Statement of Calvin Bradford before the
National Commission on Fair Housing and Equal Opportunity
Atlanta – October 17, 2008

I want to thank the Commission and the supporting organizations for inviting me to this hearing. After more than thirty years working as a researcher, policy analyst, and expert in litigation on fair housing and fair lending, I believe there could be no better time to explore the role of discrimination in our housing and credit markets. We have come here to Atlanta on the twentieth anniversary of the Atlanta Constitution's Pulitzer Prize winning series on lending discrimination – *The Color of Money*. That series sent a wake-up call about the lack of fair lending enforcement by the banking agencies, HUD, and the Department of Justice. On the other hand, it is both ironic and disgraceful that as we meet today there is an effort to blame the current banking crisis on the minorities that were victimized by subprime lending.

Recurring Bouts of Déjà Vu

The Commission has already heard testimony before about the high concentrations of subprime lending in minority communities – resulting in high concentrations of foreclosed homes in these same communities. Indeed, in my experience, minority communities have the highest concentrations of foreclosed and abandoned homes. What is often overlooked in the media and Congressional oversight of the subprime crisis is that this is not the first time these communities have suffered from lending exploitation. This is not just déjà vu for minority communities, it is, as Yogi Berra so artfully put it, "déjà vu all over again". Therefore, the Commission needs to consider how any recommendations that it makes can affect a change in fair lending enforcement that has not resulted from prior efforts.

The Birth of the Anti-redlining Campaign:

After the urban riots in the 1960s, the Kerner Commission report famously noted that we were becoming "two nations – one white, one black – separate and unequal". Part of this inequality was that minority neighborhoods had been redlined and cut off from access to mainstream mortgage loans. This redlining was documented by community groups and local government agencies in Chicago, Baltimore, Philadelphia, and other cities that used laborious searches of public records to illustrate the lack of lending by mainstream financial institutions and the exploitation of the minority markets through the use of contract sales and other vehicles that one housing researcher termed "the underworld of real estate finance". The only saving grace was that the scale of this underworld market was restricted by its own limited access to capital.

In response, HUD, under George Romney, sought to save the inner-city by literally reversing its own redlining maps and pouring FHA loans into minority and racially changing neighborhoods. But, HUD virtually eliminated sound underwriting and

oversight. Meanwhile, nothing was done to ensure that prime mortgage loans from banks and savings institutions were also made available to worthy borrowers in these markets. With the mortgages fully insured to protect the investors, with no effective oversight from HUD, and with the huge, but financially inexperienced, minority home purchase market suddenly opened up, abuse was practically assured. Unscrupulous real estate and mortgage companies teamed up to exploit the new minority market, engaging in racial blockbusting and fomenting racial change for profit. Does this sound familiar?

The results led to FHA scandals involving fraud and abuse on a massive scale. Instead of saving the cities, the result was that Romney presided over the wholesale destruction of most of his own city of Detroit and huge sections of other major cities such as Chicago, Baltimore, Philadelphia, Cleveland, and Atlanta. Notably, Fannie Mae, at that time restricted to purchasing government loans, provided an almost unlimited stream of financing that supported this discrimination and exploitation.

Thus, even after the historical patterns of redlining and discrimination had been revealed, the lack of fair lending enforcement in the private prime markets abandoned minority neighborhoods to the same kind of exploitation and abuse that had always characterized these markets – only on a much larger scale. This was déjà vu.

In response, community organizations formed in many cities to fight the subsequent onslaught of foreclosures. On the west side of Chicago, a local community organization led by Gale Cincotta, a mother of five sons, became the center of a growing coalition of inner-city organizations where white, African-American, and Hispanic residents in the very communities that had been deemed most ripe for racial conflict untied to fight this exploitation and to force prime conventional lenders to serve their neighborhoods on a fair and equal basis. Their fundamental principles could not have been more conservative. They fought the abuses of government programs and sought to bring private lenders and capital into their communities.

In 1973, these groups formed the National People's Action (NPA), and were soon joined by other groups from smaller American cities and towns that had also been suffering from disinvestment. Today, some of the strongest organizations and most dynamic community leaders come not only from urban centers like the Northwest Bronx, Chicago, or Cincinnati, but also from cities and towns across Iowa, from Kansas City, and communities in central Illinois. Through their efforts and those of other community-based organizations and development corporations, they have changed the lending landscape. With support from the National Training and Information Center (NTIC) and other technical assistance groups, coalitions of community organizations were responsible for some of the most powerful financial reform legislation, including the Home Mortgage Disclosure Act of 1975 (HMDA) and the Community Reinvestment Act of 1977 (CRA).

The HMDA provides lender by lender disclosure of the locations and types of mortgage loans. It has become an indispensable resource not only for community organizations, but for both regulators and enforcement agencies in identifying

underserved markets and patterns of possible discrimination and exploitation. The Community Reinvestment Act requires banking institutions to serve the needs of their entire communities. Through this obligation, community organizations have developed partnerships with lenders and local development organizations that provide sound conventional loans to lower-income and middle-income neighborhoods.[1] Working together with economic development organizations these self-determination efforts began rebuilding American neighborhoods that had been devastated by FHA lending, disinvestment, and redlining. Billions of dollars of private sector reinvestment went back into these communities.

Déjà Vu – The Second Time:

By the time of *The Color of Money* series, however, the continuation of fraudulent and exploitive FHA lending by mortgage companies was undermining reinvestment efforts. Community studies in the same cities that were devastated by the original private sector redlining and the massive infusion of unsound FHA loans (Chicago, Baltimore, Philadelphia, Cleveland, etc.) documented the continuing lack of conventional prime lending and the steering of minorities to FHA loans. Soon after this, new data on FHA defaults and foreclosures revealed how the continued concentration of FHA foreclosures in minority markets was suppressing reinvestment efforts. This was déjà vu - again. Again, the government – HUD, the Department of Justice, and the federal financial regulatory agencies – had abandoned minority markets to unscrupulous lenders on a massive scale.

Déjà Vu – All Over Again – All Over Again

Then, in the middle 1990s, when the subprime lenders virtually exploded onto the mortgage markets, these same minority and racially diverse communities found themselves, once again, the targets of discriminatory and exploitative lending. Subprime lenders began to concentrate their lending in minority communities. The high levels of fraudulent and abusive lending practices soon contributed to foreclosure rates that sometimes dwarfed the levels of the FHA scandals. In his 1973 book on the FHA scandals (*Cities Destroyed for Cash*), Brian Boyer noted that if all the FHA foreclosures were collected together in one city, which he called Romney City, it would have been the sixth largest city in the nation. Tracking the levels of subprime foreclosures from the middle 1990s to today, the households they represent would now likely equal the eighth largest state – somewhere between the populations of Michigan and Ohio. Again, after years of hard won reinvestment, the same neighborhoods in Detroit, Chicago, Baltimore, Cleveland, Philadelphia, and other cities that had been laid waste by the FHA scandals were now laid waste again by unsound subprime lending.

These neighborhoods are not the hot and high growth markets with soaring home values that some people used to speculate on their own homes through continual

[1] Along with this statement, I have submitted a copy of my testimony on the Community Reinvestment Act and fair lending enforcement before the Subcommittee on Domestic Policy of the House Committee on Oversight and Government Reform on October 24, 2007.

refinancing to live beyond their means. These are mostly modest neighborhoods of people who had struggled to attain the American dream of home ownership who were targeted by subprime lenders eager with marketing ploys designed to capture the equity these people had worked so hard to build up over the years. These homes were often the only real financial assets these people had.

For their part, the community organizations that had been working on reinvestment for over twenty years, warned Washington of the coming nightmare as abusive lending progressed into massive foreclosures. Research and reports from NTIC, the Center for Community Change, ACORN, The National Community Reinvestment Coalition, the Center for Responsible Lending, the Consumer Federation of America, the National Fair Housing Alliance, a host of legal assistance attorneys, and many other community and consumer groups have continually warned of the coming subprime disaster for over a decade. In 2000, HUD and Treasury built their own reports (*Curbing Predatory Lending* and *The Unequal Burden*) on the models of the community research. The reports documented the alarming increase in subprime lending, unfair and deceptive practices, and the growing concentrations of foreclosures, particularly in inner-city and minority communities. Ironically, the government did not even heed its own dire warnings.

Long before the housing bubble burst and brought the pain of subprime foreclosure to the upper-middle class and higher-income markets, the abuses in the subprime markets had already destroyed decades of rebuilding in inner-city markets. The physical impact of the foreclosures was like Katrina without the water. Whole blocks of homes were boarded up or abandoned. But, unlike Katrina, no reporters stood in the streets to cover the flood of foreclosures. Back then, no Anderson Cooper went back over and over "keeping them honest" by exposing the government's role. No cry was raised at the failure of the Washington administrations to rescue these neighborhoods. Yet, these minority neighborhoods were just as much abandoned by Washington as were the residents of New Orleans.

When I began working on the redlining issue in 1973, I toured the Austin community on the west side of Chicago. I was shocked by the concentrations of abandoned FHA homes. Last December, I went on another tour of this community – a community that had worked to reinvest millions of dollars in rebuilding. What I saw was the same concentration of abandoned homes I had seen 35 years before. The reinvestment had been all but wiped out.

Blaming the Canaries in the Mine for the Explosion

Underpinning the Blame CRA Campaign (now expanded to blame Fannie Mae and Freddie Mac) is the assumption that minorities – especially blacks - are so financially untrustworthy and such a high lending risk that making loans to blacks has pushed the entire American economy to the brink of collapse. This is a very scantily veiled form of racism. To lay blame on the minority markets whose representatives have been sending out warnings for over a decade is to blame the canaries in the mine for the explosion.

Using the Community Reinvestment Act to Blame Minorities:

As the financial markets sink rapidly into the stormy see of deregulation, ultra free market advocates looking for a scapegoat have resurrected their claim that the Community Reinvestment Act of 1977 (CRA) is to blame.[2] In particular, they claim that a revision of the CRA regulations in 1995 forced lenders to make risky loans to unworthy borrowers in order to serve an essentially minority market. They claim the regulators threatened banks with huge penalties and forced them to invest in subprime loans. As a recent editorial on *Investor's Business Daily* claimed "loans started being made on the basis of race, and often little else".[3] I offer these challenges to the claims.

First, the CRA applies only to depository institutions and simply requires that banks fairly serve the "convenience and needs" of their entire community as a *quid pro quo* for the Federal guarantee of consumer deposits. The vast majority of subprime loans were made by lenders not covered by the CRA.

After the passage of the CRA in 1977, community-based organizations in partnership with banks and savings institutions created programs that invested billions of dollars into rebuilding inner-city, small town, and rural communities across the country and across the racial spectrum. A review by the Federal Reserve found that such special CRA programs had a median loss ratio of zero.[4]

The Blame CRA campaign claims that the revision of the CRA regulations in 1995 forced lenders to invest in subprime loans and imposed harsh penalties on lenders who did not. On the contrary, the regulators made a point of emphasizing that nothing in the regulations sanctioned risky loans and that no specific loan standards, ratios or

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[2] Dealing with the spurious and misleading arguments by those blaming the CRA – and, more recently Fannie Mae and Freddie Mac – for causing the mortgage meltdown through minority lending should be the focus of both the media and Congress. Instead, the battle between those blaming minorities and those defending the CRA is being waged largely though competing re-edits of the description of the Community Reinvestment Act in Wikipedia on the Internet (see Community Reinvestment Act of 1977 at www.wikipedia.com). One advantage of this battle of the blogs, however, is that in addition to providing references to the Blame CRA movement, there are also several references to articles refuting the Blame CRA position. These articles provide a more extensive range of critiques than I can provide in this testimony.

[3] Terry Jones, "How a Clinton-Era Rule Rewrite Made Subprime Crisis Inevitable", *Investor's Business Daily*, September 24, 2008. (This article is submitted to the Commission along with my testimony. (Highlighted sections indicate the quote as also linked to Fannie Mae and Freddie Mac.)

[4] See "The Performance and Profitability of CRA-Related Lending" A Report by the Board of Governors of the Federal Reserve System, submitted to the Congress pursuant to section 713 of the Gramm-Leach-Bliley Act of 1999, July 17, 2000, page 70. While this report indicated somewhat higher levels of default for some lenders in what the Fed defined as overall CRA lending compared to prime non-CRA lending, the definition of a CRA loan was essentially any loan in a low- or moderate-income area. Since, at the time of the study, these loans already represented a rapid growth in concentrated subprime loans that local community groups challenged as being antithetical to the purpose of the CRA, only the special programs can be seen as representing reasonably underwritten risks.

measures would apply to any lender. The regulations actually deleted prior provisions that allowed the regulators to enforce the CRA with the full range of penalties and restricted future enforcement to taking account of the CRA record in reviewing applications for new branches, acquisitions, and mergers. Under the CRA, regulators evaluate bank performance and provide ratings. From the ensuing CRA exams, more than 95% of lenders have been given satisfactory ratings, essentially ensuring that all their applications would be approved.

Far from forcing lenders to make loans in minority markets, the regulators gave high ratings to some lenders that explicitly excluded minority areas from their service areas. In one case, a major national lender, Flagstar, had its CRA rating increased from satisfactory to outstanding after a Federal court found it liable for blatant discrimination by implementing a written policy specifically basing loan fees on the race of the applicant. Ironically, even though these lenders received high CRA rankings and all their applications for expansions were approved, some were sued by the Department of Justice for violating Federal fair lending laws.[5]

While it is true that the regulators did begin to give high marks to lenders who concentrated subprime loans in minority markets, it was the organizations from these inner-city and low- and moderate-income communities, and not the banking industry, that challenged this perverse application of the law. Under the 1995 regulations no lender should be given any CRA credit for making risky loans. Moreover, investments in subprime securities should not be counted under the CRA as their main purpose is not "community development" as the regulations require.

For over a decade, community organizations have been providing reports detailing the harm of subprime lending and warning the government of the coming market disaster. These warnings went unheeded and many of these communities now look like Katrina without the water, decimated by foreclosed and abandoned homes. In the process billions of dollars in reinvestment have been wasted.

The Blame CRA campaign wants to blame the victims and to ignore the high levels of fraud and exploitation in the subprime markets. In the same year as the joint HUD/Treasury reports on predatory lending, a trial in Federal court in Philadelphia against The Associates, the largest subprime lender at that time, revealed a broad range of deceptive marketing practices and programs. One program was designed specifically to flip (refinance) existing loans purely to raise the interest rates and generate more lender fees. Another program actually tested the loan offices to make sure that when loan officers folded fees and unnecessary credit insurance into the loan proposals they *did not* disclose this to the borrowers.

Data from Treasury indicate that reports of lending fraud have increased thirty-fold since 1997. Collectively, the Federal Trade Commission and the attorneys general in

[5] My statement from the October 2007 House subcommittee hearings on the CRA, submitted to the Commission with this testimony, provides an extensive review of both the 1995 revision of the CRA regulations and examples of cases where high CRA ratings were given to lenders charged with fair lending violations by Justice or having been found in violation of fair lending laws in Federal court.

every state have sued some of the largest lenders in the subprime markets (The Associates, Household Finance, Ameriquest, or, most recently, Countrywide) for deceptive and abusive practices, resulting in over nine billion dollars in settlements. None of these lenders were covered by the CRA.

Using the Meltdown of Fannie Mae and Freddie Mac to Blame Minorities:

Blaming Fannie Mae and Freddie Mac (the GSEs) which are not covered by the CRA, plays on half truths. While they did contribute mightily to the present crisis, we have no evidence that this was due to minority lending in their own community lending programs. Rather, the loans now entering the foreclosure pipeline, for the GSEs and the overall subprime market, are increasingly what are termed Alt-A loans. These are loans to people with good credit who provide only limited documentation of their income and/or have high debt ratios or other high risk factors. These loans disproportionately have gone to higher-income white borrowers.

Also, while the GSEs proclaimed they would not buy individual risky subprime loans through the front door, in a monumental expression of corporate hypocrisy, they became some of the largest purchasers of subprime securities on Wall Street through their back door. All of these moves have been opposed by the community and civil rights groups that represent the minority markets.

Sadly, even reporting by *The New York Times* has advanced the proposition that lending to minorities caused the crisis at Fannie Mae. A recent article on Fannie Mae represents the worst kind of reporting. It is strewn with claims that Fannie Mae was pressured to make more loans to low-income and minority borrowers. Then, without citing any evidence at all to indicate that loans to minorities or low-income borrowers had anything other than normal loss rates, the article cites how high risk loans led to the collapse of Fannie Mae and contributed to the fall of giants on Wall Street. The linkages between loans to minorities, risky loans, and the demise of Fannie Mae are pure innuendo. In what can be interpreted at best as a startling expression of racial tone deafness, the article quotes a former Fannie Mae employee as saying of the debacle, "This system was designed for plain vanilla loans, and we were trying to push chocolate sundaes through the gears".[6]

Ignoring Real Rescue Programs

The official government program to rescue mortgages – Hope Now – has not saved many more than normally cure themselves in the market. Moreover, it relies on sending borrowers back to the lender, or the servicer, who may have contributed to the delinquency or default through misrepresentation, fraud, or a failure to disclose the terms of the loan properly in the original underwriting, or who engaged in abusive servicing practices. This simply recreates the mismatch in expertise and knowledge that has created the problem in the first place.

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[6] Charles Duhigg, "Presured to Take More Risk, Fannie Hit a Tipping Point", *New York Times*, October 5, 2008. (I have submitted a highlighted copy of this article to the Commission.)

Meanwhile, on their own, many community groups and legal assistance attorneys have developed an expertise in reviewing the original underwriting of subprime loans for borrowers who were facing foreclosure. By challenging fraudulent or abusive underwriting and servicing practices, these groups have been able to restructure and rescue as many as eighty percent of these troubled loans in some communities – a testament to both the effectiveness of the program and the level of abusive practices in the subprime markets. This also puts the lie to the claim that loan servicing agreements prohibit loans from being restructured, especially in cases of improper or fraudulent practices by the lender or servicer. While restructuring loans where the underwriting or servicing was fraudulent or abusive may result in some write down on the loan initially, it produces a performing loan that, in the long run, stabilizes the loan. When done on a large scale, this can stabilize the mortgage-backed securities. Indeed, the present mortgage rescue legislation is based on this understanding. In the case of borrowers who have been unfairly exploited, this protects both the homeowner and the investors in the loan (be they private or be they the taxpayers).

One of the most effective rescue programs has been used by a community group in Cleveland in the Zip code with the highest number of foreclosures nationally. But while the program has proven how effective a rescue program can be, it lacked the resources to reach the scale needed to stave off the crisis either in the Cleveland market or in other communities.

Last May, representatives of the National People's Action (including groups from the Bronx, Cleveland, Cincinnati, Des Moines, and Central Illinois) met with Chairman Bernanke at the Federal Reserve in Washington. They asked him to help set up meetings with the Wall Street lenders and investment houses, with the other regulators, and with Hope Now so that they could use the community expertise to help improve the level of rescued homes nationally. Though he commented on how often he met with the investment houses on Wall Street, he arranged no meetings for the citizen groups. As a minimal request, the NPA leaders asked Chairman Bernanke if he would at least set an example by requiring his regulated lenders to simply suspend foreclosures on their loans until the original underwriting had been reviewed for fraud or deceptive or misleading practices that could be the basis for requiring the restructuring of the loan. The Chairman said that it was not even possible for him to do that. So, while Wall Street investment houses, insurance companies, and banks can be restructured and bailed out within days, minority and racially diverse communities that have been victims of the lending abuse for over a decade are abandoned by the regulatory agency that has the most powerful authority over holding companies that include all the former major investment houses, formerly independent subprime lenders, and major banks.

Some targeting of rebuilding funds to the most heavily impacted areas was included in the mortgage reform legislation passed this summer. This was due to the hard work of members of Congress from places like Los Angeles, Chicago, Cleveland, and Baltimore representing communities with high concentrations of foreclosures. Still, the existing housing relief legislation provides little hope for the victims of abusive subprime

lending. It is noteworthy, for example, that the recent mortgage reform and rescue legislation specifically prohibits the use of the funds for the most successful form of rescue - legal challenges to the foreclosure process based on fraud or misrepresentations in the original underwriting and servicing abuses.

What Ever Happened to Fair Lending Enforcement?

After *The Color of Money*, we saw increased lending enforcement efforts by the Department of Justice. Now that level of enforcement has dropped off. An initial entry into the arena of enforcement against non-bank lenders by the Federal Trade Commission has also declined. HUD's fair lending enforcement has been almost non-existent from the start. What fair lending and consumer lending enforcement has occurred recently has been largely by state attorneys general. Their actions have been focused largely on lenders not covered by federal banking regulations – as court rulings have prohibited them from initiating investigations of lenders covered by federal banking regulators.

Recent mergers (forced and unforced) have changed the scene dramatically so that not only the subprime lenders, but the investment houses that packaged and underwrote the subprime securities are now part of bank holding companies. This focuses fair lending enforcement more than ever on the actions of the Federal Reserve and its authority to regulate bank holding companies.

Under the revised CRA regulations, bank holding companies have been allowed to either include or exclude the lending of their affiliate lenders at their own discretion. Of course, when subprime affiliates were included, the regulators have given the lenders high marks for concentrating these loans in lower-income markets (which are disproportionately minority, thus, rewarding lenders for exploiting these markets.) A specific review of fair lending was actually removed from the rating factors in the 1995 revision of the CRA regulations, leaving the separate (and secret) fair lending examinations as the only source of fair lending reviews. Still, as I have indicated, lenders charged with violations of fair lending laws, and even found liable in court for fair lending violations, are routinely given high CRA marks.

Most subprime lending in the past has been done by affiliates of holding companies rather than the actual depository lender subject to the fair lending exams. For each of the financial regulatory agencies, their fair lending examination procedures specifically prohibit the examiner from reviewing the lending patterns and practices of these affiliates. These exam procedures were clearly out of touch with the structure of the mortgage markets in recent years. They are even more obsolete now that the major independent lenders have largely been absorbed in holding company affiliates.[7]

Sending FHA to the Rescue

[7] My statement from the October 2007 House subcommittee hearings on the CRA, submitted to the Commission with this testimony, provides an extensive review of the fair lending examination procedures. Also, one should note that the Office of Thrift Supervision regulates the holding companies of savings institutions. As my House subcommittee testimony indicates, the OTS has shown the worst regard for fair lending enforcement.

The mortgage reform legislation passed this summer sends special programs within FHA to the rescue of troubled subprime borrowers. Given that two of the déjà vu experiences that have ravaged minority communities have come from the abuse of FHA programs, the Commission needs to understand that many of the organizations that have worked for over thirty years to rebuild minority communities suffering from these debacles are less than enthusiastic about putting too many eggs in this defective basket. In just the past two months, there have been reports by the Inspector General at HUD on the failure of HUD to prepare itself properly for the new responsibilities and on the continued failure to control abuse in the appraisal process.