Lending Next to the Courthouse: Exposure to Adverse Events and Mortgage Lending Decisions
(Da Huo Mingzhu Tai Yuhai Xuan)

Arkodipta Sarkar
HKUST

ABFER
May 2021
Summary

This paper:

- studies the way exposure to foreclosure news can impact lending decisions.
- attributes the effect to be driven by changes in risk preference or beliefs of individuals exposed to foreclosure news.

Instrument for salience of foreclosure news

- Distance of loan officer's workplace and county courthouse.

Empirical Strategy

- Within county and within bank comparison of loan officers with varying distance to court.
- Within-county-year controls for local macroeconomic shocks.

Findings

- 8.2% increase in rejection rate.
- 9.5% lower mortgage origination.
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1. Is the motivation about identifying whether individual’s exposure can affect decision making; or
2. Is the motivation about microfounding individual’s preference as a potential source for aggregate credit misallocation

If it's the first:
▶ There exist literature that talks about individuals' exposure to different events like the great depression, communal conflicts, disasters affect their preferences.
▶ Why is this scenario of foreclosure events/news particularly different?
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If it's the second:
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Distance can possibly be a measure for higher information (Degryse and Ongena 2005). Loan officer closer to the courthouse can get soft information about the prevailing market conditions. Information advantage would also predict a higher rejection and lower loan disbursal. Consequently the effect observed in the paper could be due to higher information and not preference.
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Shift in preference would entail that loan officers sacrifice profit to fulfill their preference. Consequently, there should be lower profits in branches close to the court.

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Lower appetite for risk would also imply higher screening leading to a higher dispersion in the loans disbursed.

High standard deviation in the lending portfolios.
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Reverse Causality

Could reduced credit supply itself cause higher foreclosure?

It would be helpful if the authors to provide an event time graph?

$\alpha_{ct}$: county $\times$ year allows estimate from across branch or bank.

$\alpha_{bt}$: bank $\times$ year allows estimate from across county.

County specific heterogeneities of operation of the same bank

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