a less risky loan with lower interest rates. Those borrowers who consulted only family and friends did not fare as well as those who were helped by housing counselors. Borrowers who only made use of their social networks may not have had a friend or family member who worked in the banking and finance industry. Moreover, several borrowers in this category relied heavily on the advice received from their mortgage broker. Even if family or friends bestow “good” advice, borrowers may defer to the mortgage broker whom they see as a professional or expert. For instance, one borrower, despite her parents’ constant bemoaning for her to “go to the bank, go to the bank,” decided otherwise. Due to her concerns about her creditworthiness (despite reporting a FICO credit score of 672 at the time of application), she took the advice of her real estate agent, who told her to that if she chose a mortgage company to assist her, she would have a better chance of being approved.

4.7.1 Overreliance on Mortgage Industry Professionals with Divergent Interests

Vulnerability comes when too much discretion is placed in the hands of mortgage professionals and others who may or may not have the borrowers’ and their families’ best interest at heart. Those borrowers who failed to verify what they were told by their real estate agent or mortgage broker were often in the most disadvantageous position. Most homeowners who

refinanced did not seek advice from family or friends regarding their decision and were more likely to rely on their mortgage broker or loan officer as their sole provider of information. As a 37-year-old single mother described her interaction with her mortgage broker:

> "He told me what the best plan was for me. When I told him my number-one concern was keeping my payment down, where it was. He got to crunching some figures and said 'oh here is what we can do.' And that is when he went and asked, 'You know, do you have any other debts that you want to consolidate into this?' And I said, 'I'd love to as long as I can keep my monthly payments at X amount.' And he said, 'fine, great, we are doing it.'"

It is not uncommon for borrowers to allow brokers to determine the best loan for them, leaving the broker with utmost discretion in determining their loan outcome. The borrowers I interviewed who were completely reliant on mortgage brokers to determine their loan outcome were easy targets for predatory lenders.

4.7.2 Information Asymmetries

Even informed consumers may make bad decisions because they do not have the expert knowledge that loan officers and mortgage brokers have. This inherent disadvantage is significantly reduced when borrowers make use of a credit counselor or have individuals within their social network from whom they can distill complex information.

Borrowers who did not seek advice or help distilling information often did so for one of two reasons. First, borrowers, particularly solitary decision-makers, felt that they had to make the decision independently. They were often the ones to whom others in their social circle turned for advice, support and financial assistance when in need. Elderly homeowners with substantial equity in their homes, who were frequently the least sophisticated of all borrowers, often stated that they did not consult or ask others about their decision to refinance or have someone go over their loan documents because they did not want to "bother" others. Additionally, many elderly homeowners wanted to maintain a sense of control over their finances. This desire for control almost always set them up for trouble. Several unknowingly agreed to adjustable-rate products, particularly inappropriate given their fixed incomes. Others paid excessive amounts in fees and closing costs, stripping them of a great deal of their equity.

Second, borrowers who did not seek advice often had concerns over issues of privacy. This was one of the major reasons borrowers cited when asked why did they not seek advice in general, and particularly why they did not seek advice from multiple people. Borrowers who expressed concerns about not wanting "people in my business" tended to rely more on their mortgage brokers and were more likely to have their mortgage broker or real estate agent be their only source of information about prevailing rates and their loan options. One woman, who adamantly proclaimed, "I've never been the type to consult people with my business," admitted to making several mistakes and agreeing to terms that were much higher than she initially was told she qualified for.

Similarly, even if family or friends bestow "good" advice, borrowers may defer to the mortgage broker, whom they view as a professional or expert. For instance, one borrower who was concerned about people being "in her business" decided not to consult a cousin who was a real estate agent. Instead, she went with a real estate agent known to "put people into homes." Concerns about her creditworthiness (despite reporting a FICO credit score of 672 at the time of application) led her to take the advice of her real estate agent, who told her that if she went with a mortgage company the process would be easier, and that given her credit score she would be more likely to be approved using a broker.

When left to their own devices, borrowers may have a greater propensity to make less-than-optimal decisions, particularly refinancers, whose only point of reference is their own previous experience. These borrowers admittedly made mistakes in subsequent mortgage transactions. As one woman commented, "I didn't get any smarter the second time around." This is consistent with evidence that subprime borrowers refinance into subprime loans rather than transitioning to prime rate loans (Courchane *et al.* 2004).

4.7.3 Reasons Borrowers Obtain Financing

A borrower's motivation in seeking a mortgage matters because when short-term financial needs dictate an individual's financial decision, he or she often loses out in the long run. Though contrary to credit counselors' frequent comments, the borrowers whom I interviewed were not spendthrifts with ostentatious lifestyles. Borrowers' pressing need for cash often resulted from the central caretaker roles they played in their families. One mortgage broker vividly described this type of borrower, who was responsible for:

> "Rescuing everybody in the family…You know, it's my job to take care of Annie, Sue, Mama, Daddy, my sister's kids, you know. You have people like that who make decent money but they've rescued everybody in the family and they have nothing left for themselves."

In interviewing solitary decision-makers, I found that several borrowers in this category refinanced with the sole intent of aiding family members, not because it was financially advantageous. For instance, one woman refinanced in order to pay her daughter's wedding expenses. Ms. Ethel Hines, a solitary decision-maker, was an 81-year-old retired school cafeteria worker living on her social security income. She remarked that she will give more financially to her family than they will ever be able to give back. This sentiment was common among solitary decision-makers who had refinanced frequently. Several spoke of their home being a meeting place for family gatherings and temporary shelter for those in need. Sometimes they had taken in their children, grandchildren, or both. Even the youngest woman in this group was raising foster children.

Borrowers' pressing short-term financial needs in many instances made them more willing to accept a loan product that was more costly and/or more risky. Regardless of whether a borrowers' needs were pressing, they were not always aware of what they were agreeing to. Their overreliance on a mortgage broker who steered them into a higher-cost or unsustain-

able product arguably was more of a determinant of their loan outcome than their pressing need. This was most vividly the case for borrowers who had taken out adjustable-rate loans, despite the fact that their incomes were fixed and they had no intention of ever moving. When borrowers were aware of having an adjustable-rate mortgage, they were often told that they would be able to refinance out of it before the fixed, teaser-rate period came to end. Whether borrowers had a pressing need or were steered into high-cost products by their mortgage brokers, those who did not make use of their social capital, or those whose social circles were limited to nonexperts, often paid a high cost when they made "bad" decisions about their loan options.

5.0 Future Research and Policy Implications

This research provides a rare glimpse into the lives of borrowers and their experiences searching for and obtaining mortgage credit. In the future, a large-scale research project should be conducted to examine how the utilization of social capital varies for borrowers within and across different socioeconomic brackets, and also to what degree social capital is determinative of both choice of lender and choice of loan. Much of the research that attempts to explain racial differences relies solely on the financial characteristics of borrowers and at most uses basic demographic controls and/or examines the sociodemographic characteristics of neighborhoods. This paper illustrates that social mechanisms are at play in creating differences in borrower outcomes. Future research must then measure the effect of social capital and social networks on borrowers' choice of lender and loan product on a larger scale in order to make generalizable conclusions.

The policy implications of this research affirm the common-sense notion that borrowers make sound decisions when they have assistance. This is particularly true when obtaining mortgage financing is complicated by compensation schemes contingent on the borrowers' lack of understanding of both the process and the products. The chips are stacked against the average American borrower, just as they were stacked against Mr. McAdams and the Cheathams.

Policy makers must take a preventative stance by enacting policies that reduce the discrepancies in information inherent in the transactional environment between borrower and industry actors. Costs must be made transparent and federally mandated disclosures apprehensible. If the market is to remain largely deregulated, these minimal actions should be considered obligatory.

If the goal of public policy is to facilitate long-term and sustainable borrower outcomes, then third-party intermediaries play an essential role, particularly for borrowers who lack access to social resources or are susceptible to being targeted by exploitive or predatory lenders. Local government and nonprofit and community-based organizations play a important role in increasing awareness of the importance of seeking counsel from a third party and providing borrowers directly with both education and guidance. Many borrowers at present seek counseling just because down-payment assistance or first-time homeownership programs require it.

Industry actors could also play an important role by creating a referral network that directs borrowers to social resources (e.g., credit counseling) that will facilitate improved outcomes. Prime lenders have stringent underwriting standards that exclude many potential homeowners from accessing the lower-cost, prime sector of the market. This is particularly true of minorities. Even upper-income minorities are much more likely to be denied than their white counterparts.

Table 5.0. Denial Rates for Conventional Purchase Loans by Race-Income Combinations for the Atlanta Metro Area, 2005

High-income Whites	8.4%
High-income Blacks	28.7%
High-income Native Americans	23%
High-income Hispanics	20.5%
High-income Asians	13.7%

Where do these individuals turn when they have been denied? Do they give up the dream of homeownership, or pursue other, more costly options? By referring borrowers to nonprofit community-based groups, lenders demonstrate a commitment that they are working to ensure that borrowers get the information and guidance they need to qualify for loans at the best rates for which they qualify.

Housing counseling has been proven to reduce the likeliness of borrowers entering into severe default. A Freddie Mac study found that borrowers were "19 percent less likely to fall behind on payments for three months or more at any time during the life of the loan than borrowers in comparable circumstances who were not counseled" (Hirad and Zorn 2001). Considering that 60 percent of subprime borrowers are marginal credit risks who fall in the "A minus" credit category, many subprime borrowers would benefit from credit counseling, enabling them to qualify for conventional loans at better rates (Morse 2001). Even borrowers whose credit scores would disqualify them for conventional financing could be directed to less risky products, such as FHA-insured loans. Housing counseling agencies play a critical role in informing borrowers of their options. However, the role of housing counseling agencies as third party intermediaries needs to be amplified. At present housing counseling agencies barely touch the tip of the iceberg.

Community-based lenders also play a significant role in creating affordable mortgage products for borrowers who might otherwise turn to higher-cost loans. Such products could serve borrowers who may not qualify for traditional financing, but who do not represent the highest credit risks. It is arguable that many homeowners are steered into subprime products because it is more profitable for a lender to make a subprime loan than a prime loan. Community-based lenders can offer less risky and less costly alternatives for borrowers who have time constraints or those who are unwilling to go through longer, more intensive counseling to improve their creditworthiness.

Table 5.1. One Lender's Profit Margins Generated on Loans by Product Type

Year	Subprime	Prime	Difference
2006	1.84%	1.07%	0.77%
2005	2%	0.82%	1.18%
2004	3.64%	0.93%	2.71%

Source: *New York Times,* August 26, 2007.

6.0 Conclusion

If left unabated, the problem of homebuyers receiving loans that are inappropriate given their financial circumstance and unaffordable over the long run will result in a continued rise in the rate of foreclosures. The problem is already astronomical, as "subprime foreclosures are expected to increase in 2007 and 2008 as 1.8 million hybrid ARMS — many of which were sold to borrowers who can not afford them — reset in a weakening housing market environment" (Schumer 2007). Researchers and practitioners must realize that for borrowers, choosing a loan product is not solely based on economics; social factors greatly influence an individual's choice. Borrowers make decisions based on the information they obtain through both formal and informal networks. Arguably, their loan outcomes are affected by not just whether they consult others but whom they consult. When borrowers have access to and utilize social resources, they learn from the experiences of others, are more able to distill complex information, and are more likely to be steered in the right direction. When given the right advice, potential homebuyers choose lenders and loans that are more favorable, improve their financial circumstances and are in better positions to sustain homeownership.

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Appendix

Sampling Methods Used with Public Deeds Records

Homeowners residing in owner-occupied homes in the Atlanta metropolitan area who had purchased homes between January 1, 2004, and January 1, 2007, were targeted. The database of public deeds was searched using the name search feature. Borrowers were identified in accordance to lender. Both prime and subprime lenders, identified on lists of specialized lenders issued by the U.S. Department of Housing and Urban Development (HUD), were targeted. The names and addresses of individuals within the sampling frame were determined depending on the number of deeds associated with each lender, since several deeds had to be pulled before the name of a borrower in a selected census tract was identified. In order to get the addresses and names of borrowers, every deed had to be examined. Upon examination, additional information was collected. Public-deed records provide the amount of the loan and the lender. Sometimes they also information about the loan structure and terms and about the borrower's marital status (and occasionally gender). Additional, there is a link to the foreclosure deed, if one has been issued on the property. Using public-deed records, a sample of 157 households was selected and subsequently sent recruitment materials. Of those mailings sent out, 27 were returned to the sender. Five homebuyers expressed interest in participating either by calling or returning the response card. Of these five, only three interviews were arranged and completed.

There is a great deal of variability across census tracts in the Atlanta metropolitan area in terms of the share of all home purchase loans that are subprime, ranging from as high as 76.3 percent of all home purchase loans being subprime to as low as 0 percent, with a median rate of 19 percent. Only households in census tracts in which the share of all loans that are subprime is 25 percent or greater were sampled. Home Mortgage Disclosure Act (HMDA) data was used to identify census tracts in which the total share of subprime home purchase loans is 25 percent or greater (slightly above the metropolitan mean level of 23.3 percent). Households were additionally targeted in accordance with the income and racial composition of the census tracts in which they reside. Additionally, homeowners currently experiencing foreclosure were targeted as well.

Sample Stratification (for those recruited by mail)

First, the eligible census tracts were sorted into six clusters based on their income and racial composition. The racial composition was measured in terms of the percent of the population classified as non-Hispanic black. Predominately black neighborhoods are neighborhoods in which 50 percent of more of the total population is black.

Households with incomes less than 80 percent of the median family income (MFI) for owner-occupied households were considered low income, but were not included in the sample in order to maximize the number of potentially creditworthy borrowers with subprime products. Households with 80 percent to 120 percent of the MFI were classified as middle income. Upper-income households were defined as households with incomes over 120 percent of the

MFI. In 2004 the MFI for owner-occupied households in the Atlanta statistical area (MSA) was $63,455.

Income Level Categories	Percent of Median Family Income	Median Family Income (metro Atlanta MFI: $63,455)
Middle income	80–120 percent	$50,764 to $76,146
Upper income	Greater than 120 percent	< $76,146

Within each of the six clusters, census tracts were arranged by location (by county). The listings obtained from the records of public deed, of individuals who purchased a loan from a subprime lender in the last two years, were sorted according to their census tract location (within the six clusters). This resulted in the loss of use of many of potential subjects. Due to time constraints, however, a more rigorous sampling method could not be employed.

Data Collection

Subjects were mailed a recruitment letter that informed them of the purpose of the research project and the criteria for participation. The letter included contact information (a phone number and e-mail address) that potential respondents could call to schedule an interview or notify the researcher of their interest in participating. Additionally, a self-addressed postcard was included that household members could mail in to express their willingness to participate and to disclose their contact information and availability. Subjects received a follow up post-card requesting their participation in the study once again if no response had been received after a week.

The interviews were open-ended and semistructured, utilizing an interview guide that included basic demographic questions, as well as questions about the mortgage product and mortgage-shopping behavior (e.g., the use of technology and/or social resources). Interviews were conducted in person and were recorded with the consent of the subject.

Survey Instrument

The survey instrument was formulated to obtain demographic data about respondents that is particularly relevant to their experiences searching for mortgage credit. It also obtained data to be used as controls. Additional questions measured the amount of effort borrowers expended in their search for mortgage credit, and their use of social capital in guiding their decisions. More specifically, borrowers were asked about the degree to which they consulted friends and family prior to and during their search for mortgage credit and whether the information they received was determinative of the loan product they ended up accepting. Respondents were asked the degree to which they relied on the mortgage broker to provide them with multiple financing options, and the extent to which they comparison-shopped and used technological resources. Borrowers were asked about obstacles that they faced and who, if anyone, helped them along the way to becoming a homeowner by providing advice.