Subprime Lending, Mortgage Foreclosures and Race: How far have we come and how far have we to go?

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Capital at the point of impact.

Background

For most of the 20th century, lending discrimination occurred primarily through the denial of credit to minority group members and to the neighborhoods in which they lived. Redlining is a place-based practice in which lenders denied mortgage credit to neighborhoods with substantial numbers of minorities – typically, African Americans and Latinos. Together with the differential treatment of minority and White applicants, a people-based practice, mortgage credit discrimination accelerated segregation and neighborhood decline. For many years, the private market and federal government (e.g., through the explicit practices of the Federal Housing Administration) operated under laws and policies that permitted (and many argue, promoted) redlining and racial segregation.[1]

After the passage of a number of historically significant federal laws in the 1960s and 1970s, especially the Fair Housing Act (Title VIII of the Civil Rights Act of 1968) and the Equal Credit Opportunity Act of 1974 (ECOA), federal law and policy outlawed lending discrimination, and started to require data collection among federally-regulated lending institutions. However, early enforcement of federal fair lending laws was anemic as evidenced by the limited number of legal actions filed, most of which were by private actors.[2] Data collection on lending institutions did not begin in earnest amongst regulators until petitions were made to the financial regulatory agencies by the National Urban League in 1971. Failing to adequately respond to the National Urban League's earlier demands, as well as requests from the US Department of Housing and Urban Development ("HUD") and the US Department of Justice, the Urban League filed suits against the financial regulators in 1976. The settlement of those suits had the regulators (except for the Federal Reserve, which argued that the plaintiffs lacked standing to bring the suit)[3] agreeing to a set of changes including but not limited to: specialized training in fair lending laws for consumer protection exams, race and sex data on loan applicants, hiring of a full-time civil rights expert, studying how HMDA data could be more fully utilized. All of the remedial actions were designed to meet the civil rights aspect of their duties.[4]

With the passage of the Home Mortgage Disclosure Act in 1975, and the Community Reinvestment Act in 1977, came a large body of research by academics, regulators and advocacy groups (both community-based and industry), much of which showed a relationship between the racial composition of an area and the extent to which mortgage credit was extended (and later, as the reporting requirements of HMDA changed, the differential rates of denial between White and minority applicants).[5] Using the early HMDA data, research throughout the 1980s examined the flow of capital into minority communities, and consistently found lending disparities. While early HMDA studies were frequently critiqued because they lacked complete empirical control for the level of effective demand, study after study found that race and ethnicity had negative effects on credit flows.[6] Shlay and Goldstein (1993) reviewed 23 post-1980 through 1991 studies that examined the effect of the presence of African Americans (18 studies), Hispanics (8 studies) or minorities generally (5 studies) in an area. Every study found a negative relationship between the presence of these groups in neighborhoods and the amount of conventional mortgage credit that flowed into

[1] See, for example: Squires (1994).
[2] Schwemm (1995).
[3] See: 78 F.R.D. 543; 1978 U.S. Dist. LEXIS 17962.
[4] Goering and Wienk (1996).
[5] See: www.ffiec.gov for a complete legislative history of HMDA and CRA.
[6] See, for example, Benston (1981), Galster (1992), or Wienk (1992) for a review of the limitations of early HMDA studies.

them. These studies all had their limitations, but they did serve to document what many community development and civil rights advocates had complained of: that minority group members and minority communities were not receiving a sufficiency of mortgage credit to thrive.

The Fair Housing Act
Title VIII of the Civil Rights Act of 1968, as amended

Section 804: [42 U.S.C. 3604] Discrimination in sale or rental of housing and other prohibited practices

(a) To refuse to sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny, a dwelling to any person because of race, color, religion, sex, familial status, or national origin.

Section 805: [42 U.S.C. 3605] Discrimination in Residential Real Estate-Related Transactions

(a) In General.—It shall be unlawful for any person or other entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race, color, religion, sex, handicap, familial status, or national origin.

(b) Definition.—As used in this section, the term "residential real estate-related transaction" means any of the following:

(1) the making or purchasing of loans or providing other financial assistance—

a. for purchasing, constructing, improving, repairing, or maintaining a dwelling; or
b. secured by residential real estate.

Nineteen eighty-eight marked the twentieth anniversary of the federal Fair Housing Act ("FHAct") and the year of its most significant amendments. Not only did Congress amend the law to include protections for families with children (i.e., familial status) and persons with disabilities (i.e., handicap status), they also gave HUD significant enforcement powers going beyond mere attempts to settle cases (i.e., the authority granted in 1968). HUD was given authority to prosecute cases of discrimination, and to obtain monetary and injunctive relief for persons found to have been victims of a discriminatory housing practice. Additionally, Congress gave the Secretary of HUD the authority to file complaints alleging discriminatory housing practices on his own initiative (Section 810 of the Fair Housing Act).[7]

Concomitant with the wave of HMDA-based research was a remarkably influential series of articles published in 1988 by the Atlanta Journal / The Atlanta Constitution written by Bill Dedman. Using a variety of quantitative and qualitative sources of data, Dedman's Pulitzer Prize-winning series shined a very bright light on racial disparities in home mortgage lending in Atlanta, GA.

Prompted by the public attention to Dedman's series and a recently expanded FHAct, the Department of Justice ("Justice") commenced inquiries into the lending practices of 64 institutions.

[7] See Kushner and Fishbein (1992) for a thorough description of the pre- and post-1988 FHAct provisions and an evaluation of HUD's early enforcement efforts.

The responses from those institutions lead to Justice's more focused investigation and ultimate charge (in 1992) of racial discrimination under the FHAct and ECOA, in the seminal case - U.S. v. Decatur Federal Savings and Loan Association (Ritter, 1996). Decatur was the first case where Justice charged a *pattern or practice*[8] of racial discrimination in lending. Justice alleged, among other things, that Decatur marketed its loans primarily to White consumers, excluded African American areas from its lending footprint, refused to offer loan products that were especially desirable to African American communities (such as FHA and VA loans), employed only a small number of African Americans in key lending positions, provided assistance to White applicants that was denied to African American applicants, and denied equally qualified African Americans loans more frequently than their White counterparts. In a Consent Decree with Justice, Decatur agreed to a number of remedial measures including, but not limited to: affirmative advertising practices; practices designed to equate the mortgage production levels of loan officers in minority and White areas; appointment of a Review Underwriter and a Review Appraiser to ensure equal treatment of applicants and applicants' properties; train staff in the relevant fair housing laws and Decatur's obligations under the Consent Decree; deposit $1 million into a fund to compensate aggrieved persons; and submit reports of activities and compliance to Justice.[9]

While Justice began to prosecute cases, other groups began to use federally mandated data from lending institutions to investigate whether racial discrimination – not just disparities in credit flows - appeared to exist. Most notable among those studies was the Federal Reserve Bank of Boston's 1992 study using HMDA data augmented with a variety of traditional underwriting variables obtained from lenders (absent from all other studies to-date); this study showed that racial discrimination existed in the Boston metropolitan lending market. The authors of this study reported that controlling for relevant financial risk factors, African Americans were rejected for loans 56% more often than Whites. While the results of this study lead to a "…wholesale media and social science assault…on the study's credibility..." (Goering and Wienk, p. 15), the study's main findings confirmed the observed racial disparity (c.f., Carr and Megbolugbe, 1993).

Throughout the decade of the 1990s, the common view of what lending discrimination entailed shifted from classic differential treatment leading to the denial of credit and redlining as exemplified in *Decatur*. In 1999, HUD released a study conducted by the Urban Institute using paired mortgage application testing that found persistent discrimination against minorities, not just in the rates in which they were rejected, but in the terms of their loans (price discrimination). And using data from the American Housing Survey, HUD found considerable rates of unexplained differences in pricing between White homeowners and their African American and Latino counterparts. Thus, the paradigm was shifting away from a denial of credit to one in which credit was extended but under different terms.[10] HUD's examination of 1998 HMDA data demonstrated that subprime loans (a relatively recent market phenomena) were five times more likely to be made in African American neighborhoods than in White neighborhoods. Additionally, homeowners in high-income African American neighborhoods were twice as likely to receive subprime loans as residents in low-income White neighborhoods. HUD then examined lending in five cities: Atlanta, Philadelphia, New York, Chicago and Baltimore. They found that African Americans received disproportionate shares of subprime loans in all five cities. Calem, et al. (2002) examined HMDA data in Philadelphia and

[8] The term pattern or practice in this context generally refers to the notion that an act of discrimination within a lending institution is not a single isolated act; it is that the discrimination is a regular and routine part of the way the institution does its business. See Schwemm (2000) for a more thorough description.

[9] See: United States of America v. Decatur Federal Savings and Loan Association. Consent Decree.

[10] See, for example: Apgar, et al. (2005).

Chicago to determine the equality in the likelihood of whether African Americans and Whites received subprime loans; they also examined the impact of the racial composition of the area in which a collateral property was located. They found that over and above area and individual credit risk factors, minority group members and residents of minority communities received more subprime loans than they should have. The one exception to the pattern was refinance loans in Philadelphia. This exception was, according to the authors, possibly related to the active CRA lending in several minority communities in Philadelphia.

Both the research and Justice's involvement in fair lending cases evolved along with the shifting paradigm of what lending discrimination in the 21st century meant. From classic redlining in Decatur, Justice pursued cases alleging price discrimination, and eventually, to 'reverse redlining' and practices that could be described as *predatory lending*. Predatory lending was gaining recognition as an evolving type of lending discrimination and was acknowledged as such in academic literature,[11] private lawsuits,[12] and also by the state[13] and federal governments. This body of cases sent a signal to the lending industry of the vigor and parameters of the United States government's interpretation of the FHAct.

This evolution is generally understood to trace its roots to a set of legislative changes and associated changes in the financial sector. Specifically, four pieces of legislation – the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) and the Alternative Mortgage Transaction Parity Act of 1982 (AMTPA) and the 1986 Tax Reform Act and the 1994 Home Ownership and Equity Protection Act ("HOEPA") Amendments to the Truth in Lending Act – are generally credited with setting the stage for a rise in subprime mortgage lending and that set of transactions commonly referred to as "predatory lending."[14,15] Moreover, the rise of the process of securitizing subprime loans created a seemingly limitless well of funds looking to find a home in the first-lien (i.e., purchase money and refinances of existing loan(s) into the first position) mortgage market. HUD reported that subprime lending, which totaled $20 billion nationwide in 1993, increased to $150 billion in 1998. Subprime volume reportedly increased to $625 billion in 2005 (Goldstein, 2007; Gramlich, 2007) and to between $600 billion and $634 billion by 2006.[16] Alt-A lending volume increased from $60 billion in 2001 to $400 billion in 2006 (Coleman, et al., 2008; Zandi, 2009).

Starting with 2004 HMDA data reports, lenders included information concerning whether the loan made was at a rate at least 300 basis points higher than the relevant Treasury yield for a comparable maturity - commonly denoting a subprime loan. And in 2004, 2005 and 2006, the

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11 See, for example: Goldstein (2007); Taylor, et al. (2004); Goldstein (1999).

12 See, for example: Hargraves v. Capital City Mortgage Corp. C.A. No. 98-1021 (U.S. District Court, D. D.C.)

13 See, for example: Taylor, et al., v. McGlawn and McGlawn, et al. (http://www.phrc.state.pa.us/legal/finalorders/200027668+.pdf) or Commonwealth of Massachusetts v. H&R Block, Inc. (http://www.mass.gov/Cago/docs/press/2008_06_03_option_one_suit_attachment1.pdf)

14 See, for example: Mansfield (2000); Gramlich (2007); Ernst, et al. (2004).

15 Among other things, the HOEPA amendments allowed lenders to charge what were previously prohibited interest rates if they gave notice to consumers that the high rates were being charged. In addition to the enhanced notice, other protections became effective for loans exceeding the HOEPA threshold (e.g., a bar on negative amortization loans, HOEPA loans could not have pre-payment penalties, assignee liability, etc.). White (2004) reports that the HOEPA threshold has served to push down the points and fees typically charged so that loans would not be categorized as such.

16 TRF identified $633.7 billion of loans carrying a reportable rate spread in the 2006 HMDA data. Coleman, et al. (2008) estimate $600 billion based on data from Inside Mortgage Finance; Zandi (2009) reports $615 billion. They each report an additional $395 billion to $400 billion in Alt-A lending volume in 2006.

Federal Reserve analyzed HMDA data, and found disparities in the rate that minorities and those living in neighborhoods with significant minority concentrations, receive subprime loans. For example, in 2004, the Federal Reserve partnered with the Credit Research Center of Georgetown University to examine additional risk factors that could explain why HMDA consistently showed that minorities were more likely to receive subprime loans. After controlling for a number of risk factors, disparities between Whites and African Americans and Whites and Latinos reduced, but remained statistically significant.[17]

A number of scholars and industry / advocacy groups examined HMDA (and augmented HMDA) data, and similarly found disparities in the rate minority group members and residents of minority communities received subprime loans. For example, the Center for Responsible Lending combined HMDA data with borrower information from a loan servicer, including FICO scores, presence of private mortgage insurance, and loan to value ratios. They found that even after taking these data into account, African American borrowers were more likely to receive subprime purchase and refinance loans. The disparities were especially great amongst the subset of borrowers that have prepayment penalties. Latino borrowers purchasing homes were 29 to 142 percent more likely to receive a higher rate loan than Whites. (Differences with refinances were not statistically significant at a 95 confidence interval). At The Reinvestment Fund ("TRF"), we examined HMDA data in a number of areas, including Baltimore, Maryland; Philadelphia, Pennsylvania; Newark, New Jersey and Washington, D.C. To varying degrees, but in all locations, residents of minority neighborhoods were more likely to receive subprime loans than residents of comparable White areas.

Targeting of minorities for subprime lending is not only a case of encouraging a group of people to pay more for their mortgage, but also exposing them to a greater risk of losing their home. It is axiomatic that a subprime loan is more likely to default than a prime loan, and that more defaults lead to more foreclosures.[18] In Chicago, in Atlanta, in the State of New Jersey, researchers have all noted that increased subprime lending - consistently higher in minority communities - leads to higher numbers of foreclosures. Other research suggests that those resultant foreclosures adversely impact surrounding property values (Immergluck and Smith, 2006) and accelerate racial transition from White to African American (Lauria and Baxter, 1999).

The Regulatory and Law Enforcement Environments

Despite an increased awareness of lending discrimination and the pitfalls of subprime lending, there appears an inverse relationship between the rise of subprime lending and HUD and Justice's record of targeting abusive lending and lending discrimination. After appearing to take steps towards targeting the subprime lending industry in a small number of actions, federal fair lending cases have slowed. Justice announced they will no longer pursue disparate impact cases, a useful theory for some of the more complex predatory lending cases, and their filing of fair housing / fair lending cases is now negligible.[19]

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17 See: Avery, et al., 2005.

18 In Philadelphia, for example, as of March 2008, 5.4% of prime loans were delinquent, while 21.9% of subprime loans were delinquent.

19 See: National Fair Housing Alliance (2008); Wiggins (2008). Note that HUD, Justice and the financial regulators had a long-standing public recognition of the disparate impact theory of proof of lending discrimination as articulated in the Interagency Policy Statement on Discrimination in Lending (Federal Register, Vol. 59, No. 73, Friday, April 15, 1994, pp. 18266-18274).

HUD significantly reduced the number of FHAct cases it charges per year (of which lending cases are only a subset), from 88 in fiscal year 2001 to 31 in fiscal year 2007 (National Fair Housing Alliance, 2008). A review of Justice's Annual Reports to Congress shows that between 2000 and 2007 (inclusive), HUD referred a total of five pattern and practice lending cases. The referral in 2000 was a joint referral with the Federal Trade Commission. No referrals were made in 2006 or 2007.[20] HUD's administrative process for adjudicating housing / lending discrimination complaints that HUD itself has investigated and deemed violative of the FHAct declined so much that they no longer even have administrative law judges ("ALJ") on staff to hear cases that HUD charges and do not elect to federal district court.[21] As a result, should the parties to a FHAct case not "elect" to federal court, HUD's administrative process must offer an ALJ from another federal agency likely without the requisite familiarity with the history and congressional purpose of the FHAct necessary to render a proper decision. Between 1996 and 2000, HUD ALJ's rendered a total of 24 decisions; since 2000, the ALJ's rendered a total of 16 decisions; none were rendered in 2005 or 2006 and one of the two in 2007 was a remand from the Seventh Circuit Court of Appeals based on a contested decision rendered by an ALJ in 2004.[22] HUD's recent history of filing Secretary Initiated lending cases is scant; HUD's own website details three cases filed since 2002, none of which allege discrimination in financing.[23] More recently, the Assistant Secretary of Fair Housing and Equal Opportunity stated that the complexity of systemic lending discrimination cases and HUD's own shortage of internal specialists to conduct the complex and oftentimes statistical investigations causes the cases to remain open without resolution.[24] While Congress saw fit to entrust the responsibility for enforcing the FHAct with HUD because of the institutional knowledge and experience in the housing market, the current custodians of that responsibility allowed the administrative process to wither.

Several state officials and private actors attempted to fill the void. For example, the Attorney General of the State of Massachusetts targeted abusive lending, including recent cases against Fremont Mortgage.[25] The City of Baltimore sued Wells Fargo, alleging race discrimination in lending and the resultant foreclosures.[26] However, for multiple reasons, state prosecutions and private lawsuits are no substitute for federal action.

First, the impact of a state or city lawsuit against a lender is generally smaller and has less reach than federal prosecutions. Second, Attorneys General do not have the same jurisdiction to prosecute banks as that of the federal government. For example, after targeting national banks, former New York Attorney General Eliot Spitzer was sued by the OCC, which argued successfully that he did not have the power to regulate national banks, and that those banks were not subject to

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20 All of Justice's Annual Reports to Congress are available at: www.usdoj.gov/crt/foia.php.

21 See: National Fair Housing Alliance (2008). Note that HUD's website currently lists no ALJ's – only two vacant positions are shown. In the Office of Administrative Law Judges, there is only a Law Clerk and a Staff Assistant/Docket Clerk. See: http://www.hud.gov/offices/oha/about.cfm.

22 Data were obtained from: http://www.hud.gov/offices/oha/oalj/cases/fha/aljalpha.cfm. One 2003 ALJ decision was not among the listed cases (Secretary of HUD v. Senior Nevada Benefit Group, L.P., IDA, Inc., and Leroy Black). The Judge's conduct in this case concerning the evaluation of the Complainant's damages prompted the Secretary of HUD to remove him from the case and remand it for a new decision on damages. The 2004 ALJ decision in the case was rendered by a different ALJ.

23 http://www.hud.gov/offices/fheo/enforcement/sec_initiated.cfm

24 See: Kendrick (2007).

25 See: http://www.mass.gov/Cago/docs/press/2008_02_26_fremont_pi.pdf.

26 http://www.baltimorecity.gov/news/press/0108/Complaint%20Draft%20(FINAL)%2012%2020%2007.pdf

increasingly stringent state anti-predatory lending laws.[27] In essence, the OCC preempted the authority of the state Attorney General to enforce the law. A subsequent but related decision by the Supreme Court of the United States denied the authority of the Banking Commission of Michigan to regulate Wachovia Bank's mortgage subsidiary (Wachovia Mortgage Corporation). Thus, states cannot touch non-bank subsidiaries either.[28] And in Pennsylvania, following the City of Philadelphia's recognition of a rise in predatory lending and mounting foreclosures, Philadelphia City Council passed an anti-predatory lending law in 2001.[29] Within months, the Pennsylvania Legislature, with the strong support of the lending industry, passed a bill that preempted the City's authority to regulate in any way the activities of lenders.[30]

Concerns with the federal civil rights enforcement effort in the area of fair lending are mounting. On April 11, 2008, Congressman Barney Frank along with 15 members of the House Financial Services Committee sent a letter to the Government Accountability Office ("GAO"). In the letter, the members stated that "…information obtained by the House Oversight and Investigations (O&I) Subcommittee of the Financial Services Committee has raised questions about the thoroughness and effectiveness of Federal regulators' oversight and enforcement efforts of Fair Lending laws."[31] Among other things, Frank requests that GAO review: (1) the level and adequacy of resources; (2) utility of HMDA to identify problems and whether the regulators have fully leveraged HMDA; (3) the extent to which the regulators comply with their own procedures and whether those procedures are an effective means to identify problems; (4) consistency and efficacy of regulator follow-up with HUD and Justice; (5) adequacy and effectiveness of the procedures between HUD and Justice for when to refer and how to proceed with cases sent to Justice by HUD.

Thus, as the early (post-1988 FHAct amendments) history of Justice teaches us, to have systemic influence on the industry, federal regulation and prosecution must be active. [See Figure 1]

Subprime Lending, Foreclosures and Race

The failure of subprime lenders post-1990 is no secret. High-volume national lenders have been failing (or acquired and closed) since the 1990s, based, at least in part, on the poor quality of their loans and the drying up of the capital they needed to extend loans; United Companies Lending Corporation, The Money Store, Equicredit, Option One, Ameriqest, New Century, to name a few. More recently, we observed threats to the continued viability of lenders that did a mix of prime, Alt-A and subprime loans (e.g., Countrywide). Meanwhile, FHA loans, which lost significant market share to subprime loans over the years, have rebounded considerably. In both Pennsylvania and

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[27] In Office of the Comptroller of the Currency v. Eliot Spitzer, the court held that the National Bank Act and the OCC's regulations precluded Spitzer from "assertion of visitorial authority" and that he was "…permanently enjoined from issuing subpoenas or demanding inspection of the books and records of any national banks in connection with his investigation into residential lending practices; from instituting any enforcement actions to compel compliance with the Attorney General's already existing informational demands; and from institution actions in the courts of justice against national banks to enforced state fair lending laws."

[28] See: http://www.supremecourtus.gov/opinions/05pdf/04-1186.pdf

[29] The bill passed by Philadelphia City Council took effect even though the Mayor of Philadelphia chose not to sign the bill.

[30] See: The Reinvestment Fund (2005).

[31] Letter obtained from: www.house.gov/apps/list/press/financialsvcs_dem/press041108.shtml.

Maryland, more FHA loans were made in the first half of calendar year 2008 than in all of 2005.[32] Apparently, FHA is reclaiming a part of the mortgage market formerly captured by the nation's subprime lenders. The critical question for FHA is whether the lenders originating FHA loans can reclaim market share and at the same time maintain strong, responsible underwriting and loss mitigation techniques.

Excerpts from: "Long Road to Justice; the Civil Rights Division at 50"

The results of these efforts were remarkable in such a short period of time. Due in part to the Division's work and its general impact on the banking profession, the availability of loans to minorities expanded dramatically. At the same time, however, the Division has done little over the past 10 years to require conventional lenders to penetrate the African-American and Latino homeownership markets nationwide. It has failed to challenge the discriminatory predatory practices – such as steering Blacks and Latinos to subprime loans and lenders when they could qualify for conventional loans – that affect the lending market so dramatically today…

The general criticisms of politicization, anemic enforcement, and a disregard of mission further affect housing discrimination enforcement, as they do with regards to other civil rights issues…

The number of enforcement cases brought by the Division – both "pattern or practice" and HUD election cases – has dropped significantly in recent years; and that decrease is most evident in cases alleging racial discrimination…

Unfortunately, as with many other sections of the civil rights Division in recent years, many qualified attorneys have left and/or been pushed out by the admnistration…

Leadership Conference on Civil Rights Education Fund, pp 23-24.

There is evidence that a group of "risky lenders" clustered their lending in lower income and minority communities (California Reinvestment Coalition, et al., 2008). High-risk subprime lenders, defined by their authors as lenders that went out of business in the recent collapse of the subprime lending industry, originated significantly disparate shares of their loans in minority communities. The implication of this work is that the disparate share of risky loans in minority areas will likely go into foreclosure at elevated rates and thus the resultant damage will be magnified (and for the people, of any race or ethnic origin, who reside in those communities). In *Lost Values*, TRF examined 1998 loans that reached foreclosure in Philadelphia, and found that 3 of the top 5 lenders with loans in foreclosure were out of business.[33] However, even the proportion of 'risky lenders' - subprime

[32] Data provided by HUD's Mid-Atlantic Homeownership Center to TRF show that in the first half of calendar year 2008, FHA endorsed 11,713 purchase money mortgages in Pennsylvania and 7,402 purchase money mortgages in Maryland. In calendar year 2005, FHA endorsed 11,102 purchase money mortgages in Pennsylvania and 5,413 purchase money mortgages in Maryland.

[33] Goldstein (2004) shows data that demonstrate that all five of the top five lenders with loans in foreclosure in the lowest home price areas (which are disproportionately minority in Philadelphia) were then – or are now – out of business.

lenders that have gone out of business during the credit crunch - appear concentrated in minority communities.[34]

Research has shown that minority group members and residents of minority communities are more likely to receive subprime loans. When those subprime loans reach delinquency faster and more frequently than prime loans and those delinquencies lead to increased levels of foreclosures, they are felt unevenly by various communities. The "market corrections" that put these lenders out of business do not help the borrowers or communities within which their bad loans were originated. The market may have corrected - but the risky loans which caused them to fail are still in the hands of many homeowners, portending even more foreclosures. It is from this framework that we examine subprime lending, delinquencies and foreclosures in two cities - Baltimore and Philadelphia - and the differing levels of impact they have on communities and people of color.

The link between race and predatory lending is less well established; most research linking the two establishes the relationship between race and subprime lending. Equating the two, however, is imprecise. Predatory lending is a term that became part of the public dialogue in the mid to late 1990s. A bright-line definition of the term still eludes us. But in general, people define predatory loans as including one or more of the following characteristics: (1) a set of loan terms, costs and conditions under which the loan was made that are neither commensurate with the true risk of the borrower nor are they such that the borrower could likely maintain them over the life of the loan (e.g., interest rates and fees, single premium credit life insurance, pre-payment penalties); (2) the borrower was targeted for a given loan product because of some characteristic that makes them uniquely vulnerable to that disadvantageous loan (e.g., borrowers who have a documented history of borrowing from finance companies would thus be willing to take out expensive loans); (3) there is a vast imbalance in information and experience between the borrower and lender that the lender can exploit Typically, the loans that are considered predatory are subprime, but not all subprime loans are predatory.[35] Goldstein (2007) went beyond the association of race and subprime lending to include characteristics of transactions emblematic of predatory lending (i.e., rapid refinancing of loans, loans exceeding the likely value of the property, smaller second-position loans refinanced into a large first-position loan). This research found a positive relationship between the racial composition of an area and the prevalence of predatory lending, but that relationship was far from perfect.

Philadelphia, Pennsylvania

As in communities across the country, minority group members in Philadelphia (and the communities in which they live) received significantly greater portions of subprime lending than their White counterparts. These differentially high levels of subprime lending lead to elevated levels of delinquencies, leading to concentrations of foreclosures.

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[34] The lender with the greatest subprime loan market share in the predominantly minority parts of Philadelphia in 2006 (i.e., greater than 80% minority population in the census tract) was a still-active lender, Wells Fargo Bank (with a 7.74% market share). Following Wells Fargo, closed or severely troubled lenders among the top fifteen are: Countrywide Home Loans (2nd greatest market share, 6.11%); New Century Mortgage (3rd greatest market share, 5.74%); Long Beach Mortgage (5th greatest market share, 4.28%); Delta Funding (7th greatest market share, 3.77%); BNC Mortgage (9th greatest market share, 3.01%); Novastar Mortgage (11th greatest market share, 2.28%); American Home Mortgage (12th greatest market share, 2.12%); Option One Mortgage (13th greatest market share, 2.03%); Wachovia Bank (14th greatest market share, 1.86%).

[35] See, for example: Goldstein (1999): Carr and Kolluri (2001); Engel and McKoy (2002); Gramlich (2007); Goldstein (2007).

HMDA data for Philadelphia show how uneven subprime lending in Philadelphia is amongst different races and ethnicities. In 2006, Non-Hispanic Whites and Asian-Americans received subprime loans 24.6% and 16.1% of the time, respectively. Hispanics and African Americans received subprime loans 47.8% and 58.5% of the time, respectively.

Neighborhoods with greater concentrations of minority group members also received greater proportions of subprime loans than mostly White neighborhoods. In 2006, Philadelphia neighborhoods with less than 10% minorities, and those with 10% to 19.9% minorities, received subprime loans 29.6% and 22.7% of the time, respectively. Neighborhoods with 20% to 49.9% minorities received subprime loans 31.7% of the time. And, those neighborhoods with the greatest concentration of minorities, with 50% to 79.9% minorities and 80% to 100% minorities, received the highest percentages of subprime loans at 41.8% and 57.7%, respectively. [See Figure 2]

Data on lending are reported for Census tracts; data on delinquency at the level of the zip code. These two geographies cannot be precisely matched. However , when we break down Philadelphia zip codes by the racial composition of the residents within those zip codes, we observe that, the greater percentage of a zip code that is populated by minority group members, the greater the percentages of loans that are not current (specifically, in delinquency or foreclosure). The median zip code in Philadelphia had 26.7% of its subprime loans in a non-current status. Eight of the 9 zip codes with at least 80% African Americans, and 7 out of 8 zip codes with 50% to 79.9% African Americans had a greater percentage of loans in a non-current status than the median. [See Figure 3]

If a neighborhood has a disproportionate number of subprime loans, and those subprime loans reach delinquency at a greater rate than in other neighborhoods, the negative effects of the subprime lending are magnified. Given those rates of delinquency, we see communities with greater minority concentrations are now harder hit by foreclosures than predominantly White neighborhoods.

Assuming a lag time from originations to foreclosures, elevated levels of foreclosures in Philadelphia directly track the rise in subprime lending – a finding similar to that reported by TRF in its report to the Secretary of Banking for the Commonwealth of Pennsylvania in 2005. While subprime lending has only recently made a dramatic entry into the national consciousness, in Philadelphia (and across Pennsylvania), homeowners have been struggling with the ramifications of it for some time. In 1995, Philadelphia had 2,347 foreclosures. By 2002, the number increased to 6,200. Foreclosures trended down over the next few years, never falling below 5,000. And in 2006 and 2007, foreclosures began to rise again. By 2007, foreclosures were almost identical to 2002 levels. And based on the first six months of 2008, we predict there will be roughly 8,000 foreclosures in the city this year, easily the most in Philadelphia history, and a 340% increase from 1995.

After studying subprime lending and subprime delinquencies and their relationship to race, the next logical step is to examine whether these foreclosures disproportionately affect minority communities. TRF's research on foreclosure typically traces back from the entity filing the foreclosure against the borrower to the lender that originated the loan now subject to foreclosure. Moreover, we attached the property subject of the foreclosure to its precise geographic location. Much like research on redlining and its after-effects, examining a foreclosure in relation to the characteristics of the neighborhood in which it occurs, provides insight into how different communities are affected by, and potentially targeted by, different loan products.[36]

TRF placed 23,342 foreclosures from 2000 to 2003, and 21,906 foreclosures from 2004 to 2007, at their street address, and examined the percentage of African Americans that live in those neighborhoods. We then created an expected share of foreclosures for groupings of neighborhoods, based on the percentage of the city's owner-occupied housing units in those neighborhoods.

With greater levels of subprime lending, and increased levels of those subprime loans going into delinquency, it is of little surprise that foreclosures in Philadelphia are disproportionately located in African American neighborhoods. For 2000 to 2003 foreclosures, we use 2000 Census data to examine the racial composition of a neighborhood, and what share of Philadelphia's owner-occupied housing stock that neighborhood holds. Over these four years, mostly White neighborhoods (with less than 10% African American householders) accounted for 42.2% of Philadelphia's owner-occupied housing, but only 23.4% of foreclosures, or approximately 55% of the foreclosures that would be expected given their share of the city's housing stock. Conversely, mostly African American neighborhoods (with over 80% African American householders) accounted for 29.6% of Philadelphia's housing stock, but 38.7% of foreclosures, or 131% of the expected number of foreclosures. Neighborhoods with 20.1% to 50% and 50.1% to 80% African Americans bore an even greater burden of foreclosures, with 147% and 149% of their expected share. Neighborhoods with 10.1% to 20% African American households had just slightly more (105%) foreclosures than expected. [See Figure 4]

Foreclosures from 2004 to 2007 tell a similar story. Neighborhoods with less than 10% African Americans had only 53% of the number of foreclosures that would be expected given the share of the city's owner-occupied housing stock. Neighborhoods with 10.1% to 20% African Americans had somewhat less foreclosures than expected (91% of expected foreclosures). However, neighborhoods with 20.1% to 50% African Americans (132% of expected foreclosures), 50.1% to 80% African Americans (152% of expected foreclosures) and greater than 80% African Americans (134% of expected foreclosures) experienced greater foreclosures than their share of owner-occupied housing would suggest. [See Figure 5]

Baltimore, Maryland

Within the City of Baltimore, both minority group members and the neighborhoods where they live are more likely to receive subprime loans than White borrowers and borrowers in predominantly White areas. In 2006, for example, 26.5% of all purchase and refinance loans for non-Hispanic Whites were subprime. For Latinos and African Americans, this figure climbed to 51.1% and 60.7%, respectively. Echoing calls of redlining and reverse redlining, Baltimore neighborhoods with larger concentrations of minority group members have more subprime lending than predominantly White neighborhoods. Subprime loan originations constituted 26.7% of all loans in neighborhoods with less than 10% minorities, and 24.0% of loans in neighborhoods with 10% to 19.9% minorities. For neighborhoods with 20% to 49.9% minorities and 50% to 79.9% minorities,

[36] While we can trace the foreclosure filing to the address of the collateral property with some precision, there is no way – short of contacting each and every person in default – of knowing the race of the person facing foreclosure. Thus this research has been limited to understanding the differential spatial impacts of foreclosures on communities.

subprime lending increased to 40.8% and 49.3%. For neighborhoods that have at least 80% minority group members, this figure increases to 61.2%. [See Figure 6]

While it is impossible to detail how many of these loans specifically will reach foreclosure, as in Philadelphia, we can examine how subprime loans are performing in 2008, in zip codes with high percentages of minority group members. With a smaller number of zip codes to examine in Baltimore than Philadelphia, the relationship between the percentage of a zip code that is comprised by minority group members and the percentage of subprime loans in a non-current status is similar – although not quite as strong.

The median zip code in Baltimore had 24.4% of its loans in a non-current status. Three out of four zip codes with at least 80% African Americans had levels of non-currency above the median. Four out of eight zips with 50% to 79.9% African Americans, two out of five zips with 20% to 49.9% African Americans, and one out of two zips with 10% to 19.9% African Americans, had levels of subprime non-currency above the city median. The single zip code with less than 10% African Americans had almost one-third the percentage of loans in a non-currency status than any other zip code in Baltimore. [See Figure 7]

As in Philadelphia, high levels of foreclosures are not a new phenomenon in Baltimore. While foreclosures increased significantly from 2006 to 2007, those numbers are actually smaller than any single year from 2000 to 2003. And, as in Philadelphia, neighborhoods with greater numbers of African Americans receive a disproportionate number of foreclosures. TRF placed 19,750 foreclosures from 2000 to 2003, and 14,253 foreclosures from 2004 to 2007, at their street address, and examined the percentage of African Americans that live in those neighborhoods. We then created an expected share of foreclosures for groupings of neighborhoods, based on the percentage of owner-occupied housing units in those neighborhoods.

Examining 2000 to 2003 foreclosures versus 2000 demographic data, neighborhoods with less than 10% African American householders, and neighborhoods with 10.1% to 20% African American householders had 46% and 77% of their expected numbers of foreclosures. Neighborhoods with 20.1% to 50%, 50.1% to 80% and over 80% African American householders had more foreclosures than expected, at 110%, 118% and 125%, respectively. [See Figure 8]

TRF's examination of foreclosure filings from 2004 to 2007 against 2007 demographic data reveals the same pattern. Neighborhoods with 10% or less, 10.1% to 20% and 20.1% to 50% African American householders had 41%, 57% and 96% of their expected share of Baltimore foreclosures. Neighborhoods with 50.1% to 80% and greater than 80% African American householders had 113% and 132% of their expected number of foreclosures. [See Figure 9]

Conclusions

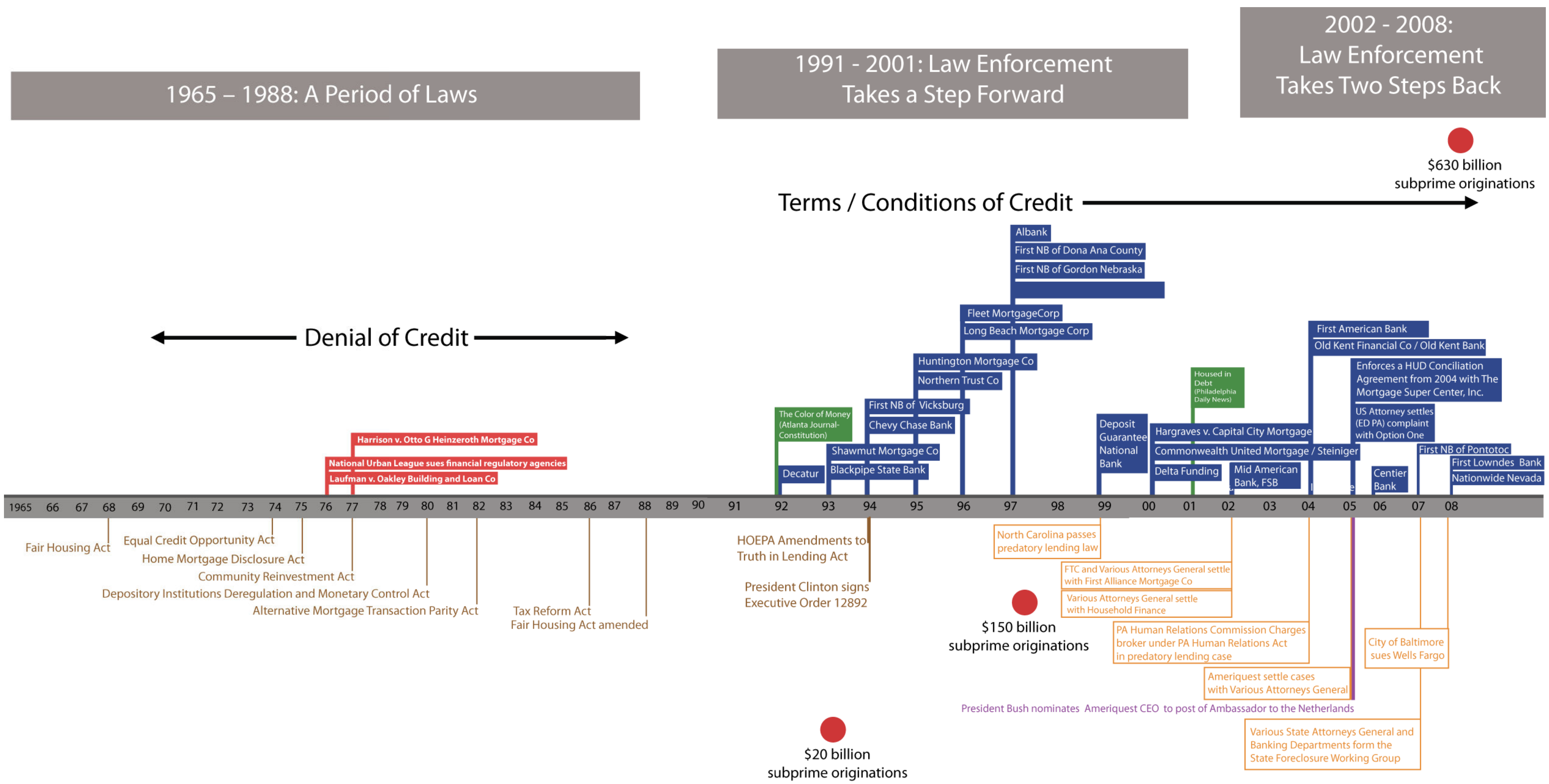
The federal government is now taking unprecedented steps to deal with the impact of the real estate and mortgage market melt-down. It is hard to know now the need for all of these actions or the future consequences (intended and unintended). What we know is that our difficulties result, at least in part, from deregulation coupled with inadequate federal enforcement. We also know that without the tangible risk of the prosecution, market actors will do that which maximizes their individual gain. The problem, as we now know to the tune of nearly $1 trillion, is that our current approach to market regulation allowed for the privatization of gain and socialization of risk and loss.

An evaluation of the existing research shows that subprime lending and the resultant foreclosures have had an adverse and disproportionate effect on minority group members and residents (of any race or ethnicity) of minority communities. While an individual's race or the racial composition of the community may not have been a conscious decision-making factor in how someone came to get a loan, in the end, one's racial or ethnic identity and the history associated with the racial composition of their neighborhood relates to the harm they now feel from the problems in our real estate and mortgage markets. There is general agreement that some significant civil rights ground appears to have been gained in the dozen years after the 1988 amendments to the FHAct, but since then, that progress has been lost.

Political intrusion in federal civil rights enforcement can (and historically has) occur in several ways – appointment of Agency principles with more limited (or more expansive) views than already established law and regulation allow, using the budgetary process to do that which Congress does not have the will to do legislatively (e.g., bar an agency's funding for certain otherwise legal purposes), providing inadequate budget to properly staff and carry out mandatory functions, provide inadequate oversight. The implication of this is that laws are not properly enforced and peoples' rights are abrogated. For all the reasons Congress saw fit to create a FHAct, and to the extent that those ideals remain worthy, the politicization of the federal enforcement mechanism is devastating.

Assuming the will to do so, it will likely take years to fix the administrative structure and law enforcement processes at HUD and Justice. In the interim, except for those people who will be protected by the few pro-active state attorneys general and private fair housing attorneys and organizations, peoples' rights will be lost owing to expiration of the statute of limitations on the FHAct and ECOA.[37] After taking a step forward with the FHAct in 1988, we seem to have taken two back. In our mad rush to try and figure out how to repair the housing and mortgage sectors, we must not lose sight of the human beings behind the SIVs, CDOs, ARMs and MBSs and that a disproportionate share of them were the casualties of a system that operated in a discriminatory fashion. It will not be enough to change OFHEO or the SEC; HUD and Justice must also get attention so that their core civil rights missions can again be actively pursued. The financial regulatory agencies, as part of their safety and soundness reviews have historically examined for ECOA and FHAct issues. Lending discrimination is oftentimes hard for individuals to detect. While the actions of the regulators were not explicitly reviewed or evaluated, they are a critical part of the mortgage lending discrimination enforcement infrastructure and they must redouble their efforts to review, identify and refer violations to HUD and Justice.

[37] Section 810 of the FHAct states that there is a one year statute of limitations on filing a discrimination complaint with the Secretary of HUD and Section 813 of the FHAct states that there is a two year statute of limitations for private rights of action.



Capital at the point of impact.

Figure 1

Racial / Ethnic Composition and Subprime Loan Originations in Philadelphia (2006)

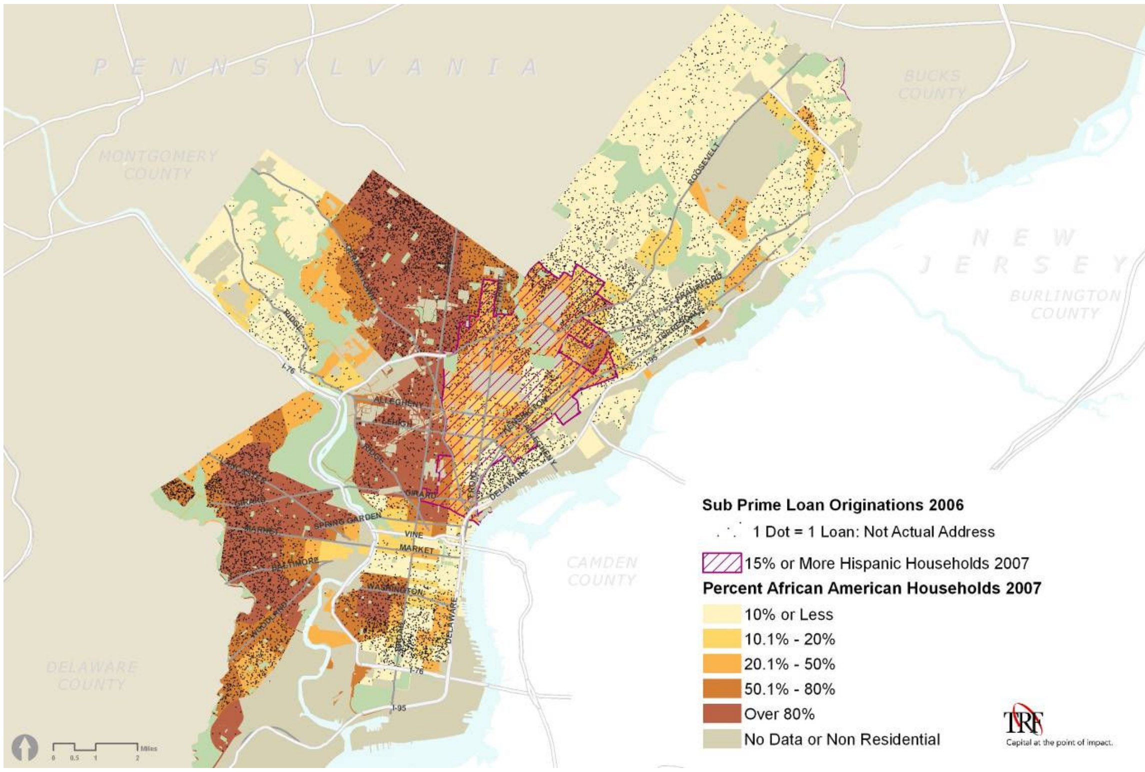


Figure 2

Subprime Mortgage Delinquencies (2008) and Subprime Loan Originations in Philadelphia (2006)

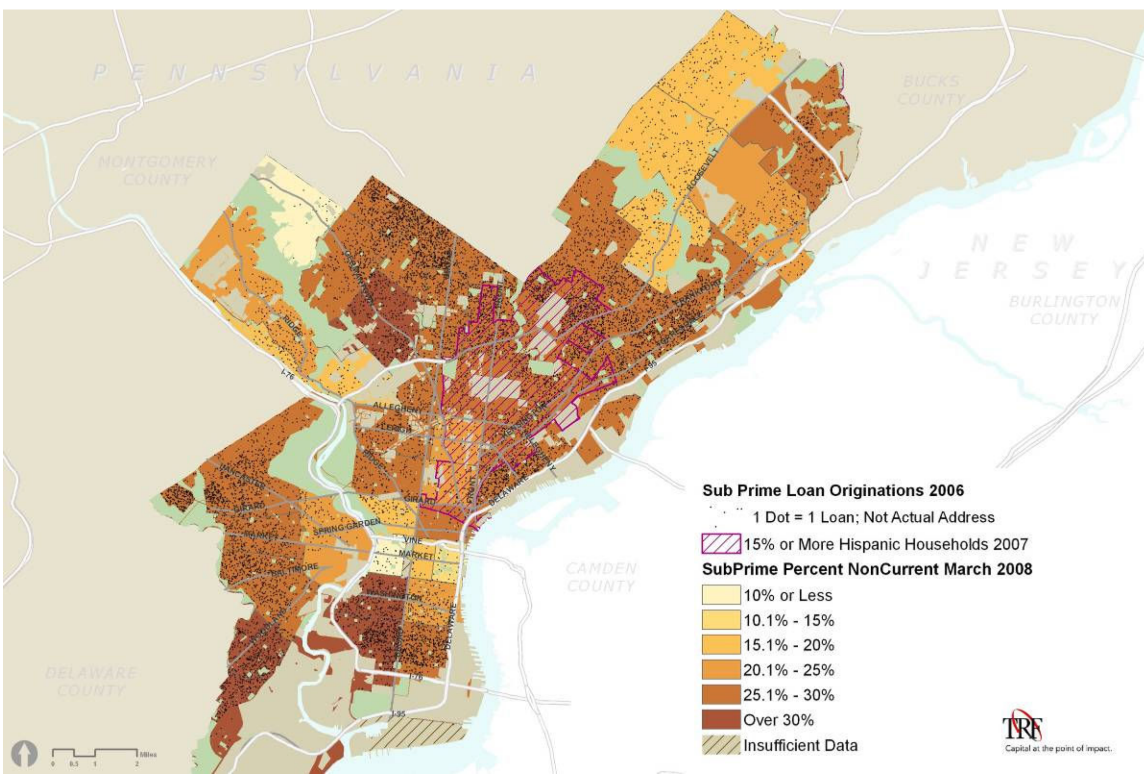


Figure 3

Racial / Ethnic Composition and Mortgage Foreclosures in Philadelphia (2000-2003)

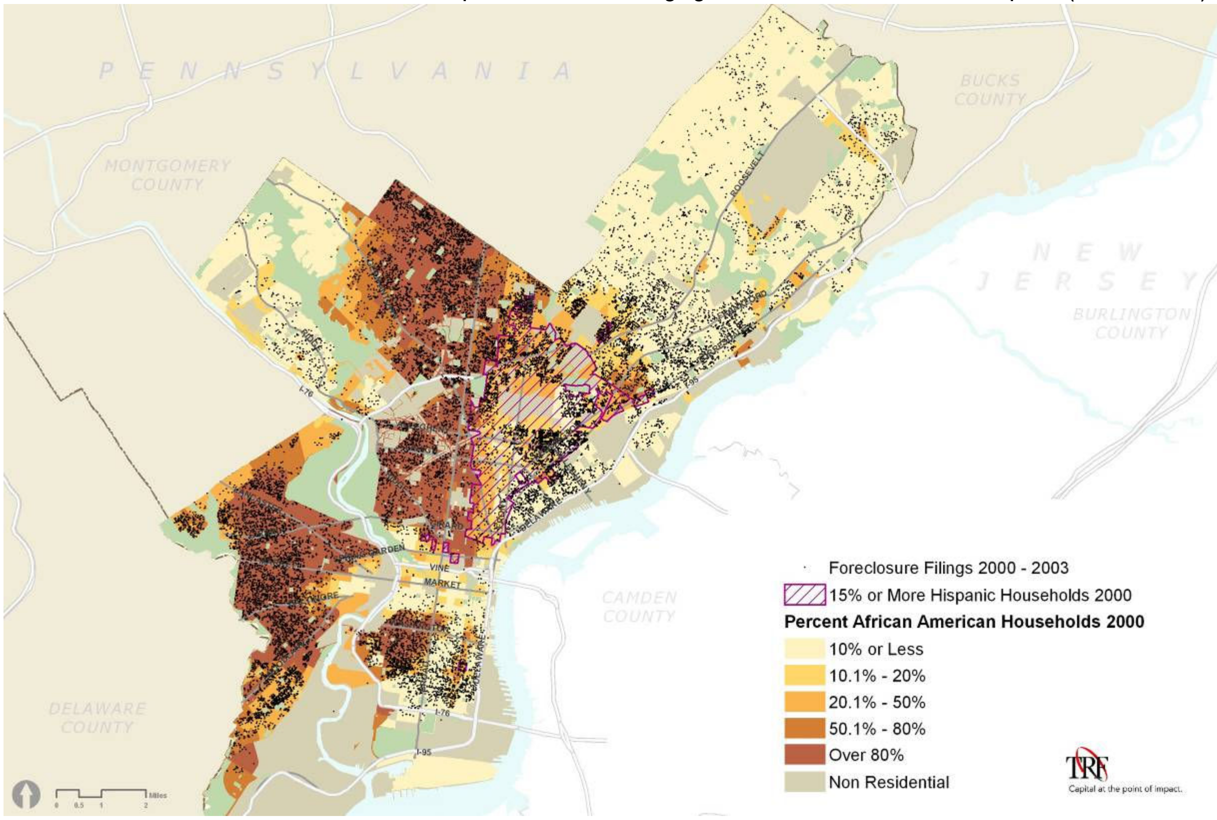


Figure 4

Racial / Ethnic Composition and Mortgage Foreclosures in Philadelphia (2004-2007)

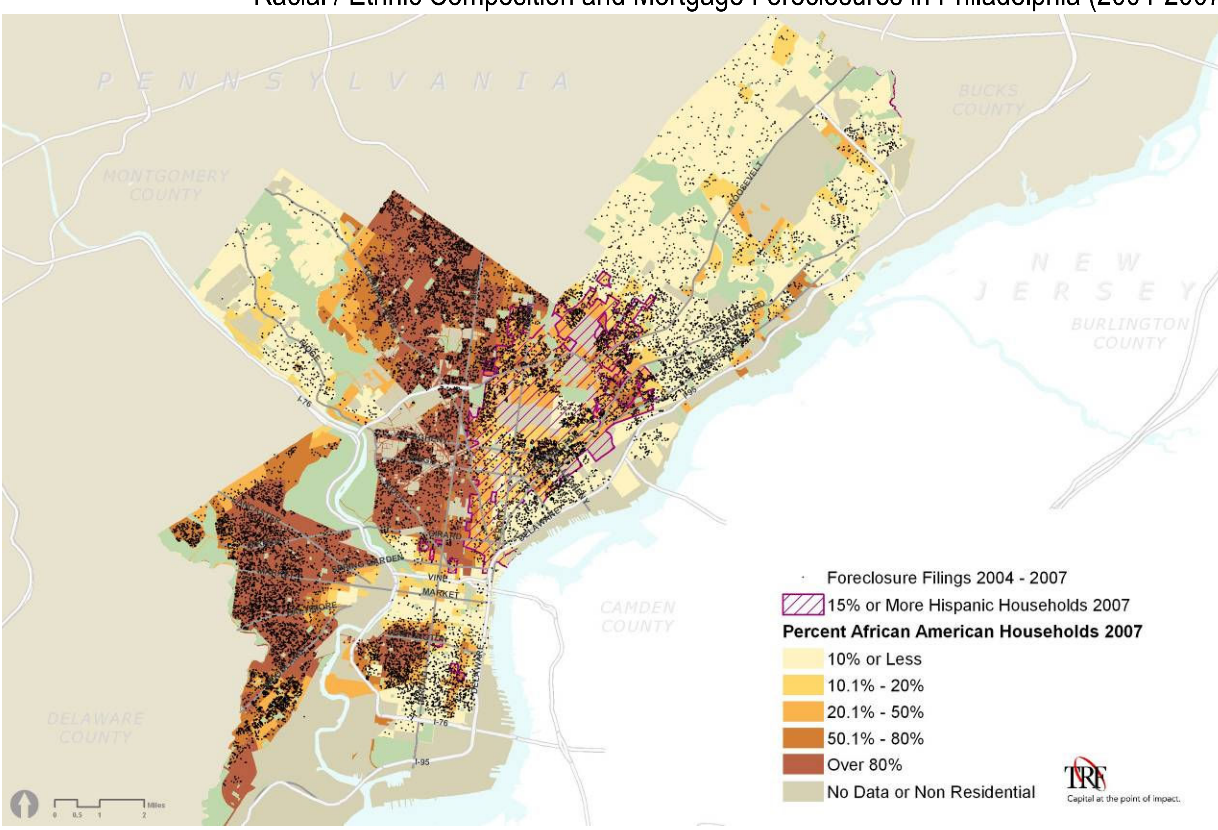


Figure 5

Racial / Ethnic Composition and Subprime Loan Originations in Baltimore (2006)

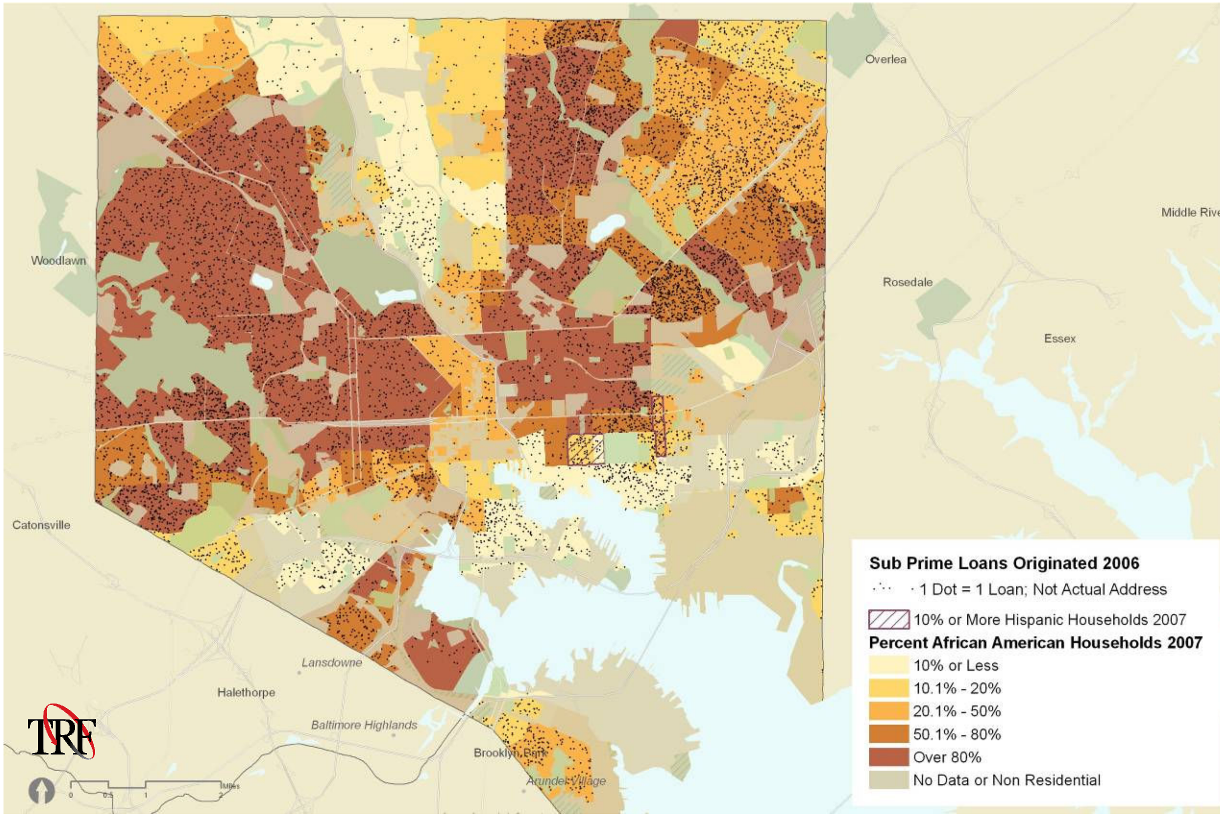


Figure 6

Subprime Mortgage Delinquencies (2008) and Subprime Loan Originations in Baltimore (2006)

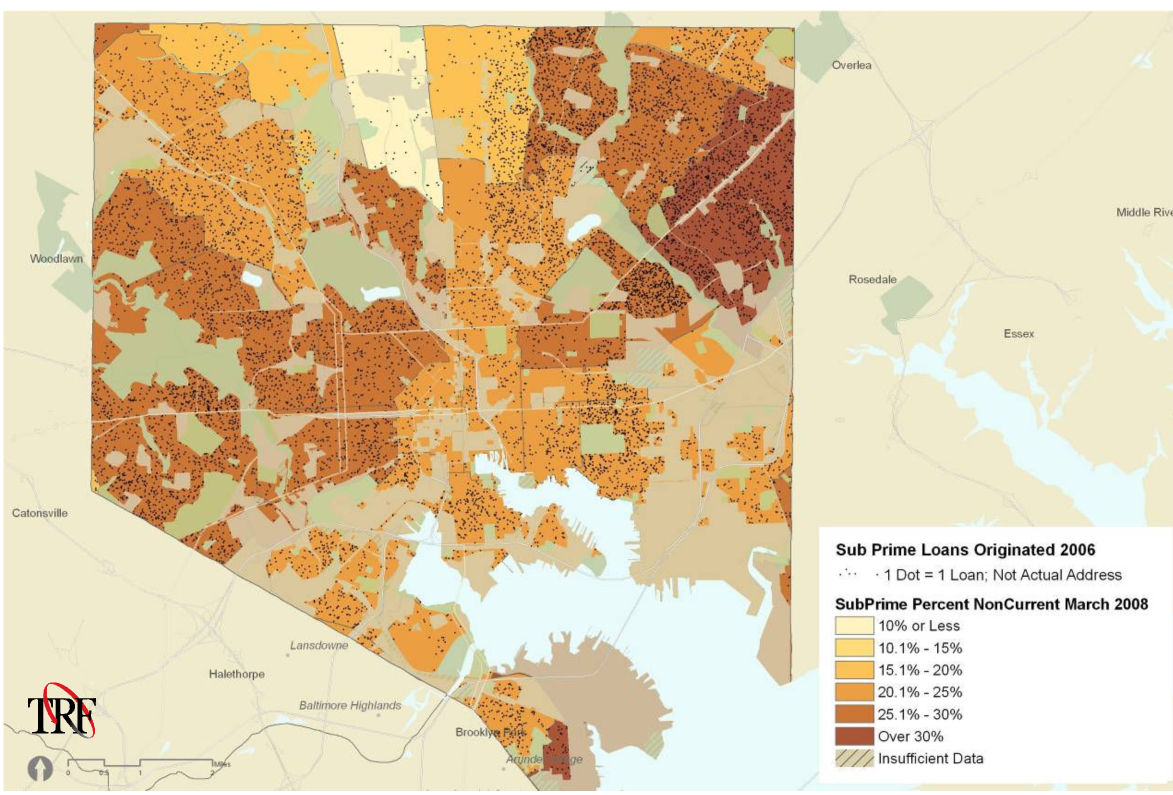


Figure 7

Racial / Ethnic Composition and Mortgage Foreclosures in Baltimore (2000-2003)

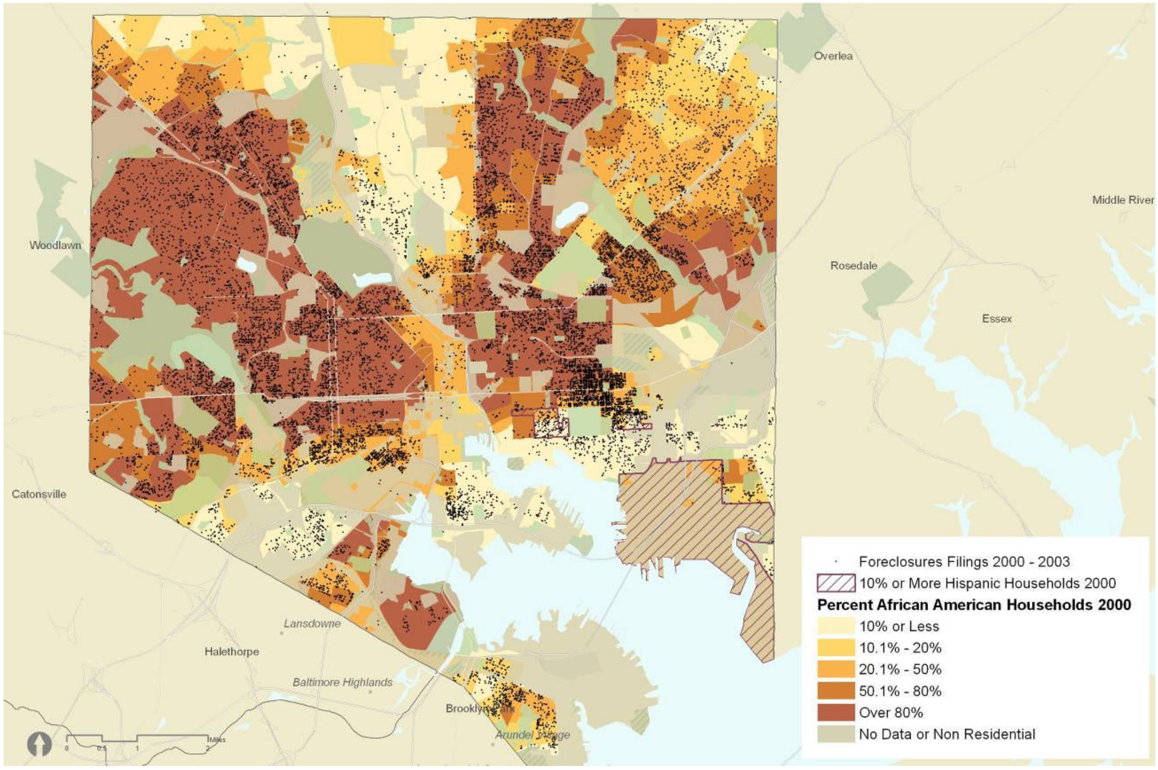


Figure 8

Racial / Ethnic Composition and Mortgage Foreclosures in Philadelphia (2004-2007)

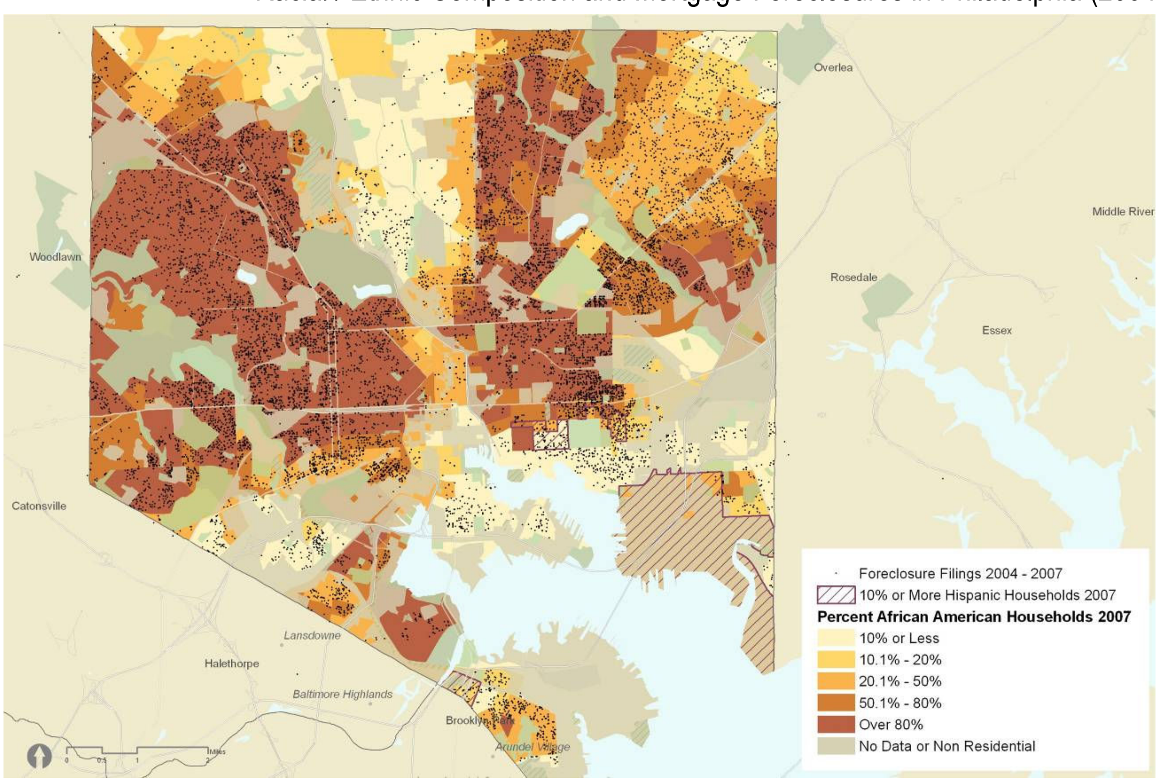


Figure 9

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About TRF

The Reinvestment Fund (TRF) is an innovator in capitalizing distressed communities and stimulating economic growth for low- and moderate-income families. TRF identifies the point of impact where capital can deliver its greatest financial and social influence. TRF's investments in homes, schools and businesses reclaim and transform neighborhoods, driving economic growth and improving lives throughout the Mid-Atlantic region. Since its inception in 1985, TRF has made more than $785 million in community investments.

TRF has also received national recognition for its research and housing-related policy analyses. TRF's data analyses focus on helping identify opportunities to invest TRF's own resources as well as providing services to the public sector and private clients seeking assistance with their own strategies to preserve and rebuild vulnerable communities.

TRF has emerged as a highly regarded source of unbiased information for public officials and private investors. TRF's Policy and Information Services group, led by Ira Goldstein, has conducted extensive analyses of predatory lending and foreclosures throughout the Mid-Atlantic region under contracts to the Pennsylvania and Delaware State Departments of Banking and the Federal Reserve Bank of Philadelphia.