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## ABSTRACT

We apply unique loan level data from New Century Financial Corporation, a major subprime lender, to assess whether attributes of Congressional Representatives were associated with access to and pricing of subprime mortgage credit. Research findings indicate higher likelihoods of subprime loan origination and lower mortgage pricing among borrowers represented by the Republican and Democratic leadership of Congress. Black borrowers also benefitted from significantly larger loan amounts in those same districts. Also, borrowers received mortgage interest rate discounts in districts where New Century donated to the Congressional Representative. Findings provide new insights into the political geography of the subprime crisis and suggest gains to trade between New Century Financial Corporation and targeted Congressional Representatives in the extension, pricing and sizing of subprime mortgage credit.

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## Introduction

Implosion in housing markets figured prominently in the 2007 meltdown in capital markets and the downturn in the global economy.[1] Neither analysts on Wall St. nor regulators in Washington, D.C. anticipated the depth of the crisis, its geographic and asset class contagion, or its adverse effects on household balance sheets. Emblematic to the crisis was the pervasive failure of subprime mortgages. Those loans provided substantially eased credit qualification and homeownership opportunity to low credit-quality borrowers. As shown in Demyanyk and Van Hemert (2007), the quality of originated subprime mortgages began to deteriorate even prior to the housing bust. By 2008, in the wake of downward spiral in house prices, a full 45 percent of subprime borrowers were underwater. Two years later, a similar share of outstanding subprime mortgages were in default.

Early on and prior to the deterioration in subprime loan performance, lenders appeared to understand the controversial nature of their product and the related importance of Congressional support. To that end, lenders may have sought to direct campaign contributions to elected Representatives to generate support for subprime loan products and to assist in easing regulatory oversight. As documented by Mian, Sufi, and Trebbi (forthcoming), lenders became politically sophisticated in making campaign contributions to elected Representatives in the years leading up to the 2000s crisis.

A second potentially complementary strategy for capturing political support was for lenders to offer more credit and at better terms to borrowers in Districts represented by targeted Congressional Representatives. As further suggested by Mian, Sufi, and Trebbi (forthcoming),

[1] As reported in Shiller (http://www.econ.yale.edu/shiller/data.htm)), US national house prices recorded a decline of 31 percent over the 2006 - 2010 period, about on par with the peak-to-trough contraction during the Great Depression.

such strategic interactions and related side-payments could be important in a world in which explicit "quid pro quo" was not politically feasible. To the extent that interests aligned, both direct campaign contributions as well as District-level direction and pricing of mortgage credit could serve the political economic interests of both the lender and the elected official. District-level expansion of mortgage and housing opportunity could be viewed as a political return to Representatives in exchange for expanded subprime lending opportunities.

This study uses the universe of first-time homebuyer residential home loans issued by a major subprime lender to study the role of Congressional political influence in the access to and pricing of subprime mortgage credit. It provides a political economy explanation for the geography of subprime lending. By merging several data sets, we seek to implement the following thought experiment. Consider two identical marginal borrowers called "A" and "B" who live in the same local labor market at the same point in time. Assume that the two borrowers live in comparable but different residential communities. If "A's" Congressional Representative is liberal, is a member of the Finance Committee, is a leader of the House of Representatives, or if this Representative receives direct campaign contributions from the subprime lending institution, do these Congressional attributes influence the probability that the institution makes a loan to A versus B? Further, are these same attributes associated with higher or lower loan amounts or loan pricing to A versus B?

The loan level data in our study come from the servicing database of the now defunct New Century Financial Corporation (New Century) and the Home Mortgage Disclosure Act (HMDA). Like other studies, we control for the borrower, loan, or locational attributes that influence the allocation and risk-based pricing of mortgage credit. Unlike other studies, those controls are not the focus of this study. Instead, while controlling for a rich set of household

attributes, zip code attributes and including state/year/month fixed effects, our goal is to assess how attributes of the local Congressional Representative influenced access to and pricing of subprime mortgage credit. The "politics" hypothesis posits that these attributes mattered because New Century had specific political goals in mind and used implicit subsidies to achieve those objectives.

The eased qualification requirements associated with subprime lending also may have been important to policymakers seeking to attain federally-mandated lending goals related to minority homeownership. Indeed, as evidenced in numerous recent studies (see, for example, Gabriel and Rosenthal (2005, 2011), racial minorities have been largely underrepresented in homeownership attainment. During the years leading up to and including the boom, substantial policy effort was directed at narrowing racial homeownership gaps.[2] Prominent among those efforts were ambitious quantitative goals for financial institution loan origination among minority and other households as embodied in the Community Reinvestment Act (CRA). Accordingly, below we test as well for whether minority borrowers received differential treatment by New Century. In particular, we test whether minority borrowers had a greater probability of receiving subprime loans as a function of their Congressional Representative's attributes. Also, conditional on receipt of a subprime loan, we test whether minority borrowers received more favorable loan terms (as evidenced in loan size or loan pricing) as a function of their Representative's attributes.

[2] Both Presidents Clinton and G. W. Bush sought to address racial and ethnic gaps in homeownership. In a statement dated June 18, 2002, President Bush noted that "The goal is that everyone who wants to own a home has a shot at doing so. The problem is we have what we call a homeownership gap in America. Three-quarters of Anglos own their home, and yet less than 50 percent of blacks and Hispanics own homes. That problem signals that something may be wrong in the land of plenty. And we need to do something about it." See White House News Release from that date.

Assessment of New Century Financial Corporation loan level data from 2003 – 2006 reveals a new political geography of subprime lending. Our findings highlight that New Century was especially active in offering differential treatment to borrowers represented by the Democratic and Republican leadership of Congress. In the case of borrowers residing in the districts of the Speaker of the House and the Majority and Minority Leaders and whips, subprime lenders were less likely to reject loans; further, New Century offered lower mortgage interest rates and large loan amounts, all things equal, to residents of those areas. This fact is especially true for African American borrowers in these districts. Also, borrowers received rate discounts in districts where New Century donated to the local Congressional Representative's election campaign.

This paper contributes to the literature investigating the causes and consequences of private industry's political contributions to the Congress. Ansolabehere, De Figueiredo, and Snyder (2003) argue that political contributions appear to yield a very high return and this raises the question of why industry does not increase its contributions to the Congress. Bombardini and Trebbi (2011) document the role of the electoral strength of an interest group that could support a representative's re-election campaign. Krozner and Stratmann (2005) study repeat contributions of PACs to representatives and document strategic interactions whereby representatives build a reputation for taking certain positions that help industry and are rewarded by special interests. Bronars and Lott (1997) and Stratmann (2002) both report evidence that changes in campaign contributions are correlated with changes in roll call voting by members of Congress. In earlier work, Stratmann (1992) presents evidence documenting how farming PAC contributions are targeted to specific representatives depending on who their constituents' attributes. Mian, Sufi and Trebbi (2010) document the voting patterns by representatives on key pieces of banking

legislation after the crisis of 2008 began. They document that representatives from areas where there were more subprime lending activity were more likely to vote for bailouts.

Unlike these earlier studies, using our detailed loan data we are able to investigate how a major firm directed its campaign contributions to specific Representatives as well as directed its loans to constituents of those same Representatives. Such representatives likely recognized that New Century was pleasing their constituents by allowing them increased access to capital at lower interest rates (see Mian and Sufi 2009). We document the geographic clusters of lending and pricing activity across congressional districts while relying on micro data that allows us to control for a rich set of borrower attributes. By enhancing credit access to underserved borrowers, the lending patterns we document were likely to have increased constituent support and helped to keep the incumbent in power.

The plan of the paper is as follows. The following section describes the data and sample. Section 3 discusses econometric strategy and results of analysis of HMDA and New Century microloan files, including assessment of mortgage origination and pricing. Section 4 provides concluding remarks.

## II. Data and Sample

Loan level information was obtained from the servicing database of New Century Financial Corporation. New Century was founded in 1995 as a REIT that originated mortgage loans in the U.S. through its operating subsidiaries, New Century Mortgage Corporation and Home 123 Corporation. As of January 1, 2007, New Century was the second largest subprime mortgage lender in the U.S., with 7,200 full-time employees and a market capitalization of $1.75 billion. On April 2, 2007 and in the wake of substantial deterioration in the performance of subprime mortgages, New Century sought Chapter 11 relief. Also that month, New Century

filed an 8-K indicating that it had previously over-stated earnings. On March 26, 2008, the bankruptcy court examiner outlined a number of "significant improper and imprudent practices related to its loan originations, operations, accounting and financial reporting processes. The complete set of New Century loan records became available for academic and research use as a result of the bankruptcy settlement. While we acknowledge that most of this paper's evidence is based on one bank's actions, these represent the best available micro data for investigating our key research questions related to the pricing of mortgages.

We analyze a subsample of loans from the two operating subsidiaries, including New Century Mortgage Corporation and HOME 123 Corporation. The dataset is comprised of a panel of individual loan records and includes an unusually rich set of borrower, loan, and locational controls. Further, the data provides a rare opportunity to evaluate loan origination and pricing for one of the largest of the nation's subprime lenders. The Loan database was merged with the Home Mortgage Disclosure Act (HMDA) data in each year to obtain the race and gender of the borrower for sampled loans. Borrower controls include borrower age, race, gender, monthly household income, FICO score, borrower combined LTV, zip code of residence, and originated loan rate. We use loans for the years 2003 through the end of 2006. Congressional redistricting took place in January 2003 and the bank shut down in February 2007. Our data cover the 108$^{th}$ and half of the 109$^{th}$ Congress.

Using the MABLE/Geocorr2K Geographic Correspondence Engine, we merged borrower zip code of residence to their Congressional District.[3] If a zip code crossed a Congressional District, we assigned the Congressional District that had a larger share of the zip code's total

[3] See http://mcdc2.missouri.edu/websas/geocorr2k.html.

population.[4] We obtained data on race, tenure, and political ideology of the Congressional Representative in each zip code from two sources. Keith Poole's voteview.com database provides information on each Representative's conservative ideology score (dwnominate's 1st factor) and a count of Congressional terms that a Representative had served (Poole and Rosenthal 1997). We collected information on whether the Congressperson was a member of the House Finance Committee, whether the Congressional Representative was a member of the House Democratic or Republican leadership (defined as Speaker of the House, Majority Leader, Minority Leader, Majority Whip or Minority Whip).[5] We also coded whether each Representative received campaign contributions from New Century during a Congressional term.[6] To determine each Representative's race (African American or Hispanic), we used information from the Congressional Black and Hispanic Caucuses.

Finally, the data set includes zip code controls from the 2000 Census of Population and Housing. Those controls included attributes of the zip code population including percent black, percent Hispanic, percentage of adults with at least a college degree, and log population density. We used data from US Census County Business Patterns dataset for the years 2003 to 2006 to compute annual log zip code annual employment. This time varying variable captures local economic growth. While our key regressions below will include state/year/month fixed effects, this additional zip code/year employment variable captures additional local labor market effects.

The analysis is undertaken using the universe of New Century loans originated over the 2003 – 2006 period. The spatial distribution of the New Century loan originations between 2003

[4] In the results reported below, we have also re-estimated them limiting the sample to households who live in a zip code that is completely located within a Congressional District. We find that our key results are almost identical when we compare our whole sample results to the results based on this subsample of the data.

5 In 2006, this set included Blunt, Boehner, Delay, Hoyer and Pelosi. Information on congressional committee assignment is available at http://financialservices.house.gov/archives/.

6 http://www.opensecrets.org/pacs/pacgot.php?cmte=C00369983&cycle=2006

and 2006 is depicted in Figures 1 and 2. We calculate each Congressional District's share of loans and these shares sum to 1. To ease the presentation, we partition these shares into five quintiles with the darkest shading representing the areas that receive the greatest shares of New Century loans.

As shown in Figure 1, New Century origination activity largely was confined to the western United States and Florida. In Figure 2, we repeat this exercise for California but the unit of analysis is a zip code and the zip code shares sum to 1. New Century made 27% of its total loans to California. As shown in Figure 2, California subprime lending was limited among expensive and highly supply constrained coastal markets and instead focused on affordable, relatively supply elastic housing parts of the Central Valley and the Inland Empire. The geographic incidence of subprime lending in the major coastal metropolitan areas of California took a similar form. Both in the San Francisco Bay Area and the Los Angeles metropolitan area, subprime originations were clustered in fast-growing and more highly affordable districts to the east, relative to the expensive coastal areas. Also notable in Figure 2 was the high concentration of subprime loans in the minority neighborhoods of eastern Contra Costa County as well as Northeast and South Los Angeles.

As shown in Table 1, the sample is comprised of approximately 892,000 individual subprime loan records.[7] Of those records, about 63 percent were adjustable-rate mortgages with an average nominal loan amount of $176,000. Subprime loan origination interest rates averaged 8.13 percent over the study period; average origination rates ranged from 7.60 percent in 2004 to 8.83 percent in 2006. Among sampled New Century borrowers, about 61 percent were male

[7] We drop observations if no initial interest rate is reported or if the FICO score is missing. We limit the sample to borrowers ages 20 to 75.

with an average age of about 42. As would be anticipated, average FICO scores among sampled subprime borrowers were relatively low at 620 with mean household incomes of about $84,000. Further, typical borrower combined loan-to-value ratio was about 86 percent. As is evident, subprime mortgages were disproportionately originated among minority borrowers and in minority neighborhoods. Blacks and Hispanics each comprised roughly 20 percent each of total New Century originations. New Century loans were originated in zip codes comprised on average of 13 percent black and 19 percent Hispanic population.

Sampled subprime borrowers resided in Congressional Districts typically represented by longstanding incumbents; the average number of terms of the local Congressional representative was close to 6. Finally, as shown in Table 1, only a small fraction of sampled New Century borrowers, on order of 6 – 9 percent, were represented by Hispanic or Black Members of Congress, respectively. New Century donated to the campaigns of roughly 11 percent of Congressional Representatives; roughly 15 percent of loans came from districts represented by a member of the House Finance Committee. New Century was more likely to donate to the campaign contributions of the Leaders of Congress, members of the Finance Committee, and to representatives whose communities featured higher shares of blacks and Hispanics. California's representatives were also more likely to receive such contributions.

## III. Empirical Analysis

In this section, we undertake detailed assessment of origination and pricing of subprime loans by New Century Financial Corporation. Broadly, we hypothesize that in absence of opportunity for explicit trades, the spatial distribution of New Century subprime mortgage extensions and pricing varied systematically with the characteristics of and the contributions to Congressional Representatives that New Century was seeking to influence. Accordingly,

controlling for the usual borrower, loan, and locational characteristics, we test whether the Congressional Representative's race, political ideology, tenure in office, committee assignments, leadership roles, and receipt of New Century campaign contributions were associated with subprime access. We undertake similar analyses of subprime loan risk-based pricing.

### 3.1 HMDA Loan Origination Models

We first assess the role of Congressional political controls in determination of mortgage lending outcomes among a broad cross-section of applicants and lenders. For this purpose, we turn to the micro data files of the Home Mortgage Disclosure Act for the year 2006. Those HMDA files often are utilized to characterize mortgage lending trends in the US; our cross-section includes in excess of 920,000 loans (a 2% random sample).[8] In this analysis, we augment standard controls available in the HMDA data with those accounting for neighborhood and Congressional Representative effects in assessment of application accept/reject decisions. Explanatory variables include a vector of census tract level controls based on year 2000 Census data, including proportion black, proportion Hispanic, proportion having earned at least a college degree, log population density, and log annual employment. Also, we add information on attributes of the local Congressional representative, including whether the Congressperson was a member of the House of Representatives Finance Committee, whether the Congressional Representative was a member of the House Leadership and whether that Representative received campaign contributions from New Century. Also, the specification includes controls for Representative race, terms in office, and conservative political ideology. Note that the analysis pertains to a single year (2006) and controls as well for state-level fixed effects. Further, the

[8] We include only first mortgage residential loan for occupied properties and drop observations for which we do not observe the household's income or location and we drop observations for whom the listed action type is greater than 3.

analysis is stratified among prime and sub-prime loans. Given the above described federal policy focus on mortgage origination and homeownership attainment among underserved and minority households, we also stratify the sample among black and Hispanic applicants. Using the published HUD subprime lender list we stratify lenders into two sets; prime and subprime lending institutions. [9]

In Table 2, we report six estimates of the linear probability model reported in equation 1. The dependent variable equals one if person i in state l in census tract z in congressional district j is rejected for a loan. The dependent variable has a mean of .19.

$$reject_{ijlz} = \alpha_l + \alpha_1 X_i + \alpha_2 Z_{jl} + \alpha_3 Tract_{lz} + \varepsilon_{ijlz} \quad (1)$$

where $\alpha$ is a vector of state fixed effects for state l, *X* a vector household attributes, *Z* a vector of Congressional Representative attributes and *Tract* a vector of census tract attributes. The standard errors are clustered by Congressional representative.

Note first the role of borrower and neighborhood characteristics in determination of origination decisions among prime lenders (see columns 1-3). As indicated, the discrete dependent variable takes on a value of 1 if the loan application is rejected. As would be expected, higher levels of applicant or census tract income serve to significantly depress loan rejection probabilities. Similarly is the case for male applicants. On the other hand, consistent with substantial literature in mortgage lending (see, for example, Deng and Gabriel (2006) and Gabriel and Rosenthal (2009), black and Hispanic applicant status and black and Hispanic census tract population shares all serve to significantly elevate rejection likelihoods among prime lenders. Among political controls, Representative membership in the House of Representative's Finance Committee serves to elevate loan denials.

[9] Our data source used for this partition is available at http://www.huduser.org/portal/datasets/manu.html.

Results for the set of subprime lenders are roughly similar to those described above for prime lenders. As would be expected, for both black and Hispanic applicants, increases in borrower and neighborhood income also serve to significantly damp loan denials among subprime lenders. Whereas status as a black applicant or higher black census tract population share serve to significantly elevate the probability of loan denial among subprime lenders, status as a Hispanic applicant had the opposite effect. In the unified analysis, among subprime lenders, none of the political controls appeared significant in determination of lending outcomes.

As shown in column (5), black applicants who apply for a loan at a subprime lending institution are four percentage points less likely to be rejected if they live in a Congressional Leader's district. This results stands in marked contrast to findings for black prime applicants and for both prime and subprime Hispanic applicants, where no significant effect of Congressional leadership was evidenced. Noteworthy as well were the significantly damped loan denial rates among Hispanic prime and sub-prime loan applicants represented by a political conservative. All things equal, these findings suggest that proxies for political influence, including representation by a conservative Congressperson or Congressional leader, appear to significantly enhance the mortgage loan origination probabilities of black subprime and Hispanic applicants.[10]

### 3.2 New Century Loan Origination by Race and Ethnicity

We turn next to assessment of the role of Congressional influence on loan origination and pricing outcomes among New Century borrowers. As discussed below, the richness of the New

[10] In results available on request, we have used the 2006 HMDA data to estimate linear probability models in which the dependent variable equals one if New Century originated the loan. We cannot reject the hypothesis that New Century is equally likely as other subprime banks to originate the loan in the Congressional Leadership districts. This suggests that there was competition among the banks to curry favor with powerful leaders.

Century dataset allows substantial borrower and locational controls. In this section, we estimate linear probability models to assess the role of Congressional representative attributes in determination of loan origination probabilities among black and Hispanic New Century borrowers. The dependent variable in the analyses equals 1 if the originated loan is to a black [Hispanic] borrower and zero otherwise. We seek to test whether conditional that New Century has made a loan, is a minority more likely to receive it as a function of Congressional attributes. We estimate equation (2).

$$Minority_{ijlzt} = \alpha_{lt} + \alpha_1 X_{it} + \alpha_2 Z_{jlt} + \alpha_3 Zip_{lzt} + \varepsilon_{ijlzt} \quad (2)$$

In equation (2), the notation represents person i in state l in zip code z at time t in Congressional district j. State/year/month fixed effects are included and the standard errors are clustered by Congressional district.[11] As shown in Table 3, the analysis includes a standard set of borrower characteristics including borrower age, gender, log household income, and FICO score.[12] We add a further control for loan-to-value ratio. The regression also includes the zip code level neighborhood and Congressional representative controls described above.

Table 3 reports results of the New Century loan origination equations.[13] As shown in the table, the controls for borrower and loan characteristics performed as expected. All things equal, the probability of loan origination among blacks and Hispanics increased with loan LTV. While increases in borrower age served to significant elevate loan origination probabilities among blacks, the opposite was evidenced for Hispanics. As expected, increases in borrower income

[11] While we include state/year/month fixed effects in all of the New Century regressions, it is relevant to note that the New Century data are bunched across months. We observe 95% of the loans being recorded in April, August and December.

[12] We include four spline segments for the FICO score with the knots taking place at the 25th, 50th, and 75th percentiles of the empirical distribution at 579, 623 and 662 respectively.

[13] The New Century data for Hispanic status is not filled in for the year 2003. This fact leads us to limit the sample to 2004 through 2006 for the estimates of econometric models for the Hispanic subsample.

served to significantly diminish the probability of New Century loan originations among blacks and Hispanics. Further, damped origination probabilities were associated with black borrowers across the FICO credit score spectrum.

Results similarly affirm the significance of a broad set of neighborhood socio-economic and race characteristics in determination of New Century subprime loan originations. Findings largely indicate that increases in college graduate population shares, log neighborhood population density, and log neighborhood annual employment serve to significantly elevate New Century originations among blacks and Hispanics. While increases in black neighborhood population share served to raise the probability of loan origination among blacks, increases in Hispanic neighborhood population shares were associated with damped lending probabilities to blacks. In a similar vein, increases in Hispanic neighborhood population share served to raise the likelihood of New Century lending to Hispanics, while increases in black population share had a damping effect.

Controlling for borrower, loan, and neighborhood characteristics as well as state/year/month fixed effects, the political controls offer new insights as to the role of political influence in determination of New Century loan originations among blacks and Hispanics. Indeed, consistent with findings of the HMDA analysis, New Century lending to blacks was significantly elevated in districts represented by Congressional leaders (nine percentage points).[14] That being said, lending to blacks was damped in districts represented by an ideological Conservative. All things equal, other factors including controls for race/ethnicity of local representative and New Century donation to representative did not significantly affect loan originations among blacks. An exception arises in the case of Hispanics. Here representation by

[14] To explain our findings based on unobserved borrower quality, one would need to explain why blacks with high unobserved borrower quality self select to live in the Leader districts. Given the rich set of individual demographica and zip code controls and our state/time fixed effects, we do not believe that this is a credible explanation.

a black Congressperson significantly diminished the likelihood of New Century loan originations among Hispanics.

### 3.3 New Century Mortgage Pricing

In Table 4, we assess the effects of Congressional political controls on the pricing of New Century mortgages. The analysis is based on the full set of loans originated by New Century over the 2003-2006 period. The dependent variable is the log of the loan origination rate charged by New Century for person I in state l in year/month t who lives in zip code z located in Congressional District j. We estimate equation (3).

$$\log(\, price_{ijlzt}) = \alpha_{lt} + \alpha_1 X_{it} + \alpha_2 Z_{jlt} + \alpha_3 Zip_{lzt} + \varepsilon_{ijlzt} \qquad (3)$$

The OLS regressions include proxies for borrower, loan, and neighborhood attributes. Also, the models include state, year, and month fixed effects to account for time variations in risk-free benchmark rates, locational variations in default and prepayment risk, and the like. Borrower attributes taken from New Century loan records include borrower race, age, gender, log household income, and FICO score spline. Also included is loan-to-value at time of loan origination. Neighborhood controls derive from the 2000 Census and include zip code racial distribution (percent black, percent Hispanic), percent college educated, population density, and log total employment in the zip code in that year. Pricing controls are identical to those specified in the New Century loan origination equations. Similarly, we stratify the pricing models by borrower race and ethnicity. The standard errors are clustered by congressional district.

Findings as regards the borrower and loan effects were largely as anticipated. In all models, higher LTVs, proxying higher levels of default risk, served to significantly increase loan pricing. Among Hispanics, older borrowers were associated with significantly higher mark-ups in pricing at loan origination, whereas male borrowers were associated with significantly lower

loan pricing. In contrast, among black borrowers, perceived default risk and hence risk premia did not significantly vary with age and gender of borrower. Log household income also was associated with significantly higher loan interest rates. As expected, as a primary indicator of borrower credit risk, increases in borrower FICO score were highly significantly associated with lower mortgage loan interest rates. Those results were evidenced for the sample as a whole as well as for the black and Hispanic sample stratifications.

Similarly, neighborhood controls largely performed as expected. Higher proportions of zip code college grads, suggestive of higher levels of financial literacy and lower default risk, were associated with significantly lower New Century mortgage prices throughout. Again, consistent with the established mortgage literature, findings suggest significantly elevated New Century mortgage interest rates in neighborhoods with higher proportions of black population. In marked contrast, increases in neighborhood proportion Hispanic population were associated with significantly lower rates of New Century risk-based mortgage pricing. Note that the findings regarding black and Hispanic neighborhood pricing effects were robust across the black and Hispanic borrower sample stratifications.

Controlling for these well-established determinants of loan pricing as well as state/year/month fixed effects, we focus on the role of Congressional influence in determination of New Century mortgage loan origination rates.[15] As shown at the bottom of Table 4, the Congressional attributes are jointly statistically significant at the 1% in all three regressions. As shown in the left column for the entire sample, all else equal, borrowers in districts represented by a Congressional Leader received a 1.4% discount on the interest rate.[16] Given that the

[15] In column 1, we control for the loan's type and the borrower's race. These coefficient estimates are suppressed to save room but are available on request.

[16] Dennis Hastert of Ohio offers a suggestive data point. In 2006, he was no longer a member of the Congressional leadership. In regressions available on request, we have re-estimated equation (3) and included a Hastert Dummy

average loan amount was $200,000 and the average interest rate was 8 percent, this works out to an annual household savings of roughly $150. Also, as evidenced in the left-hand column of Table 4, borrowers who lived in districts where New Century made campaign contributions to the Representative received a .7% reduction in their loan rate. One explanation for these loan discounts is that subprime banks are competing with each other to increase market share for loans with specific powerful representatives. This strategic competition lowers interest rates that marginal borrowers are charged.

In Table 4, we also re-estimate equation (3) for the black borrower and Hispanic borrower subsamples. As shown in the middle column, black borrowers receive 2.4 percent reduction in mortgage interest rate if they live in a Congressional Leader's district. Hispanic borrowers receive a 1.2 percent reduction in mortgage pricing if they live in a district where New Century has made a campaign contribution to the Representative. One notable non-result is that the race of the Representative is not a statistically significant correlate of receiving a loan discount.

**3.4 New Century Loan Size Analysis**

Finally, we report on the effects of Congressional influence on New Century credit provision (loan dollar magnitude) at origination. We estimate equation (4).

$$\log(loan_{ijlzt}) = \alpha_{lt} + \alpha_1 X_{it} + \alpha_2 Z_{jlt} + \alpha_3 Zip_{lzt} + \varepsilon_{ijlzt} \quad (4)$$

The regressions include an identical set of controls as those described above for the pricing and loan origination analyses. As shown in Table 5, controlling for borrower, loan, and neighborhood characteristics, log mortgage loan size is 9 percent larger in Congressional

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and a Hastert*2006 Year dummy. Along with the leader dummy, these variables are jointly statistically significant with a F-statistic of 7.51. Based on the coefficient estimates, we find that the price discount received by New Century borrowers in his district shrunk towards zero when he was no longer part of the leadership.

Leadership districts and this differential grows to a full 18 percent for black borrowers (see column 2). In contrast, among Hispanic borrowers, log loan size was significantly reduced in districts presented by a Hispanic representative or a political conservative.[17]

**Conclusion**

In this paper, we explore the role of Congressional influence in extension and pricing of subprime mortgage credit. Specifically, we apply loan level data from both HMDA and New Century Financial Corporation, a major subprime lender, we assess whether attributes of Congressional Representatives were associated with access to and pricing of subprime loans. Noteworthy among HMDA results is the significant reduction in subprime loan denials among black applicants in Districts represented by a Congressional leader. The HMDA data further reveal significantly damped loan denial rates associated with seniority of Congressional representative (terms in office) for both prime and subprime Hispanic borrowers.

We build on the HMDA findings using well-articulated New Century micro data. Research findings for New Century indicate higher likelihoods of subprime loan origination as well as significantly lower mortgage interest rates among borrowers represented by the Republican and Democratic leadership in Congress. Black borrowers also benefitted from significantly larger loan amounts in those same districts. Also, borrowers residing in districts where New Century donated to the local Congressional Representative received rate discounts.

Together with results of Mian et al (2010), our findings suggest a consistent pattern of Congressional Representative political geography in subprime lending. New Century may have viewed direction of campaign contributions to particular Representatives as well as enhancement

[17] We also run points regressions where the dependent variable is the payment to the bank divided by the value of the initial loan. In those analyses, we fail to reject the null hypothesis that our set of political variables is jointly statistically insignificant. Results of the points analyses are available upon request.

of subprime credit access in those or other Congressional Districts as consistent with profit maximization, to the extent it helped to buy Congressional support for widespread proliferation of this controversial lending instrument among less qualified borrowers. At the same time, local direction of mortgage capital may have served to elevate Representative political capital among constituents, given provision of mortgage finance to constituent households previously excluded from homeownership attainment. As boom turned to bust, Congressional proponents of the mortgage credit boom likely rushed to support legislation aimed at foreclosure relief for those same constituents. Political factors, including direction of campaign contributions and Representative-specific allocation of mortgage finance, provide important new insights as regards the political geography of subprime lending. Findings suggest that Congressional leaders as well as recipients of New Century campaign contributions may have benefited from gains to trade in the direction, pricing, and sizing of subprime mortgage loans.

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Figure 1
National Distribution of New Century Loans

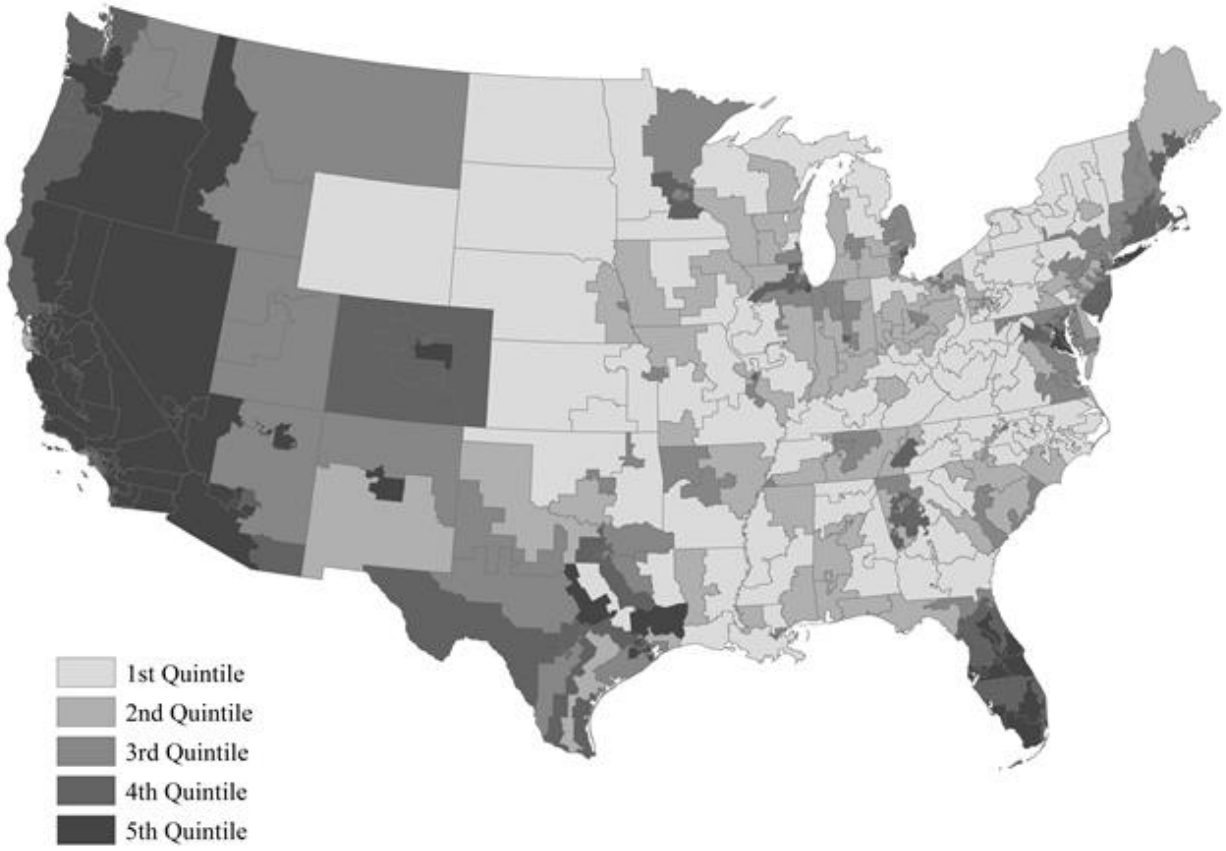


Figure 1: The figure uses data taken from the servicing database of New Century Financial Corporation on mortgage loan originations from 2003 to 2006, aggregated at the congressional district level.

Figure 2
California Distribution of New Century Loans

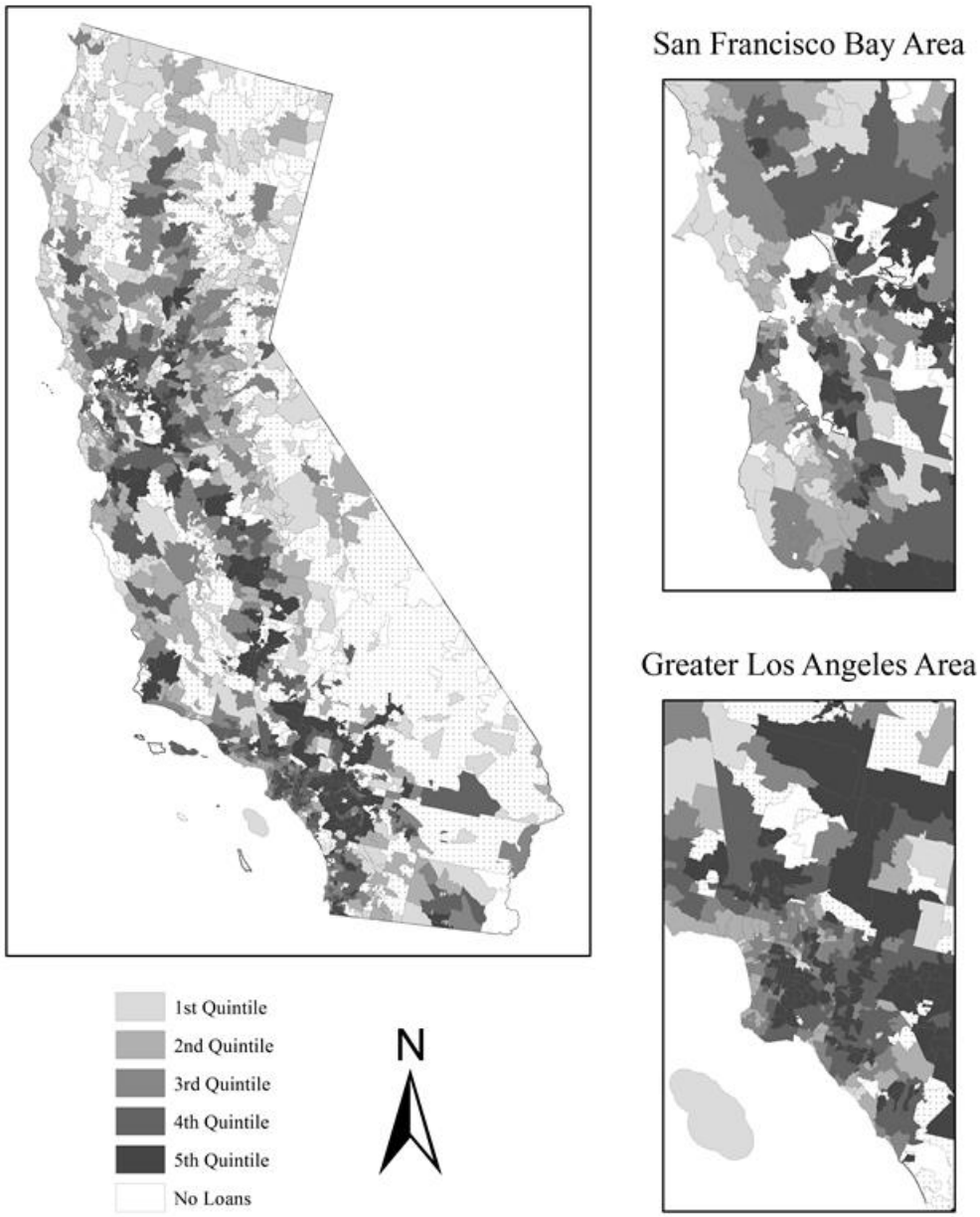


Figure 2: The figure uses data taken from the servicing database of New Century Financial Corporation on mortgage loan originations in 2006, aggregated at the zip code level.

## Table 1: Summary Statistics for the New Century Data

| Variable | All Years | | 2003 | | 2004 | | 2005 | | 2006 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Mean | S.d | Mean | S.d | Mean | S.d | Mean | S.d | Mean | S.d |
| | | | | | | | | | | |
| Congressional Attributes | | | | | | | | | | |
| Terms in Office | 5.867 | 4.023 | 5.762 | 4.137 | 5.600 | 4.012 | 5.976 | 3.995 | 5.975 | 3.999 |
| Conservative Ideology Score | 0.071 | 0.510 | 0.048 | 0.504 | 0.051 | 0.502 | 0.079 | 0.515 | 0.085 | 0.513 |
| New Century Donates to the Representative | 0.119 | 0.323 | 0.084 | 0.277 | 0.083 | 0.276 | 0.142 | 0.349 | 0.135 | 0.341 |
| Member of the Finance Committee | 0.153 | 0.360 | 0.160 | 0.366 | 0.160 | 0.366 | 0.148 | 0.355 | 0.150 | 0.357 |
| Congressional Leadership | 0.013 | 0.111 | 0.012 | 0.107 | 0.011 | 0.106 | 0.013 | 0.112 | 0.013 | 0.115 |
| Black Representative | 0.094 | 0.292 | 0.089 | 0.285 | 0.080 | 0.271 | 0.090 | 0.286 | 0.109 | 0.312 |
| Hispanic Representative | 0.064 | 0.244 | 0.057 | 0.232 | 0.061 | 0.239 | 0.068 | 0.252 | 0.064 | 0.245 |
| | | | | | | | | | | |
| New Century Variables | | | | | | | | | | |
| Original Interest Rate | 8.137 | 1.643 | 7.826 | 1.320 | 7.607 | 1.517 | 7.858 | 1.592 | 8.829 | 1.649 |
| Loan amount (nominal $) | 176189 | 126767 | 161312 | 100367 | 166912 | 111825 | 178438 | 128031 | 185954 | 142023 |
| ARM Loan | 0.629 | 0.483 | 0.669 | 0.471 | 0.595 | 0.491 | 0.628 | 0.483 | 0.634 | 0.482 |
| American Indian | 0.012 | 0.107 | 0.006 | 0.078 | 0.015 | 0.121 | 0.014 | 0.118 | 0.010 | 0.098 |
| Asian | 0.042 | 0.201 | 0.042 | 0.201 | 0.046 | 0.209 | 0.045 | 0.207 | 0.038 | 0.192 |
| Black Borrower | 0.186 | 0.389 | 0.175 | 0.380 | 0.162 | 0.369 | 0.171 | 0.377 | 0.217 | 0.412 |
| NHPI | 0.046 | 0.209 | 0.208 | 0.406 | 0.041 | 0.199 | 0.012 | 0.108 | 0.011 | 0.104 |
| White | 0.701 | 0.458 | 0.568 | 0.495 | 0.700 | 0.458 | 0.750 | 0.433 | 0.715 | 0.452 |
| Hispanic Borrower | 0.199 | 0.399 | 0.000 | 0.000 | 0.194 | 0.396 | 0.249 | 0.432 | 0.239 | 0.427 |
| Household Income | 83814 | 304719 | 71577 | 79257 | 75371 | 80463 | 85792 | 494226 | 92224 | 218845 |
| FICO Score | 619.753 | 60.649 | 601.062 | 60.508 | 621.682 | 62.602 | 625.753 | 59.598 | 621.064 | 58.919 |
| Loan to Value Ratio | 86.261 | 14.546 | 81.276 | 13.773 | 85.253 | 14.405 | 87.172 | 14.617 | 88.131 | 14.358 |
| Age of Borrower | 41.909 | 11.027 | 43.093 | 10.650 | 42.073 | 10.930 | 41.490 | 11.055 | 41.687 | 11.176 |
| Male | 0.614 | 0.487 | 0.634 | 0.482 | 0.626 | 0.484 | 0.615 | 0.487 | 0.599 | 0.490 |
| | | | | | | | | | | |
| Zip Code Variables | | | | | | | | | | |
| % College Graduate | 28.117 | 13.208 | 29.030 | 13.792 | 28.702 | 13.405 | 27.947 | 13.041 | 27.539 | 12.951 |
| % Black | 13.959 | 21.124 | 13.579 | 20.853 | 12.910 | 19.925 | 13.320 | 20.393 | 15.305 | 22.453 |
| % Hispanic | 19.407 | 21.864 | 19.753 | 22.140 | 20.264 | 22.151 | 19.803 | 21.992 | 18.400 | 21.423 |
| Log(Annual Employment) | 8.501 | 1.564 | 8.269 | 1.788 | 8.448 | 1.630 | 8.552 | 1.496 | 8.594 | 1.455 |
| Log(Population Density) | 6.274 | 1.654 | 6.330 | 1.741 | 6.340 | 1.612 | 6.269 | 1.633 | 6.215 | 1.657 |
| | | | | | | | | | | |
| N | 891361 | | 127498 | | 185731 | | 270098 | | 308458 | |

## Table 2: 2006 HMDA Models of Loan Rejection

| | (1) | (2) | (3) | (4) | (5) | (6) |
|---|---|---|---|---|---|---|
| Bank Sample | | Prime | | | Subprime | |
| Data Sample of Borrowers | All | Black | Hispanic | All | Black | Hispanic |
| | | | | | | |
| Explanatory Variables | The Dependent Variable =1 if Loan Rejected | | | | | |
| | | | | | | |
| Black Representative | 0.006 | 0.013 | -0.008 | 0.003 | 0.012 | -0.017* |
| | (0.005) | (0.008) | (0.007) | (0.007) | (0.010) | (0.010) |
| Hispanic Representative | -0.002 | -0.030 | -0.001 | 0.007 | 0.001 | 0.006 |
| | (0.007) | (0.019) | (0.010) | (0.012) | (0.026) | (0.012) |
| Conservative Ideology Score | -0.005** | -0.006 | -0.012** | -0.005 | 0.009 | -0.014** |
| | (0.002) | (0.006) | (0.005) | (0.004) | (0.008) | (0.007) |
| Terms in Office | 0.000 | -0.000 | 0.000 | 0.001 | 0.001 | 0.001 |
| | (0.000) | (0.001) | (0.001) | (0.000) | (0.001) | (0.001) |
| New Century Donates to the Representative | -0.003 | -0.007 | -0.004 | -0.005 | 0.010 | -0.003 |
| | (0.004) | (0.011) | (0.007) | (0.007) | (0.014) | (0.011) |
| Member of the Finance Committee | 0.007* | 0.008 | 0.011** | 0.007 | -0.011 | 0.009 |
| | (0.004) | (0.010) | (0.006) | (0.007) | (0.010) | (0.009) |
| Congressional Leadership | -0.006 | 0.010 | -0.015 | -0.009 | -0.040** | -0.002 |
| | (0.005) | (0.012) | (0.011) | (0.016) | (0.020) | (0.038) |
| Black Borrower | 0.122*** | | | 0.036*** | | |
| | (0.003) | | | (0.004) | | |
| Hispanic Borrower | 0.071*** | | | -0.009** | | |
| | (0.002) | | | (0.004) | | |
| log(Household Income) | -0.023*** | -0.028*** | -0.026*** | -0.035*** | -0.037*** | -0.001 |
| | (0.002) | (0.004) | (0.004) | (0.003) | (0.006) | (0.007) |
| Male | -0.016*** | 0.011*** | -0.015*** | 0.005* | 0.008* | -0.000 |
| | (0.001) | (0.004) | (0.003) | (0.003) | (0.005) | (0.005) |
| Census Tract Share Black | 0.044*** | 0.061*** | 0.049*** | 0.041*** | 0.023* | 0.016 |
| | (0.007) | (0.009) | (0.011) | (0.008) | (0.012) | (0.017) |
| Census Tract Share Hispanic | 0.039*** | 0.064*** | 0.045*** | 0.003 | -0.041 | 0.003 |
| | (0.007) | (0.021) | (0.011) | (0.013) | (0.025) | (0.016) |
| log(Median Census Tract Income) | -0.032*** | -0.048*** | -0.022*** | -0.023*** | -0.035*** | -0.021** |
| | (0.002) | (0.007) | (0.005) | (0.005) | (0.009) | (0.009) |
| Constant | 0.571*** | 0.860*** | 0.563*** | 0.756*** | 0.937*** | 0.581*** |
| | (0.026) | (0.073) | (0.058) | (0.052) | (0.095) | (0.101) |
| | | | | | | |
| Observations | 766,778 | 62,636 | 100,180 | 159,623 | 35,566 | 40,758 |
| R-squared | 0.032 | 0.021 | 0.010 | 0.009 | 0.009 | 0.006 |
| Robust standard errors in parentheses | | | | | | |
| *** p<0.01, ** p<0.05, * p<0.1 | | | | | | |
| F-Test on Political Variables | 2.92*** | 1.63 | 2.57** | 0.88 | 0.97 | 1.66 |

State fixed effects are included in each regression. Standard errors are clustered by Congressional District. The F-test tests for whether the seven Congressional attributes are jointly statistically significant.

**Table 3: New Century Linear Probability Models of Minority Loan Recipient**

| | Black Borrower | Hispanic Borrower |
|---|---|---|
| Representative Attributes | | |
| Black Representative | 0.0193 | -0.0225** |
| | (0.014) | (0.011) |
| Hispanic Representative | -0.0086 | -0.0091 |
| | (0.007) | (0.013) |
| Terms in Office | -0.0008* | -0.0003 |
| | (0.000) | (0.001) |
| Conservative Ideology Score | -0.0128*** | -0.0008 |
| | (0.005) | (0.006) |
| New Century Donates to the Representative | -0.0059 | 0.0002 |
| | (0.007) | (0.007) |
| Member of the Finance Committee | 0.0091 | 0.0014 |
| | (0.008) | (0.007) |
| Congressional Leadership | 0.0894*** | -0.0139 |
| | (0.032) | (0.011) |
| Borrower Attributes | | |
| Loan to Value | 0.0014*** | 0.0009*** |
| | (0.000) | (0.000) |
| Age | 0.0018*** | -0.0021*** |
| | (0.000) | (0.000) |
| Male | -0.0465*** | 0.0283*** |
| | (0.002) | (0.002) |
| Log(Household Income) | -0.0087*** | -0.0466*** |
| | (0.002) | (0.003) |
| Fico Score Spline First Segment | -0.0003*** | 0.0001** |
| | (0.000) | (0.000) |
| Fico Score Spline Second Segment | -0.0005*** | 0.0003*** |
| | (0.000) | (0.000) |
| Fico Score Spline Third Segment | -0.0008*** | 0.0008*** |
| | (0.000) | (0.000) |
| Fico Score Spline Fourth Segment | -0.0004*** | 0.0001 |
| | (0.000) | (0.000) |
| Zip Code Attributes | | |
| % College Graduate | 0.0011*** | 0.0006*** |
| | (0.000) | (0.000) |
| % Black | 0.0091*** | -0.0004*** |
| | (0.000) | (0.000) |
| % Hispanic | -0.0004*** | 0.0090*** |
| | (0.000) | (0.000) |
| Log(Population Density) | 0.0026** | 0.0027* |
| | (0.001) | (0.002) |

| | | |
|---|---|---|
| Log(Zip Code Annual Employment) | 0.0028*** | 0.0021 |
| | (0.001) | (0.001) |
| Constant | 0.1259*** | 0.5051*** |
| | (0.029) | (0.045) |
| Observations | 884,161 | 758,576 |
| R-squared | 0.328 | 0.304 |
| Robust standard errors in parentheses | | |
| *** p<0.01, ** p<0.05, * p<0.1 | | |
| F-Test on Political Variables | 3.16*** | 0.97 |

State/year/month fixed effects are included in each regression. Standard errors are clustered by Congressional District. The F-test tests for whether the seven Congressional attributes are jointly statistically significant. The Black borrower regression includes loans between 2003 through 2006 while the Hispanic borrower regression includes loans between 2004 through 2006. These regressions include additional controls for the borrower's income and the loan type.

## Table 4: New Century Models of Mortgage Loan Pricing

| Variables | log(Original Interest Rate) | | |
|---|---|---|---|
| | All Borrowers | Black Borrowers | Hispanic Borrowers |
| Representative Attributes | | | |
| Black Representative | -0.0032 | -0.0057 | -0.0042 |
| | (0.003) | (0.004) | (0.004) |
| Hispanic Representative | 0.0054 | 0.0000 | 0.0068 |
| | (0.003) | (0.004) | (0.004) |
| Terms in Office | 0.0002 | 0.0002 | 0.0002 |
| | (0.000) | (0.000) | (0.000) |
| Conservative Ideology Score | 0.0008 | -0.0014 | 0.0016 |
| | (0.002) | (0.003) | (0.002) |
| New Century Donates to the Representative | -0.0071*** | -0.0030 | -0.0118*** |
| | (0.002) | (0.003) | (0.003) |
| Member of the Finance Committee | -0.0014 | -0.0003 | 0.0035 |
| | (0.002) | (0.003) | (0.003) |
| Congressional Leadership | -0.0138*** | -0.0235*** | -0.0077 |
| | (0.004) | (0.008) | (0.008) |
| Borrower Attributes | | | |
| Loan to Value | 0.0006*** | 0.0005*** | 0.0007*** |
| | (0.000) | (0.000) | (0.000) |
| Age | 0.0001*** | -0.0000 | 0.0002*** |
| | (0.000) | (0.000) | (0.000) |
| Male | -0.0047*** | 0.0011 | -0.0075*** |
| | (0.000) | (0.001) | (0.001) |
| Log(Household Income) | 0.0271*** | 0.0295*** | 0.0345*** |
| | (0.001) | (0.001) | (0.001) |
| Fico Score Spline First Segment | -0.0019*** | -0.0018*** | -0.0022*** |
| | (0.000) | (0.000) | (0.000) |
| Fico Score Spline Second Segment | -0.0015*** | -0.0015*** | -0.0013*** |
| | (0.000) | (0.000) | (0.000) |
| Fico Score Spline Third Segment | -0.0006*** | -0.0005*** | -0.0007*** |
| | (0.000) | (0.000) | (0.000) |
| Fico Score Spline Fourth Segment | -0.0005*** | -0.0004*** | -0.0004*** |
| | (0.000) | (0.000) | (0.000) |
| Zip Code Attributes | | | |
| % College Graduate | -0.0011*** | -0.0012*** | -0.0010*** |
| | (0.000) | (0.000) | (0.000) |
| % Black | 0.0003*** | 0.0002*** | 0.0002*** |
| | (0.000) | (0.000) | (0.000) |
| % Hispanic | -0.0001*** | -0.0002*** | -0.0001* |

| | | | |
|---|---|---|---|
| | (0.000) | (0.000) | (0.000) |
| Log(Population Density) | -0.0007* | 0.0002 | -0.0012* |
| | (0.000) | (0.001) | (0.001) |
| Log(Zip Code Annual Employment) | 0.0000 | 0.0003 | 0.0010 |
| | (0.000) | (0.001) | (0.001) |
| Constant | 3.2124*** | 3.1165*** | 3.2774*** |
| | (0.017) | (0.031) | (0.032) |
| | | | |
| Observations | 884,161 | 164,056 | 176,203 |
| R-squared | 0.660 | 0.623 | 0.732 |
| Robust standard errors in parentheses | | | |
| *** p<0.01, ** p<0.05, * p<0.1 | | | |
| | | | |
| F-Test on Political Variables | 4.24*** | 2.07** | 3.49*** |

State/year/month fixed effects are included in each regression. Standard errors are clustered by Congressional District. The F-test tests for whether the seven Congressional attributes are jointly statistically significant. The Black borrower regression includes loans between 2003 through 2006 while the Hispanic borrower regression includes loans between 2004 through 2006. These regressions include additional controls for the borrower's income and the loan type. The "all borrowers" regression includes dummies for the borrower's race.

Table 5: New Century Loan Amounts

| | (1) | (2) | (3) |
|---|---|---|---|
| Borrower Sample | All | Blacks | Hispanics |
| Explanatory Variables | | Log(Loan) | |
| Black Representative | 0.0230 | 0.0470* | 0.0219 |
| | (0.030) | (0.028) | (0.029) |
| Hispanic Representative | -0.1095*** | -0.0427 | -0.1182*** |
| | (0.038) | (0.031) | (0.040) |
| Terms in Office | -0.0019 | 0.0003 | -0.0002 |
| | (0.002) | (0.002) | (0.003) |
| Conservative Ideology Score | -0.0357** | -0.0066 | -0.0664*** |
| | (0.016) | (0.021) | (0.023) |
| New Century Donates to the Representative | 0.0410* | -0.0101 | 0.0660** |
| | (0.021) | (0.027) | (0.027) |
| Member of the Finance Committee | 0.0352* | 0.0163 | 0.0032 |
| | (0.019) | (0.024) | (0.021) |
| Congressional Leadership | 0.0932** | 0.1821*** | 0.0319 |
| | (0.038) | (0.058) | (0.059) |
| Age | -0.0007*** | -0.0000 | -0.0014*** |
| | (0.000) | (0.000) | (0.000) |
| Male | -0.0133*** | -0.0177*** | -0.0116*** |
| | (0.001) | (0.003) | (0.002) |
| Log(Household Income) | 0.4377*** | 0.4002*** | 0.4382*** |
| | (0.006) | (0.012) | (0.010) |
| Fico Score Spline First Segment | 0.0012*** | 0.0012*** | 0.0013*** |
| | (0.000) | (0.000) | (0.000) |
| Fico Score Spline Second Segment | 0.0005*** | 0.0005*** | 0.0005*** |
| | (0.000) | (0.000) | (0.000) |
| Fico Score Spline Third Segment | -0.0001* | -0.0004*** | 0.0001 |
| | (0.000) | (0.000) | (0.000) |
| Fico Score Spline Fourth Segment | 0.0003*** | 0.0004*** | 0.0004*** |
| | (0.000) | (0.000) | (0.000) |
| % College Graduate | 0.0091*** | 0.0097*** | 0.0080*** |
| | (0.000) | (0.001) | (0.001) |
| % Black | -0.0019*** | -0.0013*** | -0.0018*** |
| | (0.000) | (0.000) | (0.000) |
| % Hispanic | 0.0022*** | 0.0028*** | 0.0017*** |
| | (0.000) | (0.001) | (0.000) |
| Log(Population Density) | 0.0168*** | 0.0074 | 0.0291*** |
| | (0.004) | (0.006) | (0.006) |
| Log(Zip Code Annual Employment) | -0.0119*** | -0.0129*** | -0.0136*** |
| | (0.002) | (0.004) | (0.004) |
| Constant | 4.8347*** | 5.2563*** | 4.9109*** |
| | (0.081) | (0.157) | (0.132) |
| Observations | 884,161 | 164,056 | 176,203 |

| | | | |
|---|---|---|---|
| R-squared | 0.794 | 0.789 | 0.852 |
| Robust standard errors in parentheses<br>*** p<0.01, ** p<0.05, * p<0.1 | | | |
| F-Test on Political Variables | 4.45*** | 2.93*** | 3.66*** |

State/year/month fixed effects are included in each regression. Standard errors are clustered by Congressional District. The F-test tests for whether the seven Congressional attributes are jointly statistically significant. The Black borrower regression includes loans between 2003 through 2006 while the Hispanic borrower regression includes loans between 2004 through 2006. These regressions include additional controls for the borrower's income and the loan type. The "all borrowers" regression includes dummies for the borrower's race.