



institute on race & poverty

Research, Education and Advocacy

# **Communities in Crisis: Race and Mortgage Lending in the Twin Cities**

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## Executive Summary

Across the United States, people of color continue to receive home loans on worse terms and at a higher cost than similarly situated white borrowers. National research also shows that people who live in segregated communities of color have borne the brunt of the mortgage crisis, receiving a disproportionate rate of subprime loans and foreclosures. *Communities in Crisis* shows that these racially disparate trends hold true for the Twin Cities Metropolitan Region. Recent data provided under the Home Mortgage Disclosure Act (HMDA) reveals strong racial disparities in mortgage lending in the Twin Cities. The data reveals that:

- **Income is No Insurance Against Mortgage Lending Disparities for People of Color**

Lenders are substantially more likely to deny loans to people of color, regardless of their income. For instance, high-income black, Hispanic and Asian applicants have higher denial rates for home purchase and refinance loans than low-income white applicants.

- **People of Color Are More Likely to Apply at a Subprime Lender Than Whites.**

Applicants of color, especially black and Hispanic applicants, are more likely to submit loan applications to subprime lenders than whites, regardless of their income. As a result, they disproportionately receive subprime loans.

- **People of Color, Even if They Are High Income, Are Much More Likely to Receive Subprime Loans Than Whites, Even Very Low Income Whites.**

High and very high income black and Hispanic borrowers are more likely to receive subprime loans than in *any* white income group. Income, of course, is not a perfect proxy for risks. However, the prime-subprime comparisons are dramatic. Unless characteristics other than income are strongly correlated with both race and risks, race by itself is still a very strong factor determining the quality (and therefore the cost) of loans that borrowers receive.

- **Segregation Creates Unequal Access to Prime Lenders.**

Segregated neighborhoods of color in the Twin Cities are under-served by prime lending institutions. Both borrowers of color and white borrowers are less likely to apply with a prime lender in segregated neighborhoods of color than in predominately white neighborhoods, regardless of their income.

- **Unequal Access to Prime Lenders Contributes to Higher Denial Rates for People of Color**

People of color are more likely than whites to apply to near-prime or subprime lenders—lenders with higher denial rates on average than prime lenders. In fact, half of the overall denial rate for people of color is due to their high application rates with near-prime and subprime lenders. This means that policies designed to increase access to prime lenders have the potential to reduce denial disparities.

- **Even When People of Color Access Prime Lenders, They Are More likely to be Denied Mortgage Loans.**

The other half of the difference in denial rates is due to the fact that non-white applicants were more likely to be denied than whites by all types of lenders—prime, near-prime and

subprime alike.

- **Fair Lending Laws Have Not Been Enforced**

Numerous laws, including the Fair Housing Act, The Equal Credit Opportunity Act, and the Community Reinvestment Act outlaw and attempt to remedy racial disparities in home mortgage lending. Federal officials, however, did not aggressively pursue lending discrimination during the subprime boom. This lack of effective enforcement of fair lending laws meant that discriminatory or predatory lending behavior faced little threat of punishment.

- **Subprime Lending Disparities Became Foreclosure Disparities**

The observed disparities in lending patterns correlate with the impacts of the region's foreclosure crisis. The enormous costs of foreclosures—to families who lose their homes as well as to cities and towns losing tax resources—have been greatest for communities of color. Both subprime lending rates and foreclosure rates have been highest in neighborhoods with the highest percentages of people of color. The impact of these patterns is especially notable in North Minneapolis, an area where prime lenders are noticeably under-represented and subprime lenders are significantly over-represented.

Mortgage lenders should know that a failure to provide credit to people of color and communities of color on fair terms is illegal. And mortgage lenders should be very aware of the content of their lending practices. Yet, the Twin Cities data show lending disparities that are not easily explained by income differences between groups. Likewise, it is very clear that prime credit is not reaching the neighborhoods that need it the most; the segregated, high poverty neighborhoods that the Fair Housing Act was designed to eliminate.

Forty years after the passage of the Fair Housing Act, banks are still disproportionately denying people of color prime, affordable mortgages. Lending disparities and the ensuing foreclosure crisis have not just cost people their homes. Homeownership has been the first step to building stability and wealth for Americans. This crisis has cost another generation of people of color the equal opportunity to join America's middle class. Strong steps need to be taken to ensure equal access to credit and the promise of homeownership for people of color.

**Remedies:**

Removing disparities in the mortgage market will require a multi-faceted approach. The mortgage market needs to be carefully monitored for unfair disparities and fair lending laws need to be enforced. In order to do that, we need to expand and aggressively enforce the Community Reinvestment Act, establish a fair housing center in the Twin Cities to monitor all segments of the housing market, and the scope of the HMDA data set needs to be expanded. Finally, federal enforcement of Fair Lending Laws needs to resume in an aggressive manner.

- **Strengthen the Community Reinvestment Act**

People of color and people who live in segregated communities of color must have access to affordable credit from responsible lenders in order to build wealth and become part of the middle class. The CRA should be expanded to monitor and regulate the lending patterns of non-bank lending institutions. Rigorous enforcement of an expanded CRA will help provide

equal access to fair credit—a necessary first step in ensuring equal opportunity for all Americans.

- **Fund an On-going Regional Fair Housing Center.**

Regional Fair Housing Centers help ensure non-discrimination in housing, rental, and home lending markets through research and advocacy. An ongoing commitment to a fair housing center is needed to ensure that the grossly disparate impact of the ongoing crisis in the region's housing and credit markets is not repeated in the future.

- **Expand HMDA**

While HMDA data has been steadily improved over the years, further improvements could make it a much better source for monitoring discrimination in the mortgage market. In particular, lenders should be required to report data on the credit status of borrowers, the interest rates for all loans, and race data for mail, phone and internet applications. Likewise secondary market participants should be required to report race data.

Fair lending, however, in-and-of-itself will not end the threat of mortgage disparities for communities of color. Segregation creates concentrated poverty, makes it more difficult for people of color to access prime lenders, and creates easy targets for predatory lenders. Monitoring and enforcement of fair lending laws are an important first step in attacking the root problem, racial segregation. In the end, the entire Twin Cities region needs to work aggressively to end segregation in order to create equal opportunity for all of its residents.

## I. Introduction

The effects of the mortgage foreclosure crisis on the economy and on the stability of banking institutions is well publicized and potential solutions to the crisis are hotly debated. Missing from much of the debate, however, is an analysis of the disproportionate impact of the foreclosure crisis on people of color.<sup>1</sup>

The impact of the foreclosure crisis on poor neighborhoods and communities of color in the Twin Cities highlights how much race still matters in home mortgage lending. Studies of housing markets have shown that mortgage institutions have continued to disinvest in neighborhoods that are predominately people of color.<sup>2</sup> These trends mimic past patterns of bank and government sanctioned redlining of neighborhoods, where lenders withheld credit from segregated neighborhoods—a practice that helped shape the geography of segregation and concentrated poverty in the U.S.<sup>3</sup> One difference between the mortgage market 30 years ago and the mortgage market today is that non-bank lenders, usually subprime or predatory lenders, rushed in to fill the mortgage market void in communities of color. This meant that more mortgage dollars were available to people of color than in the past, but this nonbank credit was much more expensive than the prime credit that was more available in white communities.

Today, the problem created by disparate lending is three-fold. First, people of color are disproportionately less likely to receive prime loans than whites, while people of color are more likely to receive subprime loans than similarly situated whites. Recent increases in subprime lending combined with racial disparities means that people of color are more likely to experience predatory lending, equity stripping, and foreclosure. Second, because subprime lending is tied to an increased risk of foreclosure, poor neighborhoods and communities of color are bearing the brunt of the foreclosure crisis and recent gains in homeownership are threatened.<sup>4</sup> Third, because foreclosures are concentrated in areas where people of color live, the mortgage crisis has eroded urban property tax bases, adding to fiscal woes in cities and older suburbs.<sup>5</sup>

It is no accident that high rates of subprime lending and foreclosures are concentrated in segregated neighborhoods of color – and the reason for this disparity is not simply individual discrimination against people of color. Instead, racial and economic segregation set the stage for concentrated subprime lending and facilitate discrimination against neighborhoods. A major factor leading to high subprime lending rates in these areas is the relative lack of access to credit in segregated neighborhoods.

Despite the Community Reinvestment Act's mandate to provide equal access to credit across communities, people who live in segregated communities are substantially less likely to have

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<sup>1</sup> Special thanks to Professors Prentiss Cox, Claire Hill, and Brett McDonnell from the University of Minnesota Law School, Amber Hawkins, Galen Robinson and Colleen Daley of Mid-Minnesota Legal Aid, Micheal Grover of the Federal Reserve Bank of Minneapolis, and Kari Rudd for their assistance with this project.

<sup>2</sup> See National Community Reinvestment Coalition, 2007, *Are Banks on the Map? An Analysis of Bank Branch Location in Working Class and Minority Neighborhoods*, 15.

<sup>3</sup> Douglas S. Massey & Nancy A. Denton, 1993.

<sup>4</sup> Dan Immergluck & Geoff Smith, 2005, 362-389

<sup>5</sup> Steve Brandt & Randy Furst, Wave of foreclosures cost cities time and money, *Star Tribune* Nov. 11, 2007.

easy access to a bank branch with lending facilities than people who live in white-segregated communities. The lack of access means that people who live in segregated communities of color are much more likely to rely on mortgage brokers. Mortgage brokers who operate in these segregated communities are more likely to offer customers subprime loans, regardless of the person's actual risk profile.

### **The History of Racial Segregation and Housing Discrimination in the Mortgage Market**

In the United States, homeownership is the bulwark of a middle class life.<sup>6</sup> For many Americans, their home's equity is their primary source of wealth.<sup>7</sup> This wealth can be leveraged in numerous ways including moving "up," into better neighborhoods and homes, co-signing loans to ensure that one's children become homeowners, and starting businesses.<sup>8</sup> Racial discrimination has greatly reduced access for people of color and communities of color to these long-term wealth-building benefits of home ownership.

Limitations on homeownership by people of color used to be blatant. Racial covenants in housing deeds, prohibitions on the sale of homes to African Americans, red-lining of neighborhoods with people of color, and real estate appraisal guidelines that required appraisers to downgrade the value of homes in racially mixed neighborhoods all obviously denied blacks and other people of color access to homeownership and home equity. Overt racial discrimination had long-term impacts on both the accumulation of wealth in communities of color and of their trust in real estate institutions.<sup>9</sup>

The Civil Rights Act of 1968 and the Equal Credit Opportunity Act of 1974 attempted to address this discrimination by prohibiting discrimination in home sales and in mortgage lending.<sup>10</sup> Nonetheless, banks, real estate appraisers, and realtors continued to redline neighborhoods, equating communities of color with decreased property values and "risky" loans.<sup>11</sup> People in poor neighborhoods and people of color were consistently denied credit—making homeownership difficult, depressing property values and the tax base in inner cities.<sup>12</sup>

In 1977, Congress passed the Community Revitalization Act (CRA), which was designed to eliminate redlining and encourage investment in impacted communities by "encourag[ing] regulated financial institutions to help meet the credit needs of their entire communities, including low- and moderate-income neighborhoods, consistent with safe and sound operations."<sup>13</sup> While some banks did expand their lending operations into poor neighborhoods and communities of color, the CRA's success in decreasing racial and neighborhood disparities in lending patterns is debatable.<sup>14</sup>

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<sup>6</sup> Henretta, 1984, 131-140.

<sup>7</sup> Justera et al., 1999 253-275.

<sup>8</sup> Aaronson, 2000, 356-369; Hurst et. al 1998, 1984-1994.

<sup>9</sup> Hylton and Rougaeu, 1996, 237-294.

<sup>10</sup> 42 U.S.C. §§ 3601-3619; 16 U.S.C. § 1691-1691(e). Larkin, 2007, 1617.

<sup>11</sup> *Ibid.*

<sup>12</sup> Shapiro, 2004, 108-109.

<sup>13</sup> 12 U.S.C. § 2903(a) (2005).

<sup>14</sup> Compare Barr, 2005, 561 (arguing that the CRA has increased community development in low-income communities) with Macey and Miller, 1995, 293-94 (showing that the CRA has done more harm than good). See also Alicia H Munnell et. al., 1996, 25-53.

Today, discrimination against people of color seeking to rent, buy, and insure houses continues to be an endemic problem across the United States. Pair testing studies continue to show racial steering by realtors in home buying and discrimination in home lending.<sup>15</sup> While overt redlining, the complete denial of credit to communities of color, is less prevalent than it was forty years ago, research shows that racial minorities receive home loans on worse terms and at a higher cost than similarly situated white borrowers.<sup>16</sup> Racially targeted predatory lending continues to deny people of color and the neighborhoods where they live equal access to stable homeownership.

### **Home Mortgage Market Participants**

**Home mortgage lenders** are financial institutions, which often specialize in different types of home loan products. Prime lenders tend to offer lower interest rates and lower cost fees often through a branch location. Subprime lenders tend to offer higher interest loans and higher cost fees often through a mortgage broker. Borrowers in the subprime market are perceived to be the highest risk borrowers and are charged more for loans accordingly; although, blacks and Hispanics received more subprime loans than whites even when controlling for risk factors.<sup>17</sup>

**Mortgage brokers** are non-bank entities that find potential customers, prepare paperwork from mortgage transactions and submit applications to lenders, which fund and underwrite the mortgage. Brokers receive compensation from origination fees and points that the borrower pays with the mortgage and often when the loan is funded.<sup>18</sup> Brokers take very little risk in the outcome of the mortgage and have little incentive to achieve the best mortgage match for borrowers, increasing the chance of defaulting loans.<sup>19</sup>

**Secondary Market Participants** are the parties that purchase loans from brokers and lenders, re-bundle the loans, and sell the repackaged mortgage securities on the bond market. The secondary mortgage market alleviated much of banks' lending risks, arguably creating a moral hazard because the parties responsible for making loans are no longer directly responsible for ensuring loan repayment. Because each individual loan was packaged and re-packaged into bond pools, it was difficult for credit agencies to accurately rate the risk of these bonds. When the secondary mortgage market was thriving, these bonds were rated substantially higher than their actual value. Eventually these values plummeted leading to the current housing crisis.

**Loan Servicers** are paid to collect payments from the borrower and to report when the loan is in default. The servicer remits portions of the payment to the trustee and investors that hold an interest in the loan. The servicer usually has a duty to collect the principal and interest and to use its own funds to make up the balance when the borrower does not make a payment in full.<sup>20</sup> When faced with rising costs, some servicers engage in abusive practices that include improper fees, late fees, forcing insurance coverage that is not required. These practices may prompt foreclosure.<sup>21</sup>

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<sup>15</sup> Turner and Ross, 2003.

<sup>16</sup> Avery, Canner and Cook 2005; Bocian, Ernst and Li, 2006; Boehm, Thistle, and Schlottmann, 2006; Courchane, Surette, and Zorn, 2004; Pennington-Cross et al., 2000.

<sup>17</sup> Bocian, Ernst and Li, 2006.

<sup>18</sup> Apgar and Calder, 2005, 4-5.

<sup>19</sup> Apgar and Calder, 2005, 6; Williams, Nesiba and McConnell, 2005, 184-187.

<sup>20</sup> Morse, 2003.

<sup>21</sup> Eggert, 2007, 286-287; Eggert, 2003, 758-761.

## **II. The Mortgage Market, Subprime Lending, and Foreclosures in Segregated Communities of Color**

Mortgage foreclosures have devastated local and national economies, contributing to one of the worst recessions in living memory. The initial impact of foreclosures centered in low-income communities of color, and the collapse of the housing market has hurt low-income people of color the most. The Center for Responsible Lending estimated that one out of eight subprime loans made between 1998 and 2004 foreclosed within five years, and the risk of foreclosure has increased dramatically since that time. Subprime loans made between 2005 and 2006 have an estimated one in five chance of foreclosure.<sup>22</sup> This crisis has hit the Twin Cities region hard. In 2005, Minnesota's foreclosure rate was the highest in state history.<sup>23</sup>

### **A. Prime, Subprime and Predatory Lending in Communities of Color**

#### **Prime and Subprime Lending**

Prime loans are the standard home loans that have allowed high rates of homeownership and housing mobility in the United States. Subprime loans have higher interest rates than prime loans and often contain additional features and costs that are absent in prime loans. Subprime loan features can include prepayment penalties; adjustable rate mortgages where interest rates are adjusted periodically; interest only loans, where the borrower only pays for the interest on the principal of the loan; and balloon payment mortgages, where interest rates climb towards the end of the loan. In theory, subprime loans have higher costs because of lenders' assessment of the riskiness of lending to borrowers. Lenders assess loan applicants' employment histories, incomes, loan cost to home value ratios, and credit scores when determining the creditworthiness of borrowers.

Prime-eligible borrowers of color often receive subprime loans.<sup>24</sup> While the use of objective lending data, such as FICO and other credit scores,<sup>25</sup> was supposed to eliminate non-risk-based disparities, unexplained racial disparities continue.<sup>26</sup> For example, one empirical study found that after controlling for credit-worthiness, African Americans were 31 percent more likely and

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<sup>22</sup> Ellen Schloemer et al., 2006, 9-16.

<sup>23</sup> Wood, 2007, 22.

<sup>24</sup> Avery, Canner and Cook, 2005; Bocian, Ernst and Li, 2006; Boehm, Thistle and Schlottmann, 2006; Courchane Surette and Zorn, 2004; Pennington-Cross et al., 2000.

<sup>25</sup> Banks often use Fair Isaac's Corporation (FICO) scores to determine whether applicants are eligible for prime or subprime loans. FICO uses statistical models to attempt to predict the likelihood that an applicant will default on a loan by comparing the borrower to similar borrowers in the market and tracing loan outcomes. FICO scores vary from 300 to 900. A FICO score of 662 is a common cutoff between prime and subprime mortgages, and a score of 640 is the common cutoff for near-prime mortgages, which cost less than subprime loans, but more than prime loans. See Fellows and Mabanta 2007, 16. Lenders also often use other credit scores, such as Equifax or Experian, which generate credit scoring using different formulas in conjunction with FICO to establish loan eligibility. Because the models are proprietary, it is impossible to know whether they contain discriminatory variables, such as the racial composition of a neighborhood. Though there has been little documentation about whether automated mortgage services have used discriminatory variables in their software products, life insurance and realtor institutions have used neighborhood racial typologies when marketing life insurance and directing home buyers into prospective neighborhoods. See Metzger, 2001, 16-19.

<sup>26</sup> Avery, Canner, and Cook, 2005; Bocian, Ernst, and Li, 2006; Boehm, Thistle, and Schlottmann, 2006; Courchane, Surette, and Zorn, 2004; Pennington-Cross et al., 2000.



Hispanics were 45 percent more likely than whites to receive higher cost loans, and that African Americans were 35 percent more likely than whites to receive high cost refinance loans.<sup>27</sup>

Segregated neighborhoods of color, neighborhoods where more than 50 percent of the residents are people of color, receive disproportionate numbers of subprime loans.<sup>28</sup> Previously redlined neighborhoods, which are still underserved by traditional lenders, are new markets for subprime lenders. Further, people who live in these segregated neighborhoods are likely to have limited mortgage market knowledge and are likely to have previously received subprime loans, both strong risk factors for subprime lending.<sup>29</sup> The Joint Center for Housing Studies at Harvard University summed up this problem of access inequalities and unequal information in the home mortgage markets:

The bewildering array of mortgage products combined with the various available combinations of points and fees and aggressive marketing tactics with “too good to be true” offers can make shopping for a mortgage an overwhelming process for even the most sophisticated borrower. Indeed, the lack of readily available data on the price of alternative mortgage products puts the consumer at a distinct disadvantage in negotiating with a mortgage broker who has ready access to this information. . . The growing use of mortgage brokers, the lack of effective regulatory oversight, the lack of readily available mortgage pricing data have combined to reinforce a dual market where some borrowers pay more for mortgage credit and/or receive less favorable treatment (or even abusive treatment) than other similarly situated and equally creditworthy borrowers.<sup>30</sup>

This unequal access to prime lenders and unequal information networks means that not all prime or subprime mortgage decisions are purely risk-based. When people apply to subprime lenders, their likelihood of getting a subprime mortgage can be independent of their income or credit risk because subprime lenders issue mostly subprime loans. A prime-eligible borrower who lacks access to good information about mortgage pricing can easily end up with the most expensive loan that they will accept, rather than the best loan their credit deserves.

### **Predatory Lending**

Although not all subprime loans are predatory, most predatory loans are found in the subprime market. Predatory lending has been defined as a "syndrome of loan abuses that benefit mortgage brokers, lenders, and securitizers to the serious detriment of borrowers."<sup>31</sup> According to Engel and McCoy (2007) loan characteristics that define predatory lending include: Loans that are explicitly structured to harm borrowers, for instance steering prime loan qualifiers into subprime loans, rent seeking, where the value of interest and fees collected by a lender outweigh the risk of lending to an applicant, illegal fraud and deception, non-fraudulent forms of non-transparency, including hidden price sheets, loan requirements that waive legal redress, lending discrimination,

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<sup>27</sup> Bocian, Ernst, and Li, 2006, 16-18.

<sup>28</sup> Calem, Gillen, and Watcher, 2004; Immergluck and Wiles, 1999; National Center for Community Revitalization, 2003.

<sup>29</sup> Courchane et al., 2004.

<sup>30</sup> Apgar et al., 2004, 5.

<sup>31</sup> Engel and McCoy (2007), 106.

and servicing abuses.<sup>32</sup> As one might expect, research has shown that there are often predatory terms on mortgages that have gone into foreclosure.<sup>33</sup>

### **The Community Reinvestment Act**

The Community Reinvestment Act (CRA) was enacted in 1977 to help ensure access to prime credit in low-income communities. The act was passed in response to evidence of persistent redlining of minority communities. The act mandates federal oversight of federally regulated banks' lending patterns, and authorizes federal regulators to hold-up mergers and expansions if banks do not extend access to mortgages in low and moderate-income census tracts.<sup>34</sup> While the CRA has been blamed for the mortgage meltdown by spurring subprime and predatory lending in communities of color, the CRA was not behind the steep increases in subprime lending.<sup>35</sup>

Nonbank institutions not covered by the CRA were responsible for the vast majority of the increase in subprime lending. Federal Deposit Insurance Corporation Chairwoman Sheila Bair testified that “only one in four higher-priced first mortgage loans were made by CRA-covered banks during the hey-day years of subprime mortgage lending. The rest were made by private independent mortgage companies and large bank affiliates not covered by CRA rules.”<sup>36</sup>

The federal failure to effectively enforce the CRA and guarantee credit-worthy borrowers in low-income communities access to good credit, however, may have worsened the foreclosure crisis.<sup>37</sup> The failure of prime lenders to have a significant market presence in communities of color created significant market opportunities for subprime lenders who faced virtually no competition from prime lenders in these neighborhoods.

### **B. Homeownership in Communities of Color and the Rise of the Subprime Mortgage Market**

In the 1990s, public and private institutions took significant steps to close the homeownership gap between people of color and whites, recognizing that the persistent gap was a major contributor to wealth disparities.<sup>38</sup> Public policies that encouraged lenders to extend credit to people of color and the subsequent rise in homeownership rates for people of color are often

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<sup>32</sup> Engel and McCoy (2007), 106. Loan characteristics that are explicitly designed to harm borrowers include packing loans with undisclosed fees, inflated appraisals, underwriting that does not consider a borrower's ability to repay, inflating the borrowers' income and coercive and fraudulent home repair schemes. Other predatory characteristics include lenders' failure to disclose terms to borrowers, pressure and intimidation of borrowers, fraudulent marketing and arbitrary provisions that ensure favorable outcomes for lenders in case of foreclosure. Bourassa, 2003. Some studies include certain loan features as indications of predatory lending including prepayment penalties, balloon payments, adjustable rate mortgages and interest only loans. Rivera et al. 2008, 9-11; National Community Reinvestment Coalition, 2002, 9-10.

<sup>33</sup> Bourassa 2003; Engel and McCoy 2008, 91; Shloemer, 2006; Stock 2001.

<sup>34</sup> 12 U.S.C. 2901.

<sup>35</sup> See, for example, Jerry Bowyer, “Don't Blame the Markets,” *New York Sun*, April 18, 2008.

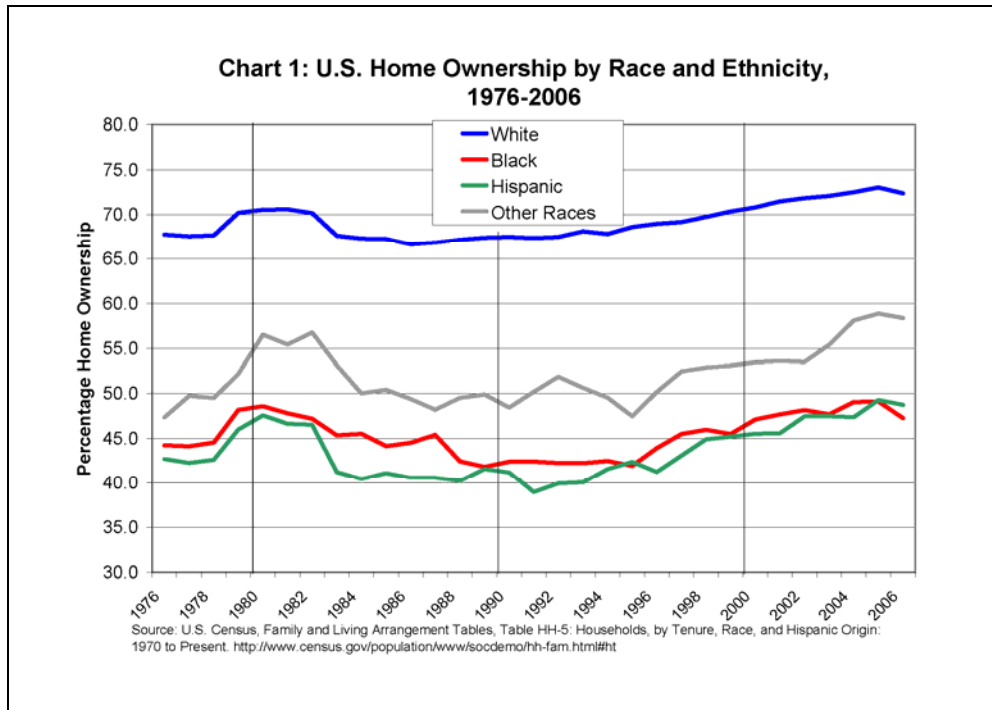
<sup>36</sup> Remarks by FDIC Chairman Sheila C. Bair Before the Consumer Federation of America, December 4, 2008.

<sup>37</sup> Traiger & Hinkley LLP. (study showing that large metropolitan regions with higher concentrations of CRA covered banks had lower foreclosure rates than regions with lower concentrations of CRA covered banks).

<sup>38</sup> Engel and McCoy, 2008; Rivera et al., 2008, 6-7, Listokin and Wyly, 2000, 599-600.

blamed for the foreclosure crisis.<sup>39</sup> The relationship between increasing homeownership and increasing subprime lending, however, is not straightforward – homeownership began increasing for people of color before subprime lending occupied a significant share of the mortgage market.

A strong economy and increased investment in underserved areas set the conditions for steady increases in homeownership for people of color consistently between the mid-1990s and 2006. The homeownership *gap* between whites and people of color, however, did not close. Whites still have homeownership rates 20 to 25 percentage points greater than blacks or Hispanics, a gap that has not changed with growth in underserved markets (Chart 1).



The increase in homeownership for people of color started in the early 1990s and held steady through 2005. The United States Department of Housing and Human Services (HUD) estimated that 80 percent of the subprime loans made in the 1990s were refinances to already existing homeowners.<sup>40</sup> The high-cost subprime market took off around 2003 (Chart 2), well after minority homeownership began to climb.<sup>41</sup> This means that it is possible to increase stable minority homeownership without relying on subprime lending. Further, there is no inevitable connection between minority homeownership and increasing foreclosures. Before subprime lending began to dominate the mortgage market in low-income areas, people of color were

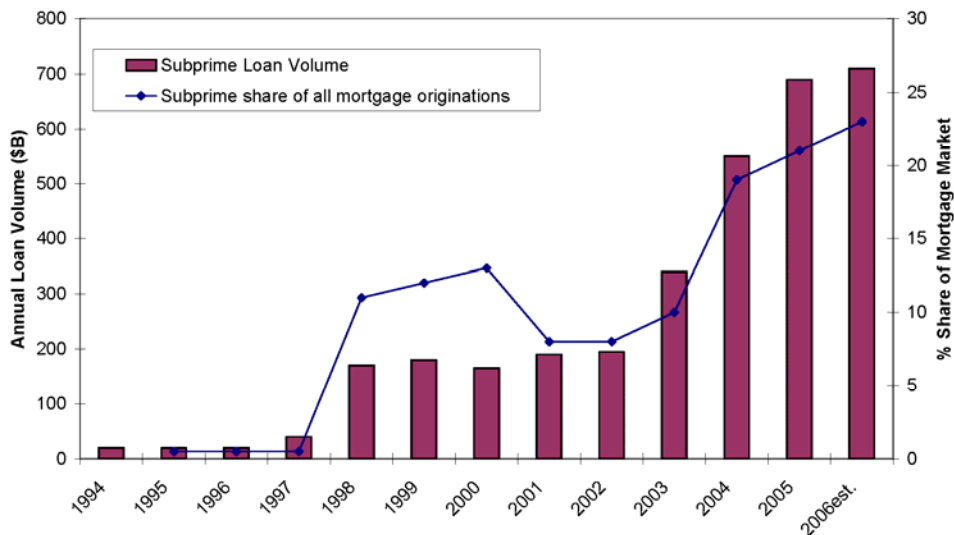
<sup>39</sup> See, for example, John R. Lott, Jr., “Analysis: Reckless Mortgages Brought Financial Market to Its Knees,” *foxnews.com*, September 18, 2008. (Arguing that lending practices promoting minority homeownership mandated by the Fed and encouraged by Fannie Mae and Freddie Mac led to problems at subprime financial institutions such as Countrywide and Bear Stearns.)

<sup>40</sup> National Fair Housing Alliance, 2008, 21.

<sup>41</sup> Other data shows that the share of mortgage loans held by blacks began increasing rapidly even before the rapid increases in the share of subprime loans. Calculated shares from table 2 in Williams, Nesiba, and McConnell, 2005, 195.

successfully purchasing houses with more stable prime loans. Moreover, research conducted by the Boston Federal Reserve suggests that many subprime loans did not result in significantly increased minority homeownership, but rather an increase in churning of subprime loans and refinances in segregated urban areas.<sup>42</sup> This means that increased subprime lending often resulted in a fast-paced turnover and foreclosure of homes already owned by people of color.

**Chart 2: Subprime Mortgage Market Growth and Share of Total Market, 1994-2006**



Source: Agora Financial; Inside Mortgage Finance

### The New Mortgage Market and New Forms of Discrimination

The process of home lending has changed dramatically over the last few decades, including the growth of mortgage brokers, automated underwriting, and loan securitization. While each of these changes potentially increased peoples' access to mortgage loans, they may also have increased the potential for hidden discrimination in lending, obscured credit discrimination against communities of color, and created a complex financial market that encouraged high-risk, predatory lending.

These changes in the mortgage market mean that by-and-large, borrowers no longer acquire loans from their neighborhood bank. Even when borrowers borrow from their neighborhood lender, oftentimes that bank does not make the decision about whether to extend credit or hold onto the loan once it is made. Instead loans, and their attendant risk, are sold on the secondary market.

The demise of the direct connection between borrowers and banks went hand-in-hand with the dramatic increase in mortgage transactions consummated through mortgage brokers.<sup>43</sup> In 2004, 65

<sup>42</sup> Gerardi and Willen, 2008.

<sup>43</sup> A national study of home lending between 1999 and 2000 found that 68 percent of borrowers of color received loans from a broker compared to 38 percent of whites. Apgar and Calder 2005; 4-5; Rivera, 2008; Kellie K. Kim-Sung and Sharon Hermanson, 2003.

percent of all mortgage transactions involved a mortgage broker.<sup>44</sup> Large lenders that dominated the mortgage market in the 1990s were often ill-equipped to establish direct relationships with underserved borrowers and often relied on relationships with other lenders and local non-profit organizations to foster those contacts. Although this helped establish loan counseling and long-term support for borrowers, as automated underwriting increased, these arrangements became less commonplace.<sup>45</sup>

This disconnect between borrowers and the holder of the mortgage loan both fueled the growth of high-cost, high-risk lending in communities of color and made it difficult for homeowners saddled with impossible loan payments to renegotiate reasonable loan terms with the investment banks that owned their mortgages. This separation also made it easier for mortgage market participants to separate themselves from the financial consequences of predatory lending and made it more difficult for borrowers to connect subprime or predatory mortgage terms with the systematic, discriminatory conduct of any one player in the mortgage market.<sup>46</sup>

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<sup>44</sup> Missouri Association of Mortgage Brokers, <http://www.mamb.net/displaycommon.cfm?an=1&subarticlenbr=26>.

<sup>45</sup> Listokin and Wyly, 2000, 633.

<sup>46</sup> For example, while mortgage brokers locate borrowers, lenders usually provide the terms of loans and the terms of the broker's cut of the loan's profits. Loan originators then sell loans to entities that bundle the loans into pools and resell them on the secondary market. Secondary market purchasers of predatory loans encouraged predatory lending by purchasing subprime or predatory loans that they knew or should have known were the result of brokers targeting neighborhoods of color. Likewise, secondary market participants directly participated in discriminatory lending through subsidiaries that engaged in racially targeted predatory lending practices, and underwriting loans in ways that encouraged racially targeted predatory lending. Debbie Bocian, Keith Ernst and Wei Li, 2006, 197 F. Supp.2d 1357 (D. Ga. 2002); Complaint, *Rodriguez v. Bear Stearns*, CV 1816 (D. Conn. Dec. 4, 2007); Comptroller of the Currency, U.S. Dep't of the Treasury, Advisory Letter 2003-3, *Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans*, 2 (2003).

### **III. Twin Cities Mortgage Lending Patterns**

Prior work by other researchers shows that the Twin Cities metropolitan area has had some of the nation's worst racial disparities in mortgage outcomes, particularly in home purchasing.<sup>47</sup> The region has typical levels of subprime lending for a U.S. metropolitan area. However, racial disparities in mortgage lending are stark—in 2006 the Twin Cities region had the seventh largest difference among 63 large metros between white and African American borrowers in the percentage of home purchase loans that were subprime. For Hispanics, the difference was eleventh largest.<sup>48</sup>

This section analyzes home lending patterns in the Twin Cities in more detail to reveal how lending activities and outcomes varied by race, income and neighborhoods between 2004 and 2006. This period was selected because it represented the largest volume of subprime lending nationally.<sup>49</sup>

The analysis of Home Mortgage Disclosure Act (HMDA) loan data shows large disparities across racial groups in access to prime lenders and prime loans. The disparities cannot be explained simply by income differences or by different mixes of loan types (prime versus subprime). The data show, for instance, that denial rates for home mortgage loans for high-income black, Hispanic and Asian applicants exceeded those for low-income white applicants. Denial rates are also greater for non-white applicants regardless of the type of lender (prime, near-prime or subprime).

The analysis also assesses the relationship between race, subprime lending and foreclosures in Twin Cities' neighborhoods and shows that neighborhoods with large shares of people of color—in both central cities and suburbs—are much more likely to have high foreclosure rates than white neighborhoods. Subprime lending and foreclosure rates skyrocket in neighborhoods where minority shares are greater than 40 or 50 percent.

Lending patterns in North Minneapolis illustrate the magnitude of the problem in the hardest-hit parts of the region. North Minneapolis has been hit harder than any other part of the region by the foreclosure crisis. The data show that at least part of the reason for this is that the area is markedly underserved by prime lending institutions and over-served by near-prime and subprime lenders. Near-prime and subprime loans are more risky and costly and, consequently, are much more likely to lead to foreclosure than prime loans.

#### **A. Analysis of Twin Cities Lending Patterns**

This section examines mortgage outcomes by race, income, and geography in order to assess the magnitude of disparities in lending for both individuals and neighborhoods in the Twin Cities

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<sup>47</sup> ACORN, 2007, Foreclosure Exposure.

<sup>48</sup> ACORN, 2007. The comparison is for the 63 metropolitan areas and metropolitan divisions with over 1 million people included in the study.

<sup>49</sup> Using this three year period also provides a data set large enough to cross-tabulate lending characteristics at the neighborhood (census tract) level with reliable results.

metropolitan area. Home Mortgage Disclosure Act (HMDA) for 2004-2006 and 2007 foreclosure data are used to examine differences in lending outcomes and to assess the relationships between race, subprime lending and foreclosures. Denial rates for mortgage applications are used to highlight how outcomes differ by race, even when accounting for variations in income. Differences in application and lending rates in prime and subprime markets are used as indicators of how access to different types of lenders varies systematically by race and neighborhood. Finally, foreclosure data highlight how these lending patterns translate into dramatically disparate effects on different types of neighborhoods and borrowers.

### **Data and Methods**

Home Mortgage Disclosure Act (HMDA) data was used to assess home mortgage lending activity in the Twin Cities between 2004 and 2006. HMDA was enacted in 1975 by the U.S. congress in response to the exclusion of racial minorities in the marketing and lending of home mortgages. HMDA requires a large majority of lending institutions (about 80%) to report their loan application transactions, which are then collected and recorded in an electronic database by the U.S. Federal Financial Institutions Examination Council (FFIEC).

HMDA records show mortgage applications that include the race and income of the applicants, the purpose of the loan, the property location, the outcome, and the name of the mortgage lender. HMDA was amended in 2004 to address the increasing high cost loan activity in the mortgage market by flagging loans that are three percentage points above the prevailing treasury rate.

Other HMDA information include whether the mortgage was a first or second lien mortgage; if the loan request was for an owner or rental unit; whether the mortgaged property was a 1-4 unit, manufactured or multifamily property; and if the loan was a conventional or government-backed loan. Only records for first-lien, conventional, 1-4 unit owner properties were included for this analysis. HMDA records that were determined by FFIEC to have edit quality issues were excluded. Records with missing data for the race of the mortgage applicant were excluded for comparisons of mortgage outcomes of different racial groups.

### **Race, Income and Mortgage Denials**

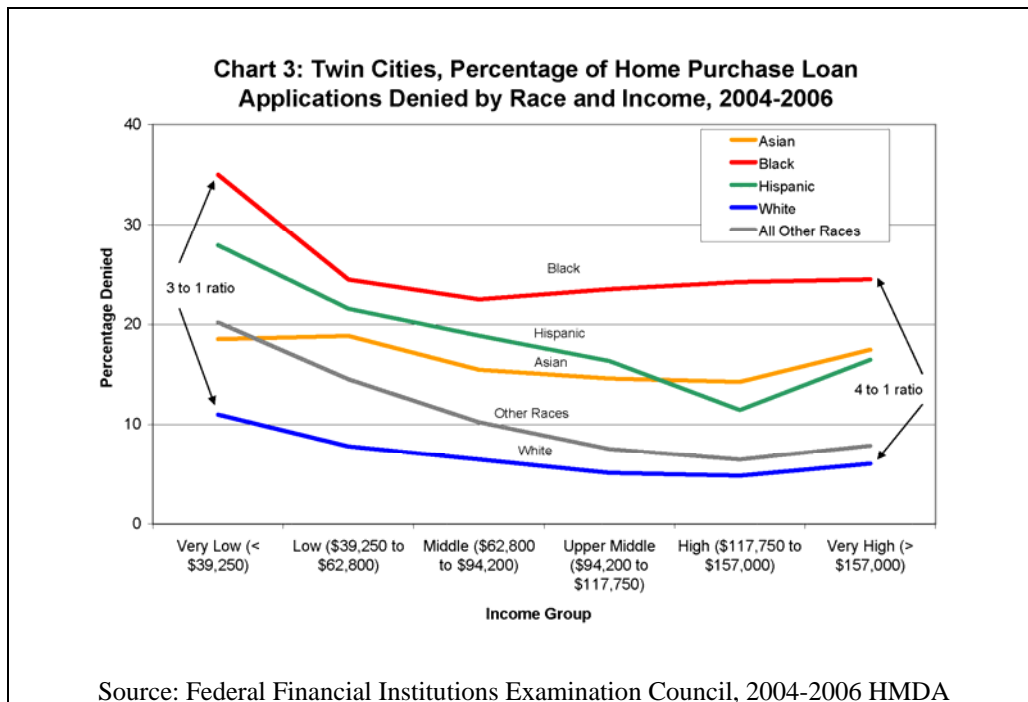
The Twin Cities lending data show large mortgage denial disparities by race. People of color are denied home purchase and refinancing loans at much higher rates than white applicants, even after controlling for income. Chart 3 shows these differences for home purchase loans. Overall, loan denial rates are highest for black applicants, followed by Hispanics, Asians, other races and whites. In general, denial rates are lower for applicants with higher incomes, regardless of race—each of the lines in Chart 3 slopes downward on average.

However, the most striking results in the chart are the differences across races. Denial rates are higher for black, Hispanic and Asian applicants than for whites, *regardless of income*. Very high income black, Hispanic and Asian applicants (applicants with incomes more than \$157,000 per year) show denial rates higher than whites in the lowest-income category (less than \$39,250 per year). The disparities are greatest for black borrowers. The denial rate for blacks with incomes above \$157,000 was 25%, while it was just 11% for Whites making less than \$39,250.<sup>50</sup>

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<sup>50</sup> Statistical analysis of the HMDA data confirm that race and income each have independent effects on denial rates after controlling for the other. A logistic regression of the likelihood that an application was denied on the 213,680

Income is not a perfect proxy for credit-worthiness. For instance, lenders also use credit scores to judge risks. It is possible that non-white and white applicants with identical incomes have different credit scores on average. This could happen if white incomes were more stable over time, for instance. However, other studies have shown that controlling for credit scores or other factors does not eliminate racial differences in credit markets<sup>51</sup> and the differences in Chart 3 are stark. It is hard to view differences of this magnitude as anything except indicators of real differences in the way the credit markets treat applicants of color.

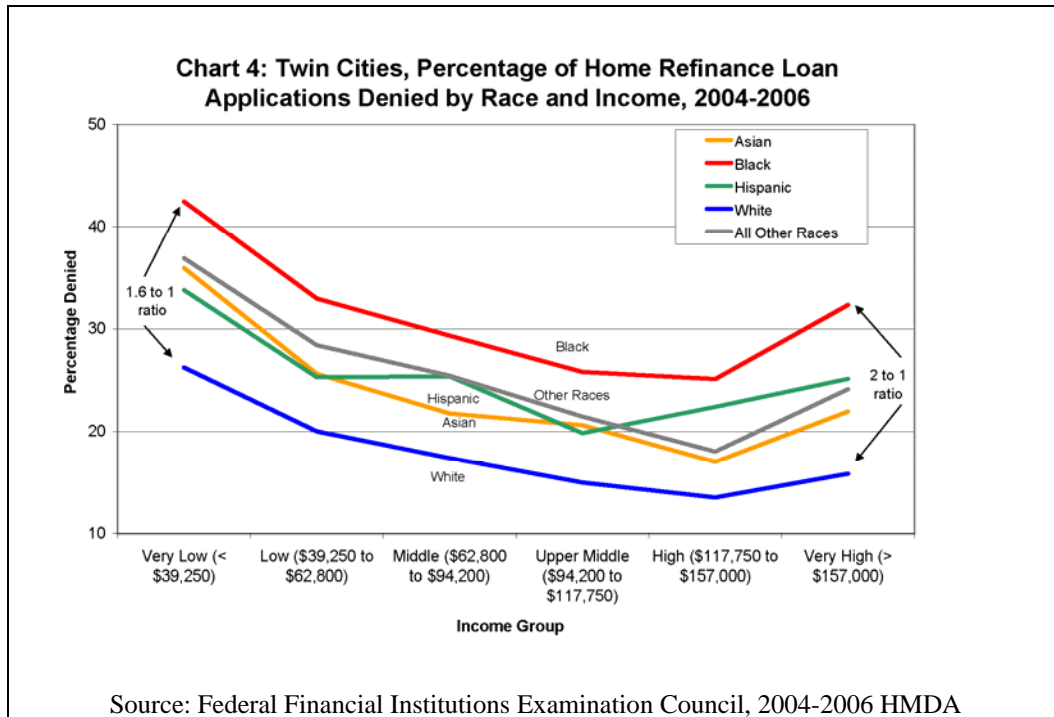


Denial rates for refinancing loans show a similar pattern (Chart 4). Overall, refinance applications are denied more often than home purchase applications and denial rates do not vary as dramatically by race. However upper-income blacks were still likely as or more likely to be denied a refinance loan than lower-income whites. Black applicants in the highest income group had refinance denial rates of 32 percent. This was about twice the denial rate for upper-income whites and six points greater than the 26 percent denial rate for the lowest-income white applicants. Black applicants in the lowest income category had extraordinarily high denial rates—43 percent, or 1.6 times the rate for lower-income whites.

purchase loan applications in 2004-2006 HMDA data for the Twin Cities shows this. Non-white applicants—measured by separate categories for black, Hispanic, Asian and other—show higher denial rates than whites after controlling for inflation-adjusted income (which is negatively associated with likelihood of denial, as expected), inflation-adjusted amount of the loan, type of lender (prime or not), gender of the applicant, minority share of the census tract of the home, and median family income of the census tract. An identical regression using data for the 253,370 refinance applications in the data set gives the same conclusions.

<sup>51</sup> Avery, Canner and Cook 2005; Bocian, Ernst, and Li, 2006; Boehm, Thistle, and Schlottmann, 2006; Courchane Surette, and Zorn, 2004; Dietrich, 2005; . Munnell et. al., 1996; Pennington-Cross et al., 2000.





The geography of mortgage denial rates reflects these patterns. Map 1 shows mortgage (home purchase and refinance loans, combined) denial rates across the region and Map 2 shows the percentage of applications that are from people of color.<sup>52</sup> The highest mortgage denial rates between 2004 and 2006 were concentrated in neighborhoods with the highest percentages of applications from people of color. The neighborhoods with the highest mortgage denial rates were largely in North Minneapolis, the adjacent northern suburbs, south-central Minneapolis, and central St. Paul (Map 1). Mortgage denial rates in these neighborhoods exceeded 25 percent and the correlation with non-white application rates (Map 2) is clear. The only other areas with high denial rates were in the periphery of the metro, places with few applicants, most of whom were low-income whites.<sup>53</sup>

### Race, Loan Types and Denial Rates

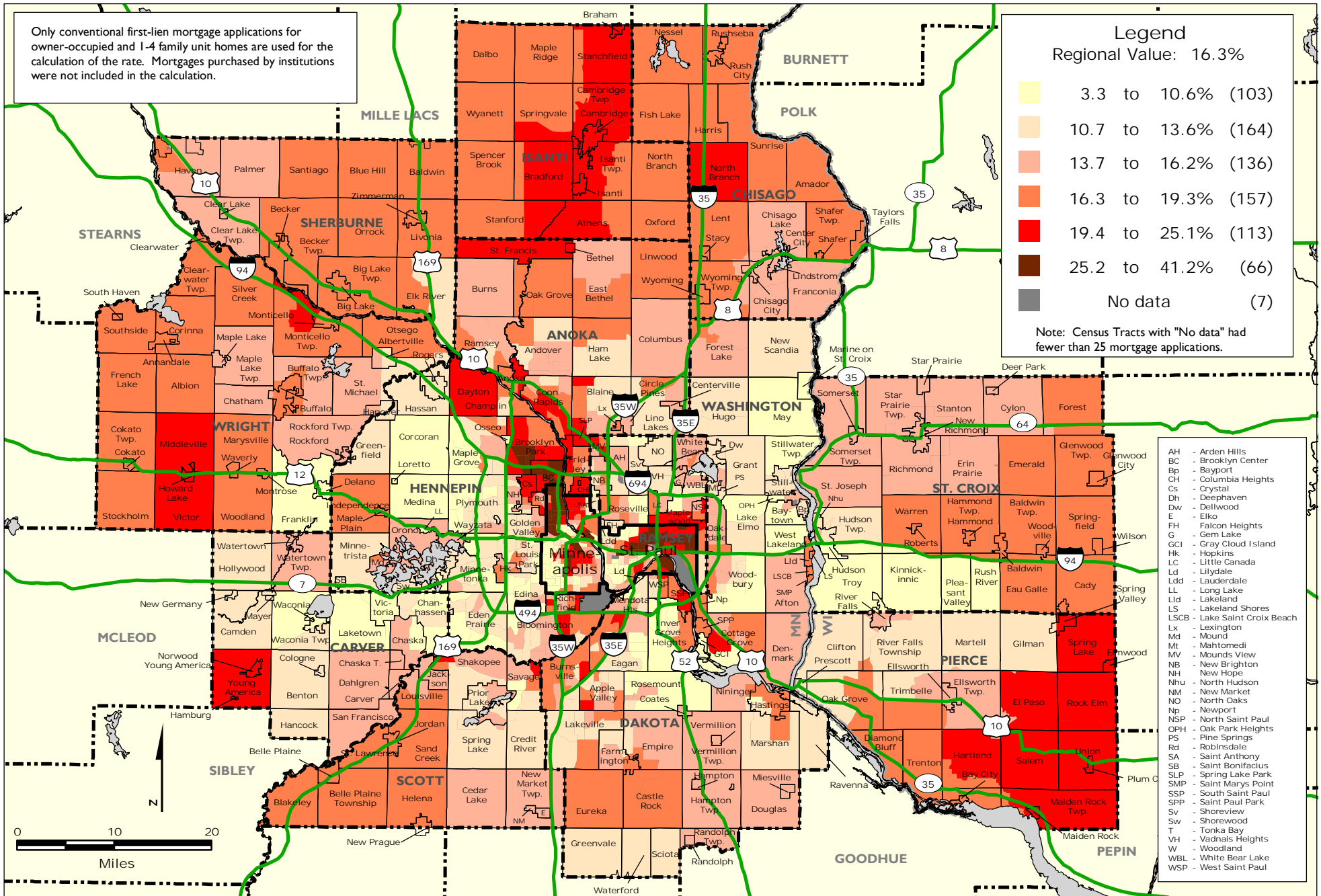
Mortgage lending disparities by race in the Twin Cities can be broken down into two parts. One part reflects the fact that denial rates differ by race regardless of the type of loan. For instance, black applicants may have higher denial rates for all types of loans—prime, near-prime and sub-prime. This can be called the “rate effect.” The other part reflects the fact that denial rates differ by loan type and different races use different mixes of loans. If, for instance, subprime loans have much higher denial rates than prime loans and black applicants are much more likely than

<sup>52</sup> Similar spatial patterns were found for home purchase loans and refinance loans. Maps 1, 2, 4 and 5 therefore show total rates regardless of the purpose of the loans.

<sup>53</sup> Tracts with high denial rates in the outskirts of the metro had substantially fewer people applying for loans compared to other tracts in the metro. For instance, tracts with high denial rates (>19.4%) in the periphery of the metro in Chisago, Isanti, Pierce, Saint Croix, Sherburne and Wright Counties had 12,291 mortgage applicants compared to 89,195 in other high denial tracts in the core of the region.

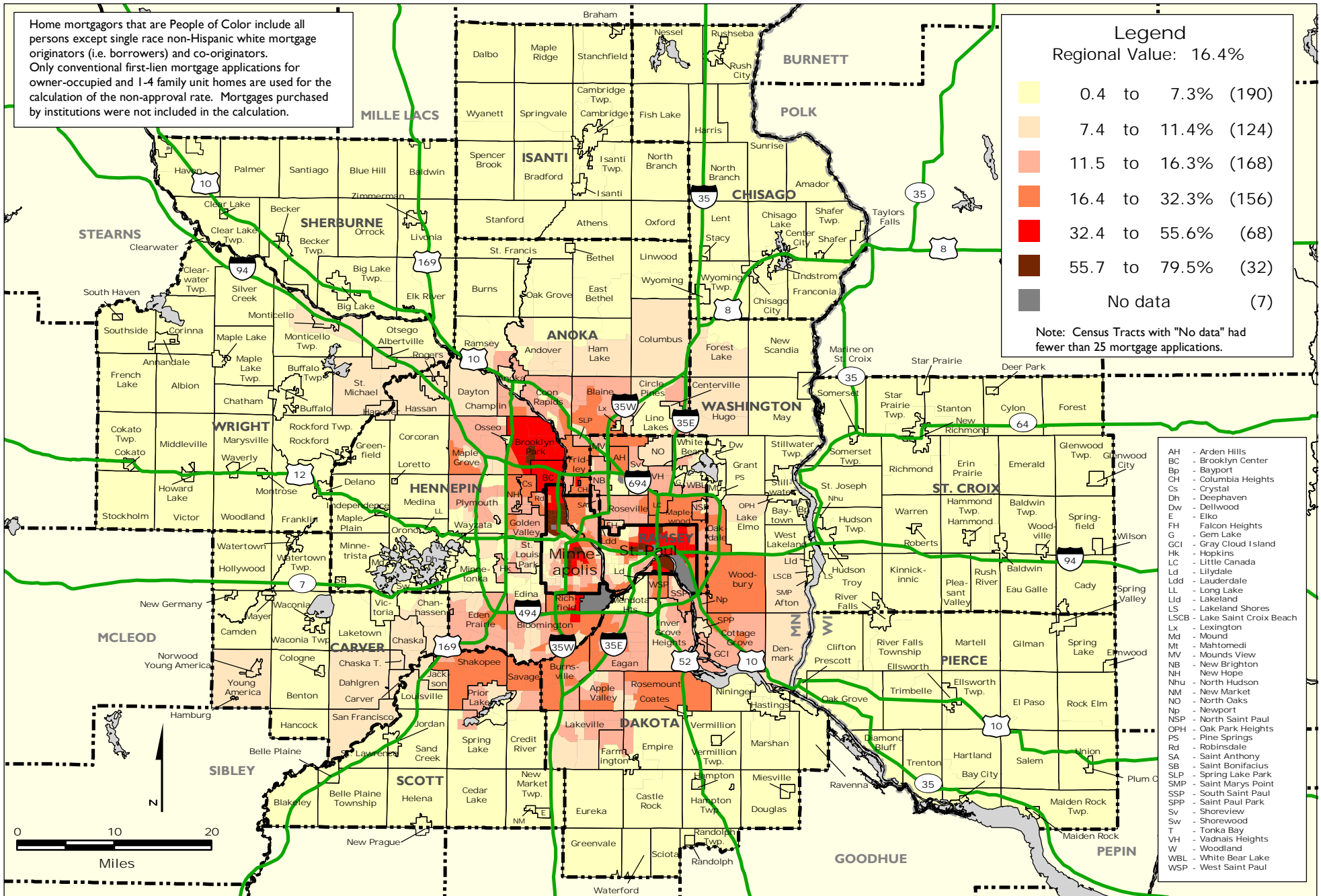
# Map 1: MINNEAPOLIS - SAINT PAUL REGION

## Home Mortgage Denial Rates by Census Tract, 2004 - 2006



## Map 2: MINNEAPOLIS - SAINT PAUL REGION

### Percentage of Mortgage Applications that are People of Color by Census Tract, 2004 - 2006



whites to use sub-prime loans, then blacks might have higher denial rates simply because of their loan mix. This can be called the “mix effect.” The distinction is helpful because the two types of disparity have different causes and remedies. A substantial rate effect most likely reflects that potential borrowers are treated differently depending on their race, while a large mix effect suggests that access to different types of lenders varies by race.

This section will first examine how loan mixes vary across races. This comparison is important for two reasons. To some extent, loan mixes reflect access to different types of lenders, so the mix is of interest in and of itself. The loan mix also can be combined with denial rate data to break out the “rate” and “mix” effects.

The ability to obtain a prime loan is affected by how accessible a prime lending bank is to a potential borrower. Mortgage lenders in the Twin Cities tend to specialize either in prime lending—banks issuing more than 90 percent prime loans—or subprime lending—banks issuing more than 50 percent subprime loans.

In the Twin Cities, home purchasers of color were much more likely than whites to apply with a subprime lender (Tables 1a and 1b).<sup>54</sup> For example, 55 percent of blacks applied with a subprime lender for a home loan, compared to only 12 percent of whites. Subprime shares were 42 percent for Hispanics and 38 percent for American Indians (table 1a). If people of color had applied to prime home purchase lenders at the same rate as whites there would have been an additional 5,033 blacks, 2,784 Hispanics and 2,462 Asians applying with a prime lender.

A similar pattern exists with refinance applications. Whites were substantially more likely than non-whites to apply to a prime lender. For instance, nearly half of white applicants (46 percent) applied for a refinance loan at a prime lender compared to just 29 percent with subprime lenders. On the other hand less than 20 percent of black applicants applied with prime lenders compared to more than 50 percent with subprime lenders. If people of color had applied to prime refinance lenders at the same rate as whites there would have been an additional 4,050 blacks, 1,928 Hispanics and 914 Asians applying with prime lenders.

Prime lenders are underrepresented in neighborhoods with large shares of people of color. Racial segregation limits access to prime lenders. A study by the National Community Reinvestment Coalition found that the Twin Cities ranked last of the 25 large metropolitan areas in the study in the availability of bank branch locations in predominantly minority census tracts (Table 2).<sup>55</sup>

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<sup>54</sup> Lenders with less than 10 percent of loans subprime are designated “prime lenders”; lenders whose total loans were 10 to 50 percent subprime are “near-prime lenders”; and lenders whose total loans were more than 50% subprime are “subprime lenders”.

<sup>55</sup> For Twin Cities’ census tracts with over 50 percent minority there were 13,473 persons per branch location, compared to 3,729 persons per branch location in tracts with less than 50 percent minority. National Community Reinvestment Coalition, 2007, p. 15.

**Table 1a: Percentage of Home Purchase Applications Filed at Prime, Near-Prime and Subprime Lending Institutions by Race of Applicant**

	Total Number of Applications	% of Applications by Lending Institution			
		All Lenders	Prime	Near Prime	Subprime
Asian	10,030	100.0	52.3	18.9	28.8
Black	10,265	100.0	27.8	16.6	55.5
Hispanic	7,408	100.0	39.3	18.3	42.5
White	131,317	100.0	76.9	11.0	12.1
Other Races	3,221	100.0	67.6	12.2	20.2
<b>Total</b>	<b>162,241</b>	<b>100.0</b>	<b>70.3</b>	<b>12.2</b>	<b>17.4</b>

**Table 1b: Percentage of Refinance Applications Filed at Prime, Near-Prime and Subprime Lending Institutions by Race of Applicant**

	Total Number of Applications	% of Applications by Lending Institution			
		All Lenders	Prime	Near Prime	Subprime
Asian	8,894	100.0	35.6	30.9	33.6
Black	15,376	100.0	19.5	29.9	50.6
Hispanic	9,849	100.0	26.3	32.0	41.7
White	233,698	100.0	45.8	25.3	28.8
Other Races	5,530	100.0	35.1	29.3	35.7
<b>Total</b>	<b>273,347</b>	<b>100.0</b>	<b>43.1</b>	<b>26.1</b>	<b>30.8</b>

Note: Mortgage lending institutions in the table are categorized according to the percentage of loans they made that are subprime. Less than 10% of loans made by Prime Lenders were subprime, 10 to 50% of loans made by Near Prime lenders were subprime, and more than 50% of loans made by Subprime Lenders were subprime.

Source: Federal Financial Institutions Examination Council, 2004-2006 HMDA

**Table 2: MSAs Ranked by Persons Per Branch in 51-100% Minority Census Tracts, 2005 (Ascending Order)**

Rank	MSA	(a)	(b)	(c)	(d)
		Persons Per Branch In 51-100% Minority Tracts	Persons Per Branch In 0-50% Minority Tracts	Column (b) - Column (a)	All Tracts
1	San Francisco	3,662	3,731	69	3,699
2	Boston	3,802	3,111	-691	3,166
3	Miami	4,500	848	-3,652	3,169
4	Washington	4,566	2,849	-1,717	3,278
5	Seattle	4,987	3,438	-1,549	3,515
6	Tampa	5,674	3,401	-2,273	3,592
7	Pittsburgh	5,699	2,954	-2,745	3,032
8	Atlanta	6,084	2,730	-3,354	3,327
9	Cincinnati	6,491	2,940	-3,551	3,136
10	Baltimore	6,692	2,869	-3,823	3,333
11	Dallas	6,692	3,123	-3,569	3,894
12	Denver	6,973	3,268	-3,705	3,627
13	San Diego	7,141	4,401	-2,740	5,154
14	Houston	7,182	2,921	-4,261	4,259
15	Cleveland	7,361	3,441	-3,920	3,835
16	New York	7,619	5,406	-2,213	6,168
17	Los Angeles	7,956	3,677	-4,279	6,021
18	Detroit	8,056	3,431	-4,625	4,027
19	Chicago	8,376	4,150	-4,226	5,116
20	Kansas City	8,578	2,689	-5,889	2,975
21	Phoenix	8,735	3,896	-4,839	4,561
22	Philadelphia	8,922	2,623	-6,299	3,161
23	Portland	9,471	3,885	-5,586	3,930
24	St. Louis	11,014	4,566	-6,448	5,026
25	Minneapolis	13,473	3,729	-9,744	3,922
<b>Median of MSAs</b>		<b>7,141</b>	<b>3,401</b>	<b>-3,705</b>	<b>3,699</b>

Source: National Community Reinvestment Coalition, 2007, Are Banks on the Map? An Analysis of Bank Branch Location in Working Class and Minority Neighborhoods, page 15.

Federal Deposit Insurance Corporation (FDIC); Office of Thrift Supervision (OTS)

The importance of the “mix effect” depends on how denial rates differ by loan type. The bottom row of Table 3 shows very clearly that denial rates are higher on average in the subprime and near-prime markets than in the prime market. The overrepresentation of borrowers of color in the subprime markets explains at least some of the overall higher denial rates for people of color shown in Charts 3 and 4. However, only a portion of the disparities can be explained this way. Table 3 also shows that denial rates are substantially higher for people of color for each type of lender, including prime lenders. For instance, home purchase loan denial rates for blacks exceeded those for whites by nine points (13 percent compared to four percent) with prime lenders, or by more than 3 to 1. The difference was 14 points (or 2 to 1) for near-prime lenders and eight points (or 1.4 to 1) for sub-prime lenders.

**Table 3: Percentage of Home Mortgage Applications that were Denied by Race and Lending Institution Types**

	Home Purchase Denial Rates				Refinance Denial Rates			
	All Lenders	Prime Lenders	Near Prime Lenders	Subprime Lenders	All Lenders	Prime Lenders	Near Prime Lenders	Subprime Lenders
Asian	16	7	24	28	24	12	32	30
Black	24	13	27	29	33	22	35	37
Hispanic	20	10	27	26	27	16	31	30
White	7	4	13	21	19	8	27	29
Other Races	11	6	16	23	26	14	32	34
Total	9	4	16	24	20	9	28	30

Source: Federal Financial Institutions Examination Council, 2004-2006 HMDA

Disparities are also evident for refinance loans. For these types of loans, denial rates for black applicants were 14 points higher (or nearly 3 to 1) for prime lenders and eight points higher for near-prime and sub-prime lenders.

Both the mix and rate effects are potentially important. In fact, analysis shows that each effect explains roughly half of the total difference in denial rates for home purchase loans between whites and each of the other three races.<sup>56</sup> This means that policies to deal with both types of racial disparities are necessary—strategies to promote equal access to prime lending as well as policies which insure that potential borrowers for all types of loans are treated equally.

### **Subprime Lending Rates by Race and Income**

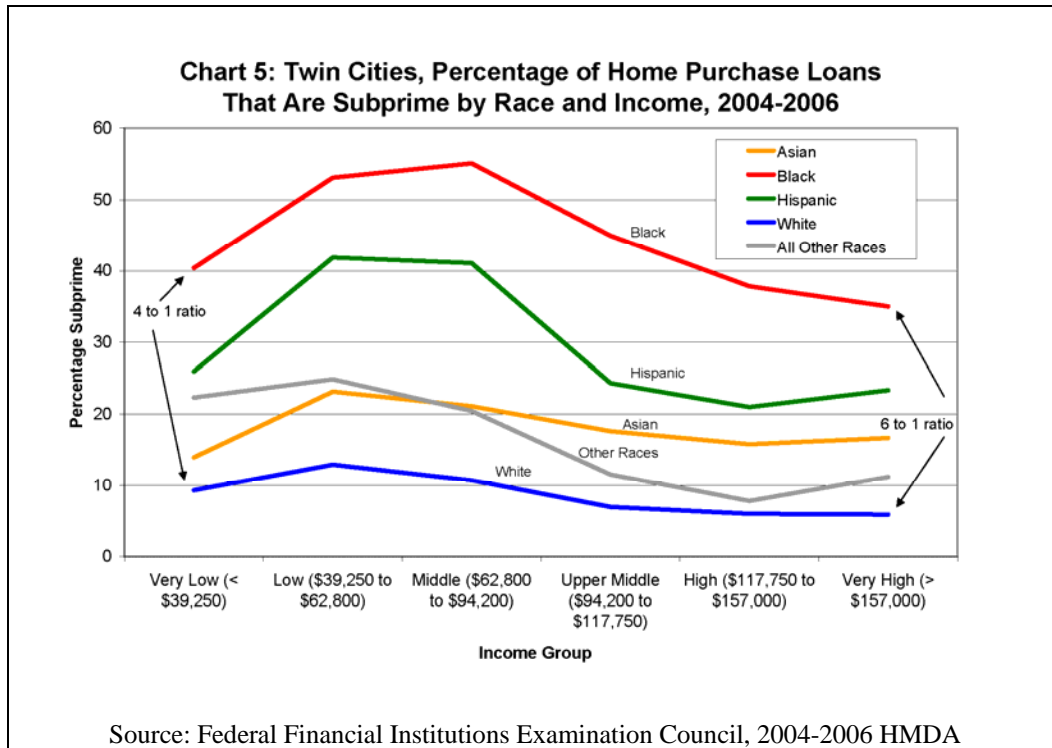
Given that such a significant proportion of the overall racial disparities in denial rates are the result of the mix of lenders that different races utilize, it is important to understand why so many non-white borrowers end up in the subprime market. If, for instance, they end up with these kinds of loans because their lower incomes make them greater risks, then the policy implications are substantially different than if they end up with subprime lenders and loans simply because of their race.

Income alone does not account for racial disparities in participation in the prime and subprime markets. In the Twin Cities, blacks are five times more likely to receive a subprime home purchase loan than whites, followed by Hispanics (a 4 to 1 ratio) and Asians (a 2 to 1 ratio). For refinances, blacks are 2.5 times more likely to receive a subprime loan than whites, followed by Hispanics (a 2 to 1 ratio) and Asians (a 1.25 to 1 ratio). Further, Chart 5 shows that high and very high income black or Hispanic borrowers are more likely to have subprime loans than in *any*

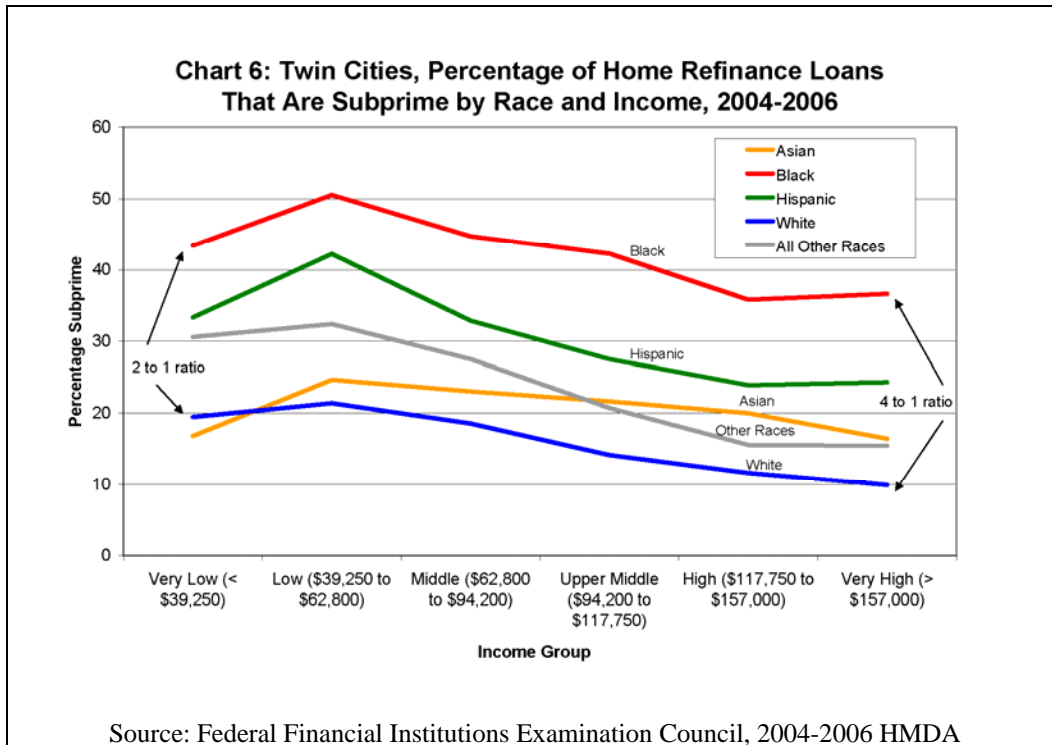
<sup>56</sup> The analysis, known as shift-share analysis, makes two calculations. The first is an estimate of the total denial rate that each race would have if it had the average mix of loan types combined with its actual denial rates for each loan type. The second is an estimate of the total denial rate that each race would have if it had its actual mix of loans combined with average denial rates for each loan type. Each of the estimates can be compared to each race's actual total denial rate to show how much of the differences between races are due to the mix and rate effects. The shift-share analysis is available from the authors on request.

white income group. The same is true for refinancing loans (Chart 6).

As noted in the discussion of denial rates, income is not a perfect proxy for risks. However, the prime-subprime comparisons are dramatic. Unless characteristics other than income are strongly correlated with both race and risks, race by itself is still a very strong factor determining the quality (and therefore the cost) of loans that borrowers receive. In other words, discriminatory practices could very well be at work in these markets.







### Lending Patterns by Neighborhood Type

Neighborhoods in the Twin Cities are highly segregated by race. This creates potential for geographic disparities in two ways. Entire neighborhoods in the core cities and inner suburbs with high non-white shares of residents are likely to show much higher than average rates of subprime loans because they are populated by racial groups most likely to receive those types of loans. Even more important, however, is the possibility that loan applicants will be treated differently by the lending market depending on the neighborhood they live in, rather than based on the individual merits of their application.

The data in fact show that there is a strong relationship in the Twin Cities between the racial composition of a neighborhood and the distribution of applications across prime, near prime and subprime lenders. Applicants are less likely to access prime lenders when attempting to acquire or refinance homes in neighborhoods with larger shares of people of color than in white neighborhoods, and they are less likely to do so regardless of the race or income of the applicant.

Table 4 shows that in predominately white neighborhoods (neighborhoods that are less than 30 percent people of color) 72 percent of all loan applications are made to prime home purchase lenders. This is significantly greater than the 52 percent of applications in integrated neighborhoods (with 30 to 49 percent people of color) and 34 percent of applications in segregated non-white neighborhoods (with 50 percent or more people of color).

The differences are also evident for refinance applications. As the racial composition of the neighborhood shifts towards greater shares of people of color, the application rates at prime lenders drop, regardless of the race and income of the applicant.

Both people of color and whites are less likely to apply with prime lenders when applying for loans in integrated or segregated non-white neighborhoods. For home purchases, the prime lender application rate for whites is highest in predominately white neighborhoods at 78 percent, dropping to 69 percent in integrated neighborhoods, and 55 percent in segregated non-white neighborhoods. Similarly, the prime lender application rate for people of color is highest in predominately white neighborhoods at 49 percent, dropping to 29 percent in integrated neighborhoods and to 22 percent in segregated non-white neighborhoods. The pattern is similar for refinance loans.

Table 4 also shows that the relationship between access to prime lenders and the racial composition of the neighborhood cannot be explained simply by the income mix of the neighborhoods. If that were the case, prime lender application rates for applicants of a given race and income would be the same in all neighborhoods—e.g. high income whites would apply for prime loans at the same rate regardless of their neighborhood type. In fact, high and very high income whites and people of color show significant drops in prime lender application rates as the share of people of color in a neighborhood increases. This shows that even high-income whites face obstacles to acquiring prime loans in high-minority neighborhoods.<sup>57</sup>

**Table 4: Percentage of Home Mortgage Applications at Prime Lenders by Racial Characteristic of Neighborhood and Applicant**

	Total %*	White %	People of Color %	High and Very High Income	
				White %	People of Color %
<b>Home Purchases</b>					
<u>Racial Composition of Neighborhood:</u>					
0 to 29% People of Color:	72	78	49	81	54
30 to 49% People of Color:	52	69	29	70	24
50 to 100% People of Color:	34	55	22	50	14
<b>Refinances</b>					
<u>Racial Composition of Neighborhood:</u>					
0 to 29% People of Color:	42	47	31	55	38
30 to 49% People of Color:	29	35	22	35	18
50 to 100% People of Color:	20	26	18	24	16

\* Includes mortgage applications without racial information

Source: Federal Financial Institutions Examination Council, 2004-2006 HMDA; 2000 U.S. Census Bureau

It is likely that the lack of prime lender branch locations in diverse and segregated neighborhoods (see Table 2) makes it more difficult for all types of applicants to apply to prime lenders. However, it is worth reiterating that differences by race are substantial regardless of the neighborhood type—applicants of color are much less likely than whites to access prime lenders, regardless of the racial composition of the neighborhood.

<sup>57</sup> Statistical analysis of denial rates also shows that loan denial rates are higher in high-minority neighborhoods even after controlling for the race and income of the applicant, the loan amount, the lender type (prime or not), gender of the applicant and neighborhood income.

### **Lending Patterns in North Minneapolis**

North Minneapolis is the area hardest hit by the foreclosure crisis in the Twin Cities.<sup>58</sup> While about two units for every hundred owner units in Hennepin and Ramsey Counties experienced foreclosure, the rate was about twelve units for every hundred North Minneapolis units. It is also the most segregated and lowest-income area in the Twin Cities. Seventy percent of North Minneapolis residents are people of color, while in the Twin Cities metro as a whole, people of color represent just 15 percent of the population. Not surprisingly, home buyers and refinancers in North Minneapolis received a large number of subprime loans.

Different types of lenders had very different lending patterns in North Minneapolis than they did in the rest of the Twin Cities region. Many prime lenders were less likely to issue any sort of loan in North Minneapolis, while many subprime lenders were disproportionately active on the Northside.

1.7 percent of all home purchase loans and 2.0 percent of refinancing loans in the Twin Cities were issued to borrowers in North Minneapolis. Forty-nine percent of these North Minneapolis home purchase loans were subprime, while 47 percent of refinance loans were subprime. In the rest of the metropolitan area, just 14 percent of home purchase loans and 20 percent of refinancing loans were subprime. In other words, a home purchase loan for a Northside property was 3.6 times more likely to be subprime than a loan for a home located elsewhere in the Twin Cities metropolitan area. Likewise, a refinancing loan for a home located in North Minneapolis was 2.3 times more likely to be subprime than a refinancing loan located elsewhere in the Twin Cities.

Many subprime lenders did a disproportionate amount of their lending in North Minneapolis, while many prime lenders did very little lending in North Minneapolis. Table 5 shows lending patterns for each of the three lending categories. The percentage of prime lender loans that went to North Minneapolis was easily the lowest—0.8 percent compared to 1.7 for all lenders, 2.5 percent for near-prime lenders and 6.7 percent for subprime lenders. For example, the region's largest prime lender, Wells Fargo Bank, NA, made just 286 of its home purchase loans in North Minneapolis out of a regional total of 35,272. If North Minneapolis had received a proportionate amount of Wells Fargo's loans, it would have received more than twice as many loans—1.7 percent or a total of 616 loans.

Likewise, among other large prime lenders, CitiMortgage made 11 of its 1,375 loans in North Minneapolis (0.8 percent); Voyager Bank made 10 of its 1,616 Twin Cities Loans in North Minneapolis (0.8 percent); and PHH Mortgage made 49 of its 6,751 loans on the Northside (0.7 percent). These lenders, along with most other large scale prime lenders were disproportionately absent from North Minneapolis loan records. Indeed, several medium-to-large-scale prime lenders made no home loans at all in North Minneapolis: DHI mortgage Co. (1,731 total loans), Ryland Mortgage Company (1,054 total loans), Universal America Mortgage Co. LLC (2,322 total loans), and Xpulte Mortgage, LLC (1,112 total loans).

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<sup>58</sup> For the purposes of this work, Minneapolis' Northside was defined as the census tracts that were completely or mostly contained in zip codes 55411 and 55412, the area most often used in studies of the Northside.

**Table 5: Home Purchase Loan Rates in North Minneapolis for Prime, Near Prime and Subprime Lenders**

	Total Metro <u>Loans</u>	North Mpls. <u>Loans</u>	% North <u>Mpls.</u>
All Prime Lenders	118,288	990	0.8
All Near Prime Lenders	21,221	537	2.5
All Subprime Lenders	18,350	1,231	6.7
All Lenders	157,859	2,758	1.7

Totals include only banks with 25 or more loans.

Conversely, most of the Twin Cities' large subprime lenders made a disproportionately large number of loans in North Minneapolis. For example, BNC mortgage made 10.8 percent of its loans on the Northside (196 out of 1,821 loans), while Long Beach Mortgage Company made 12.2 percent of its loans on the Northside (63 of 516 loans)—compared to 6.7 percent of loans for subprime lenders overall and 1.7 percent of loans for all lenders.<sup>59</sup>

This data does not prove that certain prime lenders redlined North Minneapolis or that certain subprime lenders targeted North Minneapolis. Nor does this pattern implicate all lenders in the region. Indeed, several banks, including Twin Cities Financial (TCF), made a disproportionate number of *prime* loans in North Minneapolis. Overall, however, the pattern shows that subprime lenders did a disproportionate amount of their total lending in this racially isolated community, while most prime lenders extended little or no credit to Northside homebuyers and refinancers.

### **B. Race, Subprime Lending and Foreclosures**

Subprime and predatory loans often lack transparency, have little oversight and accountability and are often unsustainable, which leads to foreclosure. Mortgage foreclosures are costly both to individual homeowners and to their communities. For instance, researchers in Chicago measured the impact of foreclosures on neighboring properties from 1997 to 1999. The estimate was that each conventional single family foreclosure resulted in a 0.9 percent decrease in the value of homes within 1/8 mile of the foreclosure. For the City of Chicago this equated to a loss of \$598 million dollars in single family property values—a \$159,000 loss to neighboring homes per foreclosure.<sup>60</sup> Re-scaling this estimate for Minneapolis and St. Paul in more recent years suggests that foreclosures in 2007 alone resulted in hundreds of millions of dollars in lost tax base in each city and a loss of roughly 2.5 percent of property tax revenues.<sup>61</sup>

<sup>59</sup> A similar pattern exists in the refinancing market, although the disparities are somewhat less extreme.

<sup>60</sup> Immergluck and Smith, 2006.

<sup>61</sup> This calculation assumes that home values in Minneapolis and St. Paul were 85 and 77 percent of those in Chicago (reflecting median values reported in 2005-2007 by the Census); that values increased from 1999 to 2007

Borrowers who face foreclosures have difficulty making ends meet and cumulatively put great pressure on the broader community. As Engel and McCoy (2008) note:

As borrowers struggle with unmanageable monthly loan payments or lose their homes, cities may also experience a greater demand for social welfare programs. More residents may turn to cities for assistance with heating costs, food and shelter. The education system can feel the effect as well. When children lose their homes, they often switch schools, which strains urban school systems that are already strapped for resources.<sup>62</sup>

Nationally, foreclosures increased 55 percent between 2005 and 2007. Subprime loans contributed to over two-thirds of the growth.<sup>63</sup> The lending disparities by race and location revealed in the prior section are bound to mean that the costs of the foreclosure crisis still at work in the U.S. and the Twin Cities will be borne very unevenly. Not surprisingly, the effects have been greatest on communities of color. There is a strong relationship in Hennepin and Ramsey county neighborhoods between mortgage foreclosures, subprime lending and borrowers of color.

Maps 3 through 6 show this very clearly in the core of the region within Hennepin and Ramsey counties. Map 3 shows the location of sheriff's foreclosure sales in 2007. Minneapolis has the largest number of foreclosures, followed by St. Paul and the inner suburbs of Brooklyn Park and Brooklyn Center. The largest cluster of foreclosures is in North Minneapolis.

Map 4 shows that the areas with the most foreclosures are also areas where most mortgage holders are people of color. The neighborhoods with the highest percentages of mortgages held by people of color are in parts of Minneapolis, St. Paul, Brooklyn Park, Brooklyn Center and Richfield. The largest concentration, where over half the borrowers are people of color, is in North Minneapolis, the neighborhood with the greatest concentration of foreclosures.

Subprime loans are also most concentrated in neighborhoods with high percentages of people of color (Map 5). Various inner city neighborhoods, as well as parts of Brooklyn Center, Brooklyn Park and Richfield show high rates of subprime lending. North Minneapolis and neighborhoods that surround downtown Saint Paul have subprime lending rates that exceed 37 percent of all loans.

Map 6 shows foreclosure rates per 100 owner occupied housing units. As expected, the census tracts with the highest percentages of people of color and the highest subprime lending rates are also the tracts where foreclosure rates were the highest. Foreclosure rates were particularly high

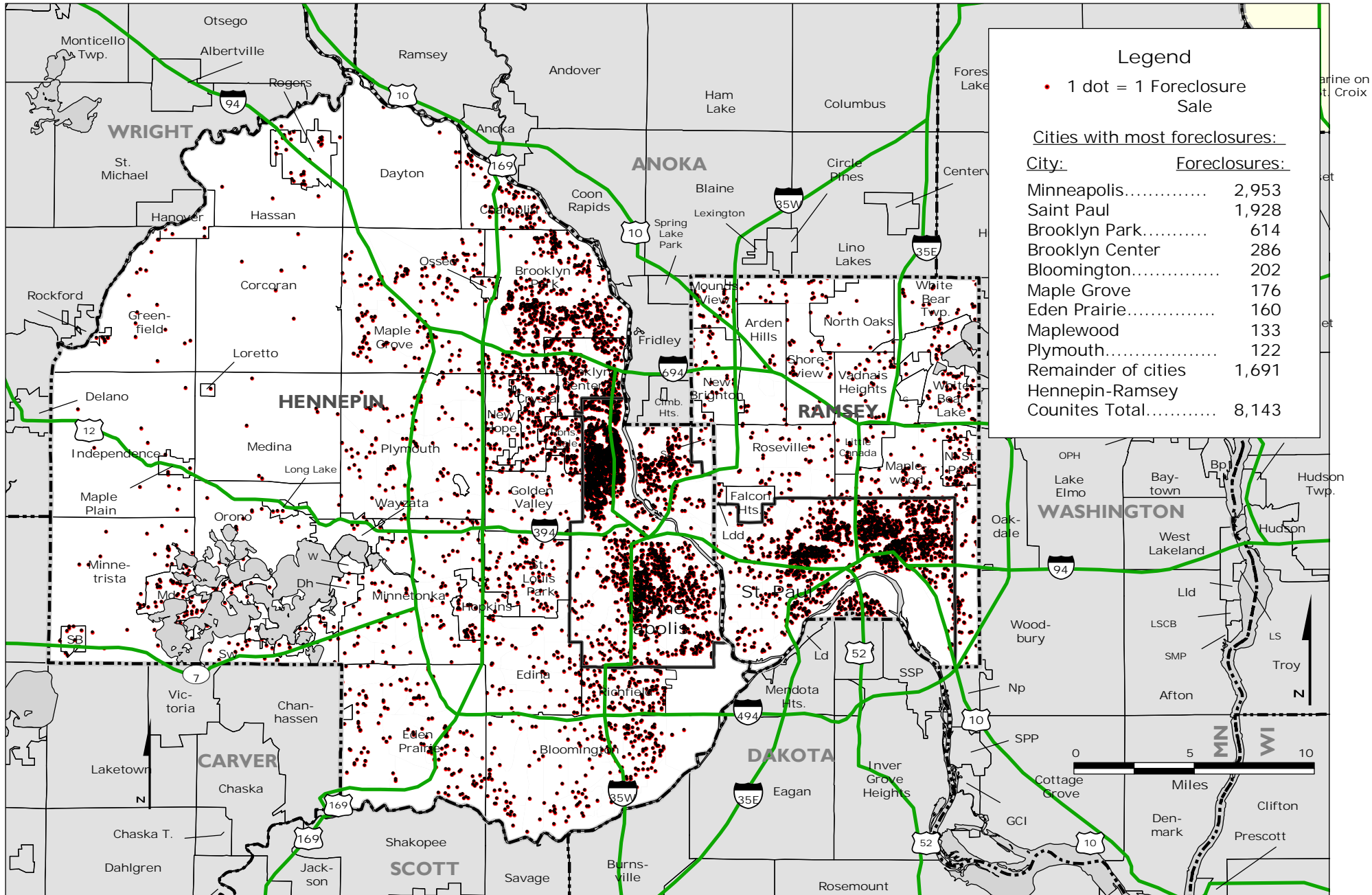
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by roughly 100 percent (which is the increase in median values reported by the Census from 1999 though 2005-2007); and that effective municipal tax rates (taxes as a percent of market value) were 0.62 percent in Minneapolis and 0.32 percent in St. Paul (reflecting taxes on a median valued home). With these assumptions, the 2,943 foreclosures that occurred in Minneapolis in 2007 would have resulted in \$814 million in lost tax base and \$10.7 million in lost property tax revenues in total and \$5.1 million for the city government alone. The equivalent figures for the 1,928 foreclosures in St. Paul are \$483 million in lost tax base and \$5.2 million in lost revenues in total and \$1.5 million for the city government alone.

<sup>62</sup> Engel and McCoy 2008, 101.

<sup>63</sup> Wood, 2007, 23-24.

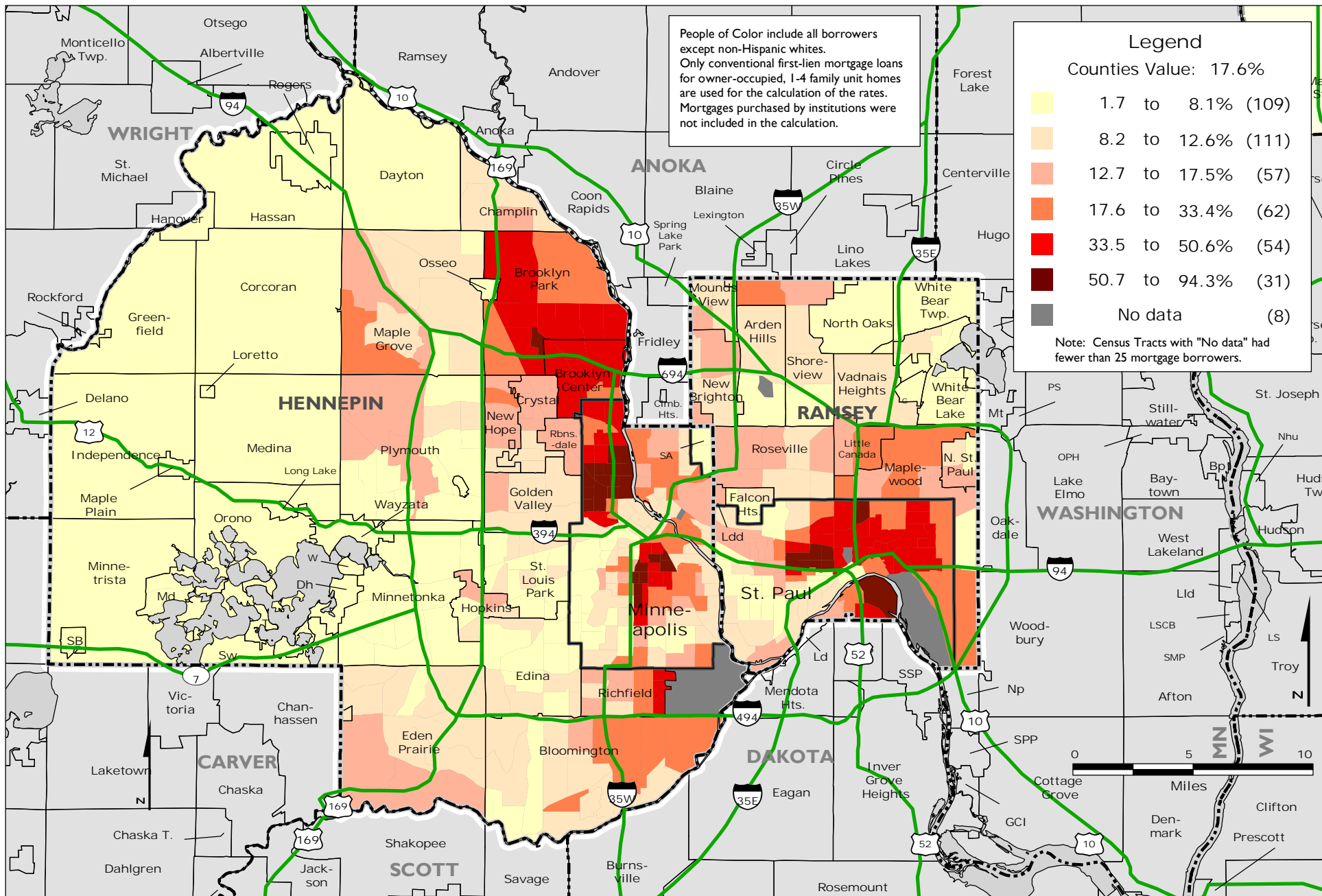
**Map 3: HENNEPIN - RAMSEY COUNTIES**  
 Sheriff Foreclosure Sales  
 by Address Location, 2007



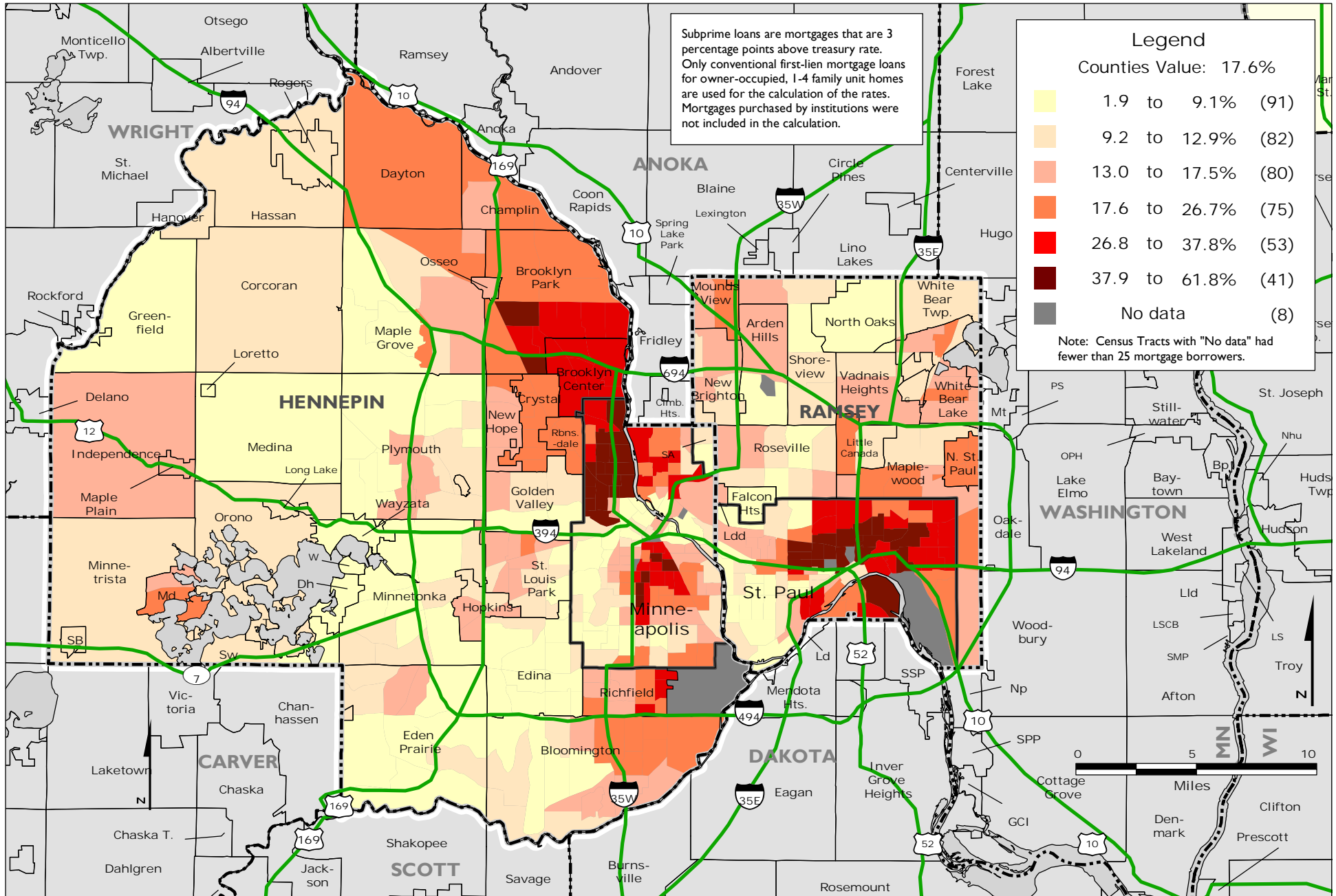
Data Source: Housing Link, Hennepin and Ramsey County Sheriffs Departments.

### Map 4: HENNEPIN - RAMSEY COUNTIES

#### Percentage of Mortgage Loans Acquired by People of Color by Census Tracts, 2004-2006

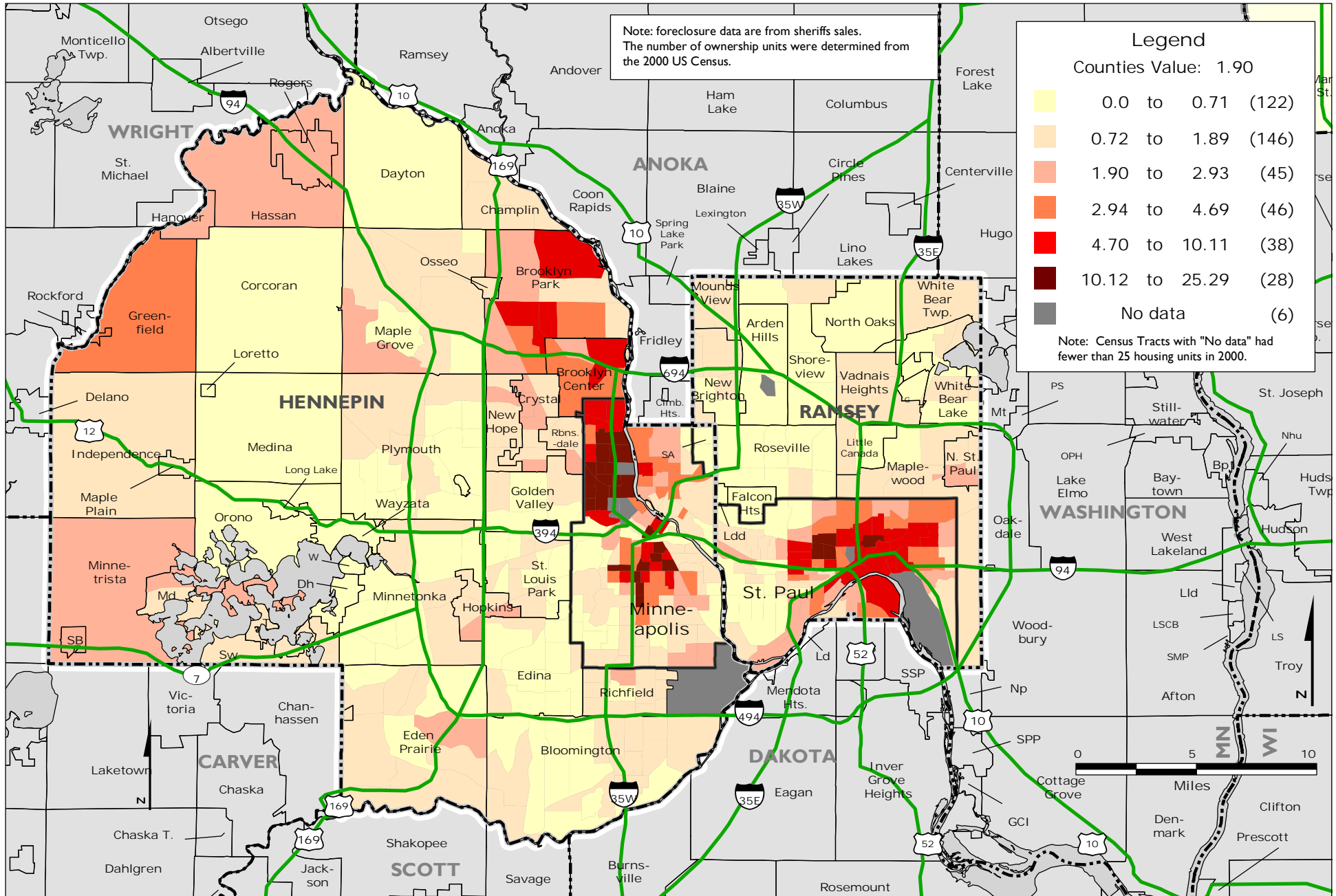


**Map 5: HENNEPIN - RAMSEY COUNTIES**  
 Percentage of Mortgage Loans that are Subprime by Census Tracts, 2004-2006





**Map 6: HENNEPIN - RAMSEY COUNTIES**  
Foreclosures Per 100 Owner Housing Units  
by Census Tracts, 2007



Data Source: Housing Link; Hennepin and Ramsey County Sheriffs Departments, U.S. Census Bureau.

in North Minneapolis, where, in many areas, there was more than one foreclosure for every 10 owner-occupied units.

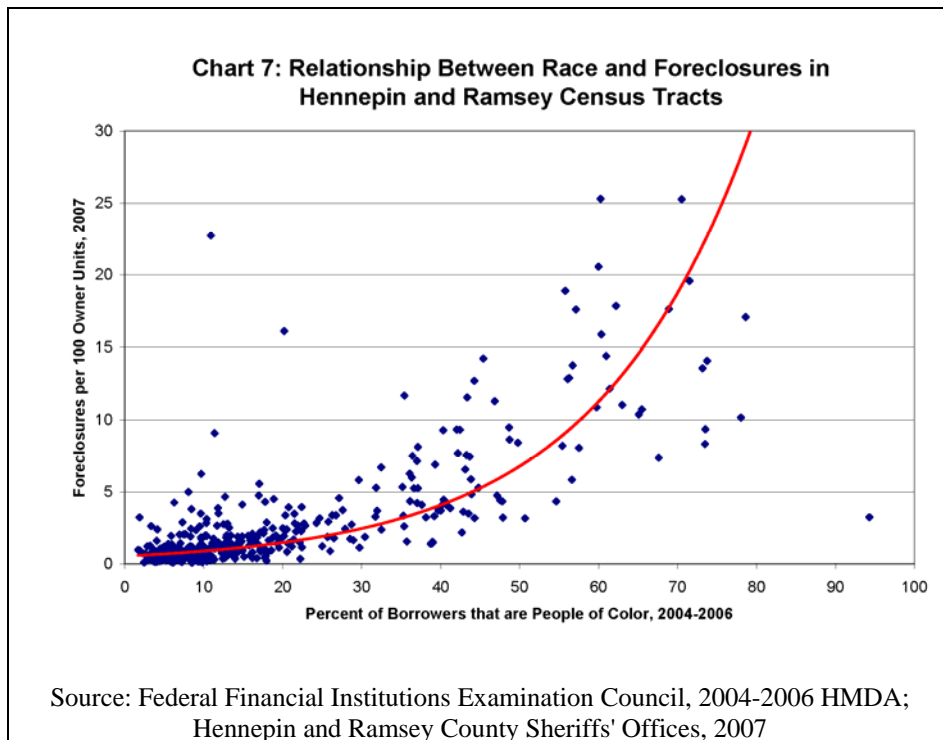


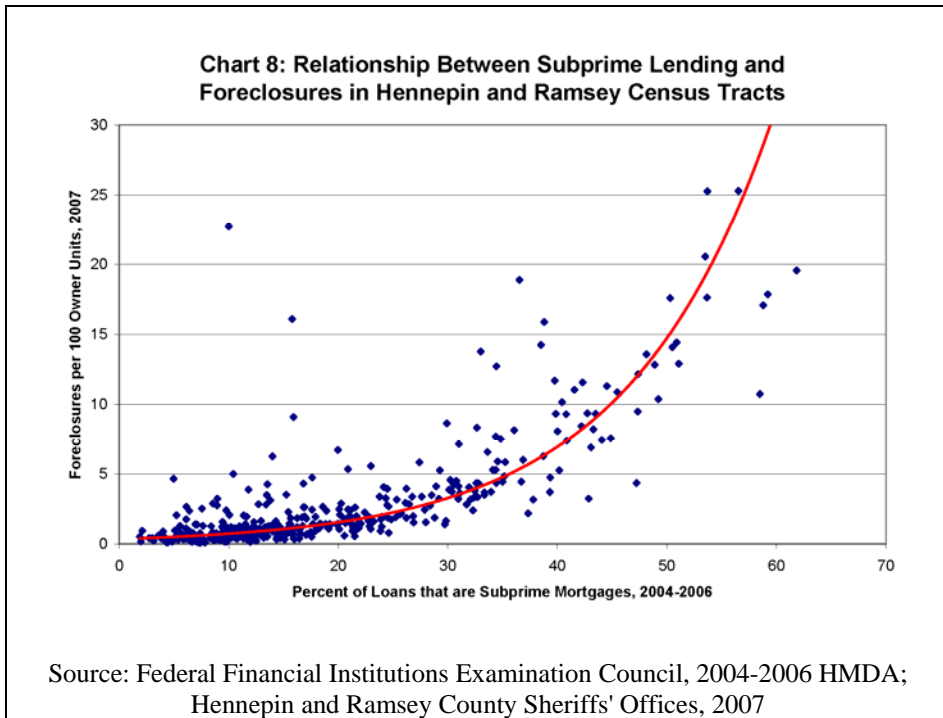
Chart 7 shows the relationship between race and foreclosures in another way. The diagram shows just how closely foreclosure rates track minority shares in Hennepin and Ramsey county neighborhoods. Foreclosure rates are clearly higher in neighborhoods where more borrowers are people of color. Even more striking is how much more dramatically foreclosure rates increase once the non-white share reaches 50 percent. The data show that the expected difference in the foreclosure rates associated with neighborhoods at 20 percent non-white and 40 percent non-white is just one or two points, but that the expected difference in neighborhoods at 50 and 70 percent non-white is more than 10 points.<sup>64</sup>

Chart 8 shows a similar relationship between foreclosure rates and subprime lending. Neighborhoods with greater subprime lending rates show greater foreclosure rates and foreclosure rates increase much more rapidly at subprime rates above 40 or 50 percent. The expected difference in foreclosure rates associated with neighborhoods at 10 and 30 percent subprime rates is just a point or two, while the difference for neighborhoods with 40 and 60 percent subprime lending rates is about 20 points.<sup>65</sup>

<sup>64</sup> The correlation coefficient for the exponential relationship shown in Chart 7 is .76, which is statistically significant at the 99 percent confidence level.

<sup>65</sup> The correlation coefficient for the exponential relationship in Chart 8 is .81, statistically significant at the 99 percent confidence level.

The clear implication of Charts 7 and 8 is that the ultimate costs of the lending crisis in the Twin Cities are being borne disproportionately by communities of color. Non-white loan applicants are substantially more likely than white applicants to be saddled with the greater costs associated with near-prime and subprime loans, regardless of their income. This increases the chances that they and the neighborhoods they live in will face the extremely disruptive effects of foreclosures. In other words, the costs of the crisis are focused, in many cases, on the people and neighborhoods least able to bear them.



## **IV. Fair Housing: Mortgage Market Participants' Responsibilities**

While some of the racial disparity in lending described in the previous section may be related to nondiscriminatory market forces, the fact remains that large racial disparities in lending should not exist. Years of housing discrimination and redlining led to an impressive body of anti-discrimination law, most of which applies to mortgage discrimination, including the Fair Housing Act and the Community Reinvestment Act. The lending patterns discussed in Section III of this report should not surprise lenders. Banks are regularly required to review and report their lending patterns. Moreover, the long reach of fair lending law holds all mortgage market participants who knowingly engaged in, encouraged, or profited from discriminatory lending practices responsible for the damage done to communities and individuals. There is no reason that a properly motivated HUD, FFIEC, and Justice department cannot enforce fair lending law and take significant steps to eliminate inequalities in mortgage markets. Yet, despite expansive laws prohibiting racial discrimination in all parts of the mortgage and home buying process and the lenders' knowledge of those lending patterns, racial discrimination seems to continue.

### **A. Mortgage Discrimination Law**

While regulation of mortgage market participants is complex and often byzantine, civil rights law governing fair lending can be applied to market participants in a straightforward manner. Discrimination under federal fair housing law is more expansive than what the public often assumes. It includes both intentional discrimination and the unnecessary discriminatory effects of otherwise neutral actions. Aggressive federal and private enforcement of existing fair lending laws is the first step to ending racially discriminatory lending.

Mortgage market participants violate the Fair Housing Act, the Equal Credit Opportunity Act, and Sections 1981 and 1982 of the Civil Rights Acts when their actions make housing, credit, or contract rights unavailable because of the plaintiff's protected class.<sup>66</sup> Congress gives protected classes statutory protection against discrimination. Under the Fair Housing Act, Congress prohibited discrimination on the basis of a person's race, color, religion, sex, handicap, familial status, and national origin.<sup>67</sup>

Federal and state consumer protection laws, along with the common law of contracts and torts, prohibit fraudulent and some predatory lending practices.<sup>68</sup> The Fair Housing Act prohibits discrimination against individuals or classes of individuals seeking mortgage loans.<sup>69</sup> For example, the Fair Housing Act prohibits banks and brokers from targeting communities of color for subprime or predatory loans. The Community Reinvestment Act, on the other hand, is supposed to address access to credit. The Community Revitalization Act was created to ensure

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<sup>66</sup> 42 U.S.C. §§ 3601-3619 (2006); 15 U.S.C. § 1691 (2006); 42 U.S.C. § 1981 (2006); 42 U.S.C. § 1982 (2006); 42 U.S.C. § 1983 (2006); 12 U.S.C. §§ 2901-2908; See Schemm, 1995.

<sup>67</sup> 42 U.S.C. §§ 3604-3606, 3617. Federal and state consumer protection laws, along with the common law of contracts and torts, prohibit fraudulent lending and some predatory lending practices.

<sup>68</sup> Although consumer protection is a large part of the predatory lending story, this Report focuses on the incidence of racial discrimination in lending.

<sup>69</sup> 42 U.S.C. §§ 3604-3606, 3617. Federal and state consumer protection laws, along with the common law of contracts and torts, prohibit fraudulent lending and some predatory lending practices.

all communities have equal access to credit, directing banks to “meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions.”<sup>70</sup>

While secondary market participants, such as the bundlers and sellers of repackaged subprime loans, may feel divorced from the on-the-ground-discriminatory practices of brokers and banks, they can, nonetheless, be held responsible for them. The Fair Housing Act and other civil rights law prohibit (secondary actors) from condoning or knowingly profiting from housing or mortgage discrimination. Civil rights law prohibiting housing discrimination and unfair lending extends liability to secondary mortgage market participants.<sup>71</sup> The rationale for the liability is that if the secondary market actors created incentives for the sale of discriminatory loans or knowingly profited from them, the market participation created conditions that furthered discrimination.<sup>72</sup>

### **Enforcement of Fair Lending Laws**

The United States Justice Department and federal regulatory agencies, such as HUD and the Securities and Exchange Commission (SEC), have the duty to enforce fair lending and fair housing laws.<sup>73</sup> Federal government diligence in enforcing fair lending laws varies, of course, from administration to administration. In the face of federal inaction, however, individuals usually have the right to file lawsuits challenging mortgage market discrimination. In 2008, individuals and groups representing individuals, such as the NAACP, sued mortgage brokers, lenders, and secondary market actors for the discriminatory effects of their conduct. Individuals, however, do not have the ability to file suit to ensure equal access to credit under the Community Reinvestment Act.

While federal regulation and enforcement of fair lending may be a more efficient method of ensuring equal access to credit, individual liability may deter mortgage market participants from engaging in discriminatory lending practices. Holding individual market participants responsible for their participation in discriminatory patterns, however, is a complex problem. Because of the exponential growth in non-traditional lending, finding and punishing the party to blame for lending discrimination is no longer a simple matter.

Multiple parties are responsible for marketing loan products, issuing loans, and offsetting the terms of loans. Therefore, multiple parties must be held responsible for racial disparities in mortgage lending. As the foreclosure crisis has escalated, numerous plaintiffs have filed suit against mortgage market participants. Examples of how individual lawsuits have sought to hold mortgage market participants accountable for unfair lending follow.

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<sup>70</sup> 12 U.S.C. § 2901.

<sup>71</sup> 42 U.S.C. §§ 3601-3619 (2006); 15 U.S.C. § 1691 (2006); 24 C.F.R. § 100.125(b) (2007); 12 C.F.R. § 202.2(l), Official Staff Commentary § 202.2(l). Secondary mortgage market participants can violate civil rights laws by condoning the racially discriminatory practices of primary market actors and with discriminatory loan purchase restrictions. *Ibid.*

<sup>72</sup> See Sandler et. al.

<sup>73</sup> 42 U.S.C. §§ 3608-3614; 15 U.S.C. § 1691 (c).

## Legal Standards for Lending Discrimination: Intentional Discrimination and Disparate Impact

Civil rights law does not require proof of racial animosity to find discriminatory behavior. The law instead requires proof of either intentional discrimination or disparate impact.

To prove **intentional discrimination**, the plaintiff must show that the lender discriminated on the basis of a protected class, status, such as race and religion and that that discrimination damaged her.<sup>74</sup> The intentional discrimination does not have to be based in racial hatred, targeting minorities for high-cost mortgage sales is intentional discrimination.<sup>75</sup>

To prove **disparate impact**, the plaintiff must demonstrate that the defendant's actions adversely affect a disproportionate number of people of a protected class. The burden of proof then shifts to the defendant to show that her actions were a business necessity. This standard has two prongs: the defendant must show that the action was bona fide and legitimate and that no other less-discriminatory action would achieve the same business need.<sup>76</sup> Intent is irrelevant in disparate impact cases, the plaintiff, instead shows that the defendant's action had an inexcusable discriminatory effect.<sup>77</sup>

Some federal circuit courts have set separate burden shifting frameworks for "reverse redlining," or racially targeted predatory lending cases, but courts have not adopted a universal standard, although all circuits recognize that the action is illegal.<sup>78</sup>

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<sup>74</sup> To show intentional discrimination the plaintiff does not need to be a member of a protected class, she merely needs to have suffered damage because of the defendant's intentional discrimination against a protected class. *Havens Realty Corp. v. Coleman*, 455 U.S. 363, 372 (1983).

<sup>75</sup> *Hargraves v. Capital City Mortgage Corporation*, 140 F.Supp.2d 7, 20-22 (D.D.C.2000) *Matthews v. New Century Mortgage Corp.*, 185 F.Supp.2d 874, 887 (S.D.Ohio 2002).

<sup>76</sup> *N.A.A.C.P. v. Huntington*, 844 F.2d 926 (2nd. Cir. 1988); *Resident Advisory Bd. v. Rizzo*, 564 F.2d 126 (D. Penn. 1977). Although the Supreme Court has not decided that disparate impact violates the Fair Housing Act or the Equal Credit Opportunity Act, every circuit has held that they can. *Ibid.* Courts distinguish disparate treatment cases, subject to the *McDonnell Douglas* framework, from disparate impact cases. Some courts, inevitably confuse the two, and allow/require to plaintiff to take a third step and prove that the defendant's explanation is pretext. In all cases, however, courts recognize that the standard is business necessity, which requires a showing of necessity, rather than simply showing a legitimate, non-discriminatory reason for the decision. See *Marbly v. Home Properties of New York*, 205 F.Supp.2d 736 (D. Mich, 2002) (requiring the defendant to prove necessity, even though the court uses the *McDonald-Douglas* framework). A plaintiff can use statistical evidence to show disparate impact. *Tsombanidis v. West Haven Fire Dep't*, 352 F.3d 565, 575-76 (2d Cir.2003).

<sup>77</sup> *Watson v. Fort Worth Bank & Trust*, 487 U.S. 977, 988 (1987).

<sup>78</sup> See, for example, *Wiltshire v. Dhanraj*, "[T]o establish a prima facie case of [reverse redlining] discrimination ..., the plaintiff must show: (1) that she is a member of a protected class; (2) that she applied for and was qualified for loans; (3) that the loans were given on grossly unfavorable terms; and (4) that the lender continues to provide loans to other applicants with similar qualifications, but on significantly more favorable terms. [citation omitted] In the alternative, if the plaintiff presents direct evidence that the lender intentionally targeted her for unfair loans on the basis of sex and marital status, the plaintiff need not also show that the lender makes loans on more favorable terms to others." 421 F.Supp.2d 544, 554 (D.N.Y. 2005).

## **B. Regulation of Mortgage Market Participants**

### **Mortgage Brokers**

State laws directly regulate mortgage brokers, this means that state oversight of brokers varies tremendously. Some states, such as Minnesota, require registration and prohibit certain types of lending, while others have virtually no regulation. Mortgage brokers are, nonetheless, unquestionably subject to federal and state fair housing laws.

Mortgage brokers often make the on-the-ground decisions that result in racial disparities, and, thus, are frequent targets for lawsuits alleging lending discrimination, particularly in the area of predatory lending or reverse redlining. For example, in *Ware v. Indymac Bank*, a recent federal lawsuit in Illinois alleges racial discrimination where plaintiffs were contacted by a broker who enticed them to refinance their home. The plaintiffs, Carter and Thelma Ware, alleged that the mortgage broker, Homestart Mortgage Corporation, falsified loan documentation, issued a loan that was unnecessarily expensive, and made that loan on less favorable terms than it made loans to white individuals. The discriminatory action made it more difficult for the Wares to refinance their loan in order to escape the loan's predatory terms and eventual foreclosure.<sup>79</sup> These allegations, if proven, would make the mortgagee broker in violation of the Fair Housing Act (discriminating in the terms of credit available for home refinance), the Equal Credit Opportunity Act (discriminating in an aspect of a credit transaction), state consumer protection laws (Illinois Uniform Deceptive Trade Practices Act), and federal consumer protection laws (the Truth in Lending Act).

### **Loan Originators**

Loan originators, are directly regulated by either state or federal laws, depending on whether they are state or federally chartered. A recent Supreme Court case, *Watters v. Wachovia*, exempts federally chartered banks and banking institutions from state consumer protection laws, but does not hold that federal law preempts state civil rights laws.<sup>80</sup> Therefore, both state and federal civil right laws, including the Fair Housing Act and its progeny regulate loan originators.

Loan originators can violate civil rights laws either by directly making discriminatory decisions or by knowingly creating incentives for brokers to engage in unfair or racially targeted lending. For example, in the above case, *Ware v. Indymac Bank*, the plaintiffs alleged that the bank, Indymac issued a yield spread premium<sup>81</sup> to the Wares' mortgage broker, which it knew had a discriminatory impact, violating the Fair Housing Act and the Equal Credit Opportunity Act.<sup>82</sup> Likewise, in *Buycks-Roberson v. Citibank*, the District Court for the Northern District of Illinois granted class-action certification to African Americans plaintiffs, alleging violations of the Fair

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<sup>79</sup> 534 F.Supp.2d 835 (N. D. Ill. 2008).

<sup>80</sup> 127 S.Ct. 1559 (2007).

<sup>81</sup> A yield spread premium is a payment (often a cash bonus) made to a mortgage broker for selling a mortgage with a higher interest rate than the borrower qualified for from the wholesale lender. While yield spread premiums can serve a legitimate purpose, paying the broker for his or her services, the premiums can also incentivize pushing very expensive loans on inexperienced and vulnerable people such as people of color, women, and seniors. Moreover, since the premiums are not disclosed upfront, people do not know that they are not getting the best interest rate available to them. See Center for Responsible Lending, (2004) Yield Spread Premiums: A Powerful Incentive for Equity Theft.

<sup>82</sup> 534 F.Supp.2d 835 (N.D.Ill. 2008).

Housing Act and the Equal Credit Opportunity Act. The court held that these high-income African American plaintiffs who were denied home loans because of the subjective application of Citibank's neutral underwriting criteria could show Citibank's liability by showing both their own qualifications for home loans and the statistical disparity between loans denied to white applicants and black applicants and the disparities between applicants in different neighborhoods or census tracts.<sup>83</sup>

Similarly, in *Hargraves v. Capital City*, the District Court for the District of Columbia held that reverse-redlining constituted a violation of the Fair Housing Act.<sup>84</sup> Specifically, the court held that racially targeted predatory lending violated the provision of the Fair Housing Act that made it illegal to "refus[e] to sell...or otherwise make unavailable or deny a dwelling to a person because of race, color" because predatory lending "can make housing unavailable by putting borrowers at risk of losing the property which secures the loans."<sup>85</sup> The *Hargraves* plaintiffs produced data showing that Capital City Mortgage, a subprime lender, directed most of its lending and loan marketing towards borrowers and home owners in segregated, African American neighborhoods because they believed African Americans living in segregated neighborhoods to be unsophisticated or financially desperate and therefore more susceptible to their fraudulent lending practices.<sup>86</sup> The court in *Hargraves* did not require the plaintiffs to show that the bank treated white borrowers better than African American borrowers, just that the bank lent so disproportionately in African American neighborhoods to amount to targeting and that these loans were made on grossly disadvantageous terms.<sup>87</sup>

### **Secondary Market Participants**

Federal laws directly regulate most secondary market participants, preempting state regulations. This makes it harder for states to control the actions of these secondary market participants through regulation. This does not mean that secondary market participants cannot be held liable for their participation in discriminatory lending; civil rights laws are applicable to their conduct. Federal antidiscrimination law holds these secondary market participants liable for condoning discrimination in the primary market, which the participant could do by purchasing loans issued by a lender or broker that it knows or should know engaged in racial discrimination in lending.<sup>88</sup>

For example, the now defunct Bear Stearns investment bank, a secondary market participant, has recently been sued over its participation in discrimination against minority borrowers. Bear Stearns is accused of engaging in racially discriminatory predatory lending, in violation of the Fair Housing Act, through its purchase of loans made by a subprime subsidiary. The subsidiary had profit sharing methods that encouraged brokers to target racial minorities with predatory

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<sup>83</sup> *Ibid.*

<sup>84</sup> *Hargraves v. Capital City Mortgage Corp.*, 140 F.Supp.2d 7, 20 (D.D.C. 2000).

<sup>85</sup> In *Hargraves*, the plaintiffs avoided summary judgment by alleging that the terms and conditions of the loans made to African Americans were unfair and predatory and that the defendants were targeted on the basis of race. *Ibid.* at 21.

<sup>86</sup> See Brief Of The United States As Amicus Curiae In Support Of Plaintiffs' Opposition To Defendants' Motion For Judgment On The Pleadings Or, In The Alternative, For Summary Judgment, No. 98-1021, March 2000.

<sup>87</sup> *Hargraves v. Capital City Corp.*, 140 F. Supp.2d 7, 21 (D.D.C. 2000).

<sup>88</sup> 42 U.S.C. §§ 3601-3619 (2006); 15 U.S.C. § 1691 (2006); 24 C.F.R. § 100.125(b) (2007); 12 C.F.R. § 202.2(l), Official Staff Commentary § 202.2(l).



loan products.<sup>89</sup> Bear Sterns is also accused of seeking out subprime loans, encouraging rampant subprime lending in communities of color, and then subjecting these primarily black and Latino borrowers to predatory servicing agreements.<sup>90</sup>

## **V. The Regulation and Enforcement of Civil Rights Law in Mortgage Lending**

While inadequate regulation of mortgage brokers and new lending tools allowed the market to engage in unsafe and unfair lending practices, the failure to effectively enforce fair lending laws allowed predatory lending and the ensuing foreclosure crisis to disparately impact communities of color. The federal and state governments have not enforced fair lending laws, allowing lenders to engage in illegal discriminatory behavior with little threat of punishment. Further, the response to the escalating foreclosures in communities of color has been scattershot. While states have banded together to get the worst of the worse subprime lenders, there has been little concerted action to make the entire industry accountable for what is an industry-wide problem. When the last round of redlining was uncovered, Congress passed numerous laws expanding lenders' fair lending responsibilities and reporting requirements. The laws imposed fair lending conditions on the entire industry – an appropriate remedy to an industry-wide problem. There is a similar need today to hold the entire industry responsible for solving the problem of credit access in impacted communities of color.

### **Twentieth Century Law in a Twenty-first Century Market**

As the mortgage market became multilayered and immensely more complicated, lending regulations remained the same. Federal regulations essentially assume that banks will not issue mortgages likely to result in foreclosure because banks traditionally took a loss when a loan issued by the bank defaulted. This assumption, clearly, is no longer true in a market that encourages the rapid resale and securitization of loans. For example, the Fair Debt Collection Protection Act sets the standard for debt collectors, prohibiting harassment, misleading representation, and forbidding threats of foreclosure when there is no legal right of foreclosure.<sup>91</sup> This consumer protection is not applicable to servicers of mortgages that are not in default.<sup>92</sup>

Today, loan servicers<sup>93</sup> are almost never the creditor, much less the originator of the loan. And servicers today make their money in much the same way as other professional debt collection agencies; they enforce loan contracts, collecting payments from debtors. However, loan servicers are not regulated to the same degree as traditional debt collection agencies, creating greater

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<sup>89</sup> Complaint, *Rodriguez v. Bear Sterns*, CV 1816 (D. Conn. Dec. 4, 2007).

<sup>90</sup> *Ibid* at 11.

<sup>91</sup> Fair Debt Collection Practices Act, (FDCPA), 15 U.S.C. §§ 1692-1692p.

<sup>92</sup> *United States v. Fairbanks Capital Corp*, 2004 WL 3322609 (D. Mass. 2004). When the law was enacted, most loan servicers were the same party that originated the loan, meaning that most consumers picked their servicer.

<sup>93</sup> Loan servicers are the entities that collect mortgage payments from borrowers and manage escrow accounts. While servicers notify the holder of a mortgage loan if the loan goes into default and impose late fees, servicers have little power over the actual terms of the loan and can rarely modify the terms of the loan.

potential for them to engage in harassing and misleading behavior.<sup>94</sup> For example, servicers can often “pyramid” late fees, which results in a borrower paying many months of late fees after only one late mortgage payment.<sup>95</sup> Likewise, the Truth in Lending Act (TILA) only makes creditors and assignees of creditors liable for violations of the act. Assignees are only liable if the illegal disclosure is apparent on the face of the mortgage contract. Loan sellers (brokers), underwriters, and trustees, the entities that engineer the terms of the loan, are unaccountable under TILA.<sup>96</sup>

Securitization has led to opaque business structures, complicating paper trails and leaving consumers unaware of who actually owns their loan.<sup>97</sup> The advent of electronic mortgage recording systems, the Mortgage Electronic Recording System (MERS, Inc) in particular, as “nominee of record” on county property records makes public real estate records nearly useless in attempting to track mortgage transactions. Moreover, borrowers who have experienced unfair and illegal lending are often unable to identify the chain of ownership of their mortgage. This makes it difficult to access their records and impose liability on mortgage market participants.

The securitization and deregulation of the mortgage lending industry has created a market that would have been unrecognizable to the legislatures that drafted fair lending laws. As the market evolved, fair lending laws and the enforcement of those laws ought to have kept pace, making sure that a changing market did not open up room for abusive lending practices. Today, the Twin Cities region, along with the rest of the country is facing a foreclosure crisis—and communities of color, like North Minneapolis, are bearing the brunt of the crisis. While the modernization and enforcement of fair lending laws would probably not have completely averted the crisis, it would have softened the blow to communities of color and made inroads towards a fairer and more just housing market.

### **The Federal Failure to Enforce Fair Lending Laws**

While federal agencies have the responsibility to monitor fair lending activity and to investigate and enforce fair lending laws, there was little proactive investigation of discrimination in mortgage lending from 2000 to 2008.<sup>98</sup> Although the Clinton administration oversaw changes in the lending industry and a roll back of mortgage market oversight, it also initiated a number of high profile investigations and lawsuits against discriminatory lenders.<sup>99</sup> In contrast, the Bush administration oversaw an immediate decline in the federal enforcement of fair housing laws.<sup>100</sup> That decline continues.<sup>101</sup> Today, HUD no longer even staffs a fair housing administrative law judge; these cases are now heard by a different department’s administrative law judge.<sup>102</sup> In the absence of federal enforcement of fair lending laws, mortgage market participants have little reason to fear getting caught in a discriminatory act, and even if they are caught, they pay a small price for their actions.<sup>103</sup>

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<sup>94</sup> Servicers are considered debt collectors under the FDCPA after the loan goes into default.

<sup>95</sup> Eggert, 2004, 756-761.

<sup>96</sup> Peterson, 2007, 2185, 2259.

<sup>97</sup> Peterson, 2007, 2185, 2265.

<sup>98</sup> National Fair Housing Alliance, 2008, 46-63.

<sup>99</sup> *Ibid.*

<sup>100</sup> *Ibid* 54.

<sup>101</sup> *Ibid.*

<sup>102</sup> National Community Reinvestment Coalition 2002, 54.

<sup>103</sup> National Fair Housing Alliance 2008, 3-4, 47, 46-50.

### **The Scattershot Approach: Private Action Against Discriminatory Lending**

In the face of federal inaction, fair housing advocates, along with homeowners facing foreclosure as a result of predatory lending, have brought numerous lawsuits against mortgage market participants. Plaintiffs across the United States have filed complaints of racially discriminatory lending practices against many of the Twin Cities' top prime and subprime lenders, including Countrywide Financial, Decision One Mortgage, Ameriquest Mortgage Company, Wells Fargo Bank, Option One Mortgage Company, Long Beach Mortgage Company, BNC Mortgage, Encore Credit Corporation, Accredited Home Lenders, GMAC, and Fieldstone Mortgage Company.<sup>104</sup>

Bear Stearns, the defunct investment bank, was sued for discriminating against minority borrowers through its secondary market participation.<sup>105</sup> Bear Stearns was accused of engaging in racially discriminatory predatory lending through its purchase of loans made by a subprime subsidiary, which had profit sharing methods that encouraged brokers to target racial minorities with predatory loan products.<sup>106</sup> Encore Credit, now Bear Stearns Residential Mortgage, was another subprime arm of the Bear Stearns investment bank and was a major subprime lender and refiner in the Twin Cities area.

Nationally, plaintiffs have filed numerous complaints alleging that lenders engaged in a two-tiered system of lending. Loans issued from bank storefronts were predominantly prime loans on good terms, issued primarily to white homebuyers and refinancers. Loans obtained from mortgage brokers are much more likely to be subprime and contain predatory terms, such as ballooning interest rates, prepayment penalties, and high loan origination costs. Brokers disproportionately made these loans to people of color. Banks encouraged brokers to engage in predatory lending behavior by sharing profits for high cost loans, encouraging brokers to sell subprime or predatory loans to applicants who were otherwise eligible for prime-rate loans.<sup>107</sup>

While private parties have filed a skyrocketing number of lawsuits alleging discriminatory lending, a far greater number of wronged mortgage borrowers never assert claims against mortgage market participants because of the high cost of litigation. Securitized lending has only made fair lending lawsuits more expensive. Opaque lending structures make it difficult or impossible for consumers to identify the entity that owned, processed, or securitized their loans.<sup>108</sup> Moreover, the sheer number of entities involved in mortgage market transactions means that the basic requirements of civil procedure, services of process, depositions, and

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<sup>104</sup> Complaint, Baltimore v. Wells Fargo Bank, LO 08CV-062 (D. Mass., Jan. 8, 2008); Complaint, Allen v. Decision One Mort. Co., 07-11669 (D. Mass. Sept. 6, 2007); Complaint, Jones v. Long Beach Mortgage, CV 11-372 (D. Mass. July 26, 2007); Complaint, Miller v. Countrywide Bank, 11257-RGS (D. Mass. July, 12, 2007); Complaint, NAACP v. Ameriquest Mortgage Co., et al., SAV07-0794 (D. Cal. July 11, 2007); Complaint, NCRC v. Novastar, CV 00861 (D. D.C. May 9, 2007); Complaint, Tribett v. BNC Mortgage, CV 02-809 (D. Ill. May 18, 2007).

<sup>105</sup> Complaint, Rodriguez v. Bear Stearns, CV 1816 (D. Conn. Dec. 4, 2007).

<sup>106</sup> *Ibid.*

<sup>107</sup> See Complaint, Allen v. Decision One Mort. Co., No. 07-11669 (D. Mass. Sept. 6, 2007); Bocian et al., 2006; National Fair Housing Alliance, 2008, 23.

<sup>108</sup> Peterson, 2007, 2265.

interrogatories are cost-prohibitively expensive in relation to expectations of damages.<sup>109</sup>

Federal agencies and the Department of Justice have the means to most effectively investigate violations of fair lending laws and to punish wrong-doers. While the sheer number of private party allegations against mortgage market participants illustrates the widespread problem of discriminatory lending, the scattershot approach of private action is unlikely to deal with the full problem. Without concerted state and federal action, most wrongs will go uncorrected and all but the most egregious violations of fair lending laws will go unpunished.

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<sup>109</sup> Plaintiffs have been filing suit in state courts, in an attempt to avoid the long delays and costs associated with federal litigation and to take advantage of state consumer protection laws. Although many states also have statutes prohibiting racial discrimination in lending, federal courts have been holding that federal civil rights law pre-empts state enforcement of fair lending laws— further complicating private enforcement of fair lending laws. Bagley, 2004, 2274.

## VI. Conclusion and Recommendations

Discrimination against people of color seeking to rent, buy, and insure houses continues to be an endemic problem across the United States. Pair testing studies continue to show racial steering by realtors in home buying and discrimination in home lending.<sup>110</sup> While overt redlining, the complete denial of credit to communities of color, is less prevalent than it was forty years ago, research shows that people of color receive home loans on worse terms and at a higher cost than similarly situated white borrowers.<sup>111</sup>

The most recent Home Mortgage Disclosure Act (HMDA) data reveal strong racial disparities in mortgage lending in the Twin Cities. A careful analysis of the HMDA data shows that prime lenders are substantially more likely to deny loans to people of color, regardless of income; lenders are more likely to deny home loans in neighborhoods which are identifiable as communities of color. HMDA also shows that people of color, regardless of income, are more likely to submit loan applications to subprime lenders and are disproportionately receiving subprime loans.

The magnitude of the disparities imply that credit markets in the Twin Cities treat people of different races differently, to the clear disadvantage of people of color. It is a problem not only of access to opportunity and but also of disparate treatment. Prime loans are less accessible to people of color and in integrated and segregated neighborhoods of color, while all parts of the market, prime and subprime alike, are more likely to refuse credit to applicants of color, regardless of their income.

Mortgage lending discrimination against individuals and communities has been illegal for over forty years. The most basic purpose of the Fair Housing Act, Title VIII of the Civil Rights Act of 1968 is to prevent racial discrimination in housing, including discrimination in mortgages transactions.<sup>112</sup> The twin purpose of the Act was to remedy segregation and expand integrated living opportunities.<sup>113</sup> Congress again outlawed racially discriminatory lending through the Equal Credit Opportunity Act of 1974 and directed federal banking regulators to oversee and enforce fair lending in low-income communities of color through the Community Reinvestment Act of 1977.<sup>114</sup> Congress further created the Home Mortgage Disclosure Act (HMDA) in order for federal regulators, banks, and communities to monitor the lending practices of mortgage market participants.<sup>115</sup>

In short, mortgage lenders should know that failure to provide credit to people and communities of color on fair terms is illegal. And mortgage lenders should be very aware of the content of

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<sup>110</sup> Turner and Ross, 2003; Turner et. al., 2002.

<sup>111</sup> Avery, Canner and Cook, 2005; Bocian, Ernst, and Li, 2006; Boehm, Thistle and Schlottman, 2006; Courchane, Surette, and Zorn, 2004, 365–92; Pennington-Cross et. al, 2000.

<sup>112</sup> 42 U.S.C. 3601 (stating that “[i]t is the policy of the United States to provide, within constitutional limitations, fair housing throughout the United States.”). The Act specifically bans discrimination in home mortgage and refinancing lending. 42 U.S.C. 3605

<sup>113</sup> 114 Cong. Rec. 2276, 3422, 9559, 9591, 2275, 2706 (remarks of Senators Mondale and Congressmen Cellar and Ryan).

<sup>114</sup> 15 U.S.C. 1691; 12 U.S.C. 2901.

<sup>115</sup> 28 U.S.C. §§2801-2810.

their lending practices. Yet, the most recent HMDA data provide strong evidence of lending disparities that are not easily explained by income differences between groups. Likewise, it is very clear that prime credit is not reaching the neighborhoods that need it the most—the segregated, high poverty neighborhoods that the Fair Housing Act was designed to eliminate.

Forty years after the passage of the Fair Housing Act, banks are still disproportionately denying people of color prime, affordable mortgages. Today, however, the discriminatory effects of traditional denial of credit to communities of color has been compounded by lenders targeting people and communities of color with predatory loans—loans issued on such unfavorable terms that buyer default is likely.

### **Recommendations**

Simply passing consumer protection laws that ban the worst predatory practices that have occurred over the last ten years will not address the heart of the problem of lending and race in the Twin Cities. In order to ensure equality in mortgage lending, we need to first ensure access to fair credit and then work to end racial segregation.

Fair lending, ensuring that individuals and communities of color have equal access to prime credit, is an essential part of protecting the wealth and mobility of communities of color. Strengthening and enforcing the Community Reinvestment Act and establishing Fair Housing Centers to monitor fair housing conditions will combat lending disparities. Likewise, reforming HMDA will allow researchers and community activist to more effectively monitor lending patterns. These suggestions are detailed below.

Fair lending, however, in-and-of-itself will not end predatory practices in communities of color. Several prime lenders in the Twin Cities, most notably Twin Cities Financial (TCF) actually made a disproportionately large number of prime loans in North Minneapolis. But even homeowners who received loans on fair terms have been severely impacted by the foreclosure crisis as their homes lost equity and their neighborhoods became less stable.

Likewise, consumer protection laws only go part of the way in protecting against disparate lending. For example, in 2007, Minnesota passed two strong laws curbing many of the predatory lending practices that may have driven much of the foreclosure crisis in North Minneapolis.<sup>116</sup> In theory, these laws should reduce the impact of subprime and predatory lending on communities of color. However, limiting predatory lending does not mean that prime lenders will then start lending to communities of color. Racially targeted predatory lending is directly tied to the physical and social isolation of communities of color. These neighborhoods have historically

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<sup>116</sup> The first bill prohibits mortgage brokers who are licensed and regulated by the state, from equity stripping, making loans without regard to the borrower's ability to pay, and churning and flipping loans. 2007 Minn. Laws ch. 18. The law also creates a fiduciary duty on the part of the broker, requiring brokers to act in good faith and give borrowers loans on the best terms available. 2007 Minn. Laws ch. 18. The second bill prohibits both lenders and mortgage brokers from charging prepayment penalties on subprime loans, creates criminal penalties for mortgage fraud, and creates a private right of action to enforce most of the substantive provisions of Minnesota's statutes prohibiting unfair and predatory lending. 2007 Minn. Laws ch. 74.

been denied credit and have been targeted by subprime lenders because of the isolation of these communities.

Simply preventing “bad” loans in communities of color will not induce the market to make “good” loans. Racially and economically integrated neighborhoods are more likely to attract and sustain prime lenders. More bank branches in integrated neighborhoods will facilitate access to prime lenders and give subprime lenders market competition. Treating predatory lending as solely a consumer protection issue misses the larger civil rights implications of unfair lending. Predatory lending must be addressed as part of the larger problem of segregation and access to credit.

In the end, the entire Twin Cities region needs to work aggressively to end segregation. Segregation creates concentrated poverty, makes it more difficult for people of color to access prime lenders, and creates easy targets for predatory lenders.

**Strengthen the Community Reinvestment Act.** While conservative commentators have blamed the mortgage meltdown on the CRA, research shows that the CRA could not have been responsible for the lending crisis. Non-bank institutions not covered by the CRA were responsible for the vast majority of the increase in subprime lending. Federal Deposit Insurance Corporation Chairwoman Sheila Bair testified that “only one in four higher-priced first mortgage loans were made by CRA-covered banks during the hey-day years of subprime mortgage lending. The rest were made by private independent mortgage companies and large bank affiliates not covered by CRA rules.”<sup>117</sup>

This research shows that a good part of lending disparities in segregated communities of color is related to access to prime credit. People in these communities are substantially more likely to seek loans from subprime rather than prime lenders, regardless of their income or race. While some of this reluctance to seek out prime lenders may have to do with historical experiences with discrimination, prime lenders are underrepresented in segregated communities. Instead, non-bank lenders have been able to sell subprime and sometimes predatory loans in these neighborhoods with little competition from prime lenders.

Ensuring access to CRA-covered banks, mostly prime lenders, should increase access to affordable, prime credit for people who live in segregated communities of color. Research shows that CRA banks were more likely to make prime loans in minority communities than non-covered lending institutions.<sup>118</sup> Further, in the fifteen largest large metropolitan regions, regions with higher concentrations of CRA covered banks had lower foreclosure rates those with lower concentrations of CRA covered banks.<sup>119</sup>

People of color and people who live in segregated communities of color must have access to affordable credit from responsible lenders in order to build wealth and long-term economic stability for their families. The CRA should be expanded to monitor and regulate the lending patterns of non-bank lending institutions. Rigorous enforcement of an expanded CRA will help

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<sup>117</sup> Remarks by FDIC Chairman Sheila C. Bair Before the Consumer Federation of America, December 4, 2008.

<sup>118</sup> Traiger & Hinkley LLP.

<sup>119</sup> *Ibid.*

provide equal access to fair credit—a necessary first step in ensuring equal opportunity for all Americans.

**Fund a Regional Fair Housing Center.** Regional Fair Housing Centers help ensure non-discrimination in housing, rental, and home lending markets through research and advocacy. These centers use trained test marketers to hold realtors, landlords, and banks accountable for discrimination. The Twin Cities lost its fair housing center several years ago, after the center lost funding. Since that time, there has been no systematic testing of Twin Cities markets for discriminatory practices. This means that there is no Twin Cities entity that is responsible for consistently ensuring that brokers, banks, real estate agents, and insurers are treating people equally. An on-going commitment to a center of this sort is needed to ensure that the grossly disparate impact of the on-going crisis in the region's housing and credit markets is not repeated in the future.

**Expand the scope of HMDA Data.** HMDA data today has the greatest coverage of mortgage loans in the U.S. It has been improved, most recently with the inclusion of interest rates for higher cost loans made to borrowers. Further improvements could make it a much greater resource for monitoring discrimination in the mortgage market. In particular, the data set should include a variety of loan characteristics and lending activities that have become increasingly common and that are strongly tied to mortgage outcomes.

Often mortgage lending institutions claim that racial disparities in mortgage lending are due to the credit status of borrowers. Many studies using proprietary data have contested this suggestion. HMDA should include data on the credit status of borrowers so that researchers can determine how credit history relates to mortgage outcomes. The incoming Obama administration's plan to create a Homeowner Obligation Made Explicit score, a standardized metric for the credit-worthiness of a borrower similar to a FICO score, would be a useful data component for HMDA.

Other loan characteristics that impact mortgage outcomes and that should be included in HMDA are the mortgage loan cost to home value ratio, prepayment penalty costs and information about points and fees. The use of mortgage brokers in the application process also strongly influences mortgage outcomes. HMDA should include information about whether the loan was sold by a mortgage broker, a correspondent, or at a retail lending location.

HMDA could also be expanded by including interest rates for all loans, which would allow researchers to better understand differences between the prime and subprime lenders. Additionally, the inclusion of a unique identifier in HMDA for first and second lien loans would allow researchers to calculate the overall cost associated with home purchases and would help them examine the role that secondary liens play in mortgage outcomes.

HMDA has seen a steady decrease in the reporting of race information. Racial information collection for HMDA is optional when mortgage forms are sent in the mail, by phone, or through the internet. Automated underwriting, in theory, helps remove the chance that individual face-to-face discrimination could occur in a mortgage transaction. Yet redlining also involves the withholding of mortgages because of the racial composition of neighborhoods. The exclusion of



race data in automated applications means that individual discrimination and redlining results can be understated or confounded. Race data should be required in HMDA for mail, phone and internet applications.

Secondary market institutions that do not meet HMDA requirements are also not required to report race. Although many secondary market participants do not make credit decisions for individual borrowers, they can influence the practices and policies of financial institutions that do in such a way that could produce disparate impacts on racial groups. Because of this, racial information should be included in HMDA records for all mortgages sold in the secondary market.

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