

Foreclosure Crisis Caused by Borrowers who 'Overreached': Study

By: Brittany Dunn 05/07/2010

The true cause of the foreclosure crisis is up for debate. Did banks prey on unwitting consumers, or did households “overreach” and borrow more than they could afford? Economists at the [University of Arkansas](#) recently completed a study to answer that very question.

The study, [The Foreclosure Crisis: Did Wall Street Practice Predatory Lending or Did Households Overreach?](#), found the latter to be true.

Although the researchers found some evidence of predatory lending, they concluded that a more accurate explanation of the foreclosure crisis was households who got in over their heads after borrowing more than they could afford. However, the researchers were careful not to excuse Wall Street banks, as reckless lending enabled households to become dangerously leveraged.

“Our evidence does not disprove or excuse reckless subprime lending by the large Wall Street banks,” said Tim Yeager, associate professor in the [Sam M. Walton College of Business](#) and lead author of the study. “We argue that there is plenty of blame to go around for the financial crisis. Both banks and consumers overreached. Banks extended too much credit to households, and households purchased more home than they could afford.”

Relying on massive datasets from private companies that compile information about demographics, real-estate properties, and foreclosures, Yeager and four other researchers created profiles of households who were in foreclosure during the third quarter of 2008. The researchers used a classification system to identify and examine the characteristics of these households, which they separated into 21 life-stage groups, each with specific demographic characteristics that tied them together.

The researchers then developed two categories of groups based on formulas for “excess foreclosure shares” and “relative default shares.” The first calculation determined, in absolute numbers, which groups accounted for the most foreclosures. The second calculation showed which groups had the highest likelihood of foreclosure.

By far, the group with the greatest excess foreclosure percentage was “Cash & Careers,” the most affluent generation of adults born between the mid-1960s and early 1970s. Members of this group had high household incomes, high education levels, high home values, and none to only a few children. In addition, members of this group were classified as aggressive investors, most of who lived in areas of rapid real estate appreciation, such as California, Nevada, Arizona, and Florida.

However, “Cash & Careers” ranked seventh on the list of groups most likely to default. At the top of this list were four groups – “Mixed Singles,” “Gen X Singles,” “Boomer Singles,” and

“Beginnings” – characterized by low income and low net worth. Members of these four groups were most likely to be victims of predatory lending, the report said. But except for “Boomer Singles,” these groups showed up at the bottom of the excess foreclosure list.

“Although we did find evidence that low-income households had a higher statistical likelihood of foreclosure, most households in foreclosure were relatively affluent and well educated,” Yeager said. “Also, these household defaults were strongly clustered in southwestern and southeastern states, which is consistent with the overreaching-consumer explanation of the foreclosure crisis.”

Overall, the study found that most foreclosed households were not “duped” into bad loans. Rather, they were caught up in a housing price bubble in which both consumers and lenders were too aggressive.

Yeager said the policy implication from these results is that strong consumer protection laws, though necessary to prevent Wall Street banks from offering high-risk loans to the most vulnerable, will not be sufficient to prevent another financial crisis like the one the U.S. economy experienced in 2007 and 2008. He said the only comprehensive solution may be to pop housing bubbles, which is a much more complex task that would require the Federal Reserve to recognize and limit asset price bubbles.

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