The Opportunity Agenda

Subprime Lending: A Threat to Opportunity in America

Because homes are often a family's strongest financial asset, opportunities for homeownership—which have historically been limited for some racial and ethnic minority groups and low-income families—are strongly linked to wealth creation and financial security.

The abilities of a broad segment of the American population to build wealth through homeownership are impeded by the prevalence of high cost lending that drains homeowner equity. Indeed, building wealth through homeownership has been the American Dream and the path to opportunity for Americans for generations. Stakeholders need to come together to ensure that wealth-building opportunities are preserved by increasing equal access and fairness in the lending marketplace.

Subprime vs. Prime Loans by Race

Subprime home loans feature higher interest than prevailing rates, and as a result are often the only lending option available to those with credit blemishes. **Subprime lending also crowds out prime lending in traditionally underserved communities, restricting the kinds of loan options available in these communities and increasing the likelihood that some will fall victim to predatory and deceptive lending practices.**

- In 2004 minorities received a share of subprime loans that were greater than their share of the nation's households but received a share of prime loans that were smaller than their share of households. Minority neighborhoods also received a disproportionate amount of subprime loans.[1]
- Disproportionate to their population, African Americans received 20.1 percent of the subprime purchase loans issued during 2004. Although they represented 12 percent of the population, only 5.5 percent of the conventional prime home purchase loans were issued to African-American homebuyers.[2]
- As income levels rose, so did the racial disparities in the proportion of borrowers receiving subprime loans. In 2004 the share of middle- and upper-income African Americans with subprime loans was 2.7 times greater than that of middle- and upper-income whites.[3]

Gender Disparities in Fair Lending

Within racial groups, the disparity in subprime shares of loans to females relative to males widened as income level increased.

- Subprime loans were 7.6 percent and 6.4 percent of the home purchase loans to low- and middle- income (LMI) female and male Asian Americans, respectively. Consequently, LMI female Asian Americans were 1.2 times more likely than LMI Asian-American males to receive subprime loans.
- In contrast, middle- and upper-income (MUI) female Asian Americans were 1.5 times more likely than MUI male Asian Americans to receive subprime loans. **Subprime loans constituted 7.2 percent of the loans to MUI female Asians but just 4.9 percent to MUI male Asians**.[4]

Immigrant and Minority Neighborhoods

Lending disparities also increased between immigrant and white neighborhoods as income level of borrowers increased.

- Subprime lending accounted for 13 percent of the home purchase loans to

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LMI borrowers in predominantly immigrant neighborhoods (in which more than 50 percent of the residents are foreign born). Subprime loans were a higher share of loans (15 percent) to LMI borrowers in white neighborhoods.[5]

- In contrast, subprime loans made up 13.6 percent of the loans to MUI borrowers in immigrant neighborhoods but just 8.3 percent of the home purchase loans to MUI borrowers in white neighborhoods during 2004.[6]

Minority neighborhoods (more than 50 percent of the residents are racial or ethnic minorities) also experienced greater disparities in lending than white neighborhoods as income levels of borrowers increased.

- **Minority neighborhoods obtained 28.4 percent of the subprime home purchase loans, which is almost twice as great in percentage point terms than their share of the nation's owner-occupied housing units.**[7]
- White neighborhoods, in which less than 50 percent of the residents were minority, contained 84.6 percent of the nation's owner-occupied housing units and received 84 percent of the prime home purchase loans. In contrast to minority neighborhoods, white neighborhoods received a lower percent of subprime loans (70.7 percent) than their share of the nation's owner-occupied housing stock.[8]

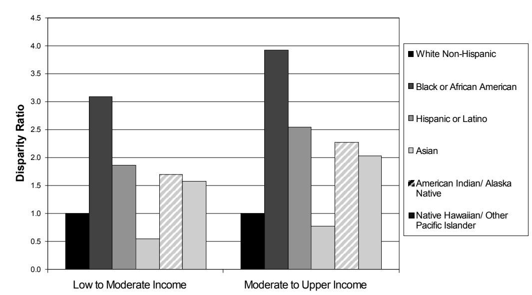
Refinance Loans

Lenders issued 4.8 million prime conventional refinance loans and 886,536 subprime conventional refinance loans during 2004. **Most subprime loans were refinance loans**.

- The absolute number of subprime refinance loans (886,536) was twice that of subprime home purchase loans (433,902). Also, a greater percent of refinance loans were subprime (15.4 percent) than all single family loans (14.2 percent).[9]

The Department of Housing and Urban Development also found that after controlling for housing and income level characteristics of the census tract, subprime lending increases as the percentage of minority residents of the tract increases.[10] Even the Research Institute for Housing America, an offshoot of the Mortgage Bankers Association, found that **minorities were more likely to receive loans from subprime institutions, even after controlling for the creditworthiness of the borrowers**.[11]

Figure 1. Disparity Ratio, Subprime Home Purchase Loans, by Race, Ethnicity, and Income



Equity Loss For Families and Communities

For a family who is creditworthy for a prime loan but receives a subprime loan, the total loss in equity can be easily between $50,000 and $100,000. If we take as an example a $140,000 30-year mortgage, we can estimate that the difference in total costs between a 6.25% (the current prime rate) and 9.25% (an example of a subprime rate) loan is $104,310.[12] This amount represents resources that could have been used to send children to college or start a small business. Instead of building family wealth, the equity was transferred from the family to the lender.

- For even one neighborhood, the magnitude of wealth loss due to pricing disparities and/or discrimination is stark. Across the country, the wealth loss is staggering and tragic. Suppose 15 percent or 300 families in a

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predominantly minority census tract with 2,000 households receive subprime loans although they were creditworthy for prime loans.

- Further, assume that each family pays $50,000 more over the life of the loan than it should. **In total, the 300 families in the minority census tract have paid lenders $15 million more than they would have if they had received prime loans for which they could have qualified.** The $15 million in purchasing power could have supported economic development and wealth building for the families and neighborhood.

Recommendations

Subprime lending that targets certain disadvantaged families threatens opportunity for entire communities. The wealth-building that homeownership traditionally provides is undermined when purchase loans and refinancing loans come at an inflated cost. Economic security is threatened when funds that would be invested in neighborhoods are turned over to lenders. Furthermore, the unequal distribution of subprime loans reflects continuing discrimination against the elderly, women, and people of color. In order to maintain fairness in the lending marketplace and truly protect opportunity for all Americans we must:

- Enhance the Quality of Home Mortgage Disclosure Act (HMDA) Data. *Congress and the Federal Reserve Board (which implements the HMDA regulations) must enhance HMDA data so that regular and comprehensive studies can scrutinize fairness in lending to ensure that minorities, the elderly, women, and low- and moderate-income borrowers and communities receive fairly-priced loans.*

- Federal Reserve Board Must Step Up Anti-Discrimination and Fair Lending Oversight. *The Government Accountability Office concluded that the Federal Reserve Board has the authority to conduct fair lending reviews of affiliates of bank holding companies. The Federal Reserve Board, however, continues to insist that it lacks this authority.*[13] *This issue must be resolved because comprehensive anti-discrimination exams of all parts of bank holding companies are critical.*

- *Comprehensive Anti-Predatory Lending Legislation.* Since our analysis revealed a disproportionate amount of subprime lending targeted to vulnerable borrowers and communities, Congress must respond by enacting comprehensive anti-predatory lending legislation. Such legislation would eliminate the profitability of exploitative practices by making them illegal.

- Stop Regulators from Weakening the Community Reinvestment Act (CRA). *The CRA imposes an affirmative and continuing obligation on banks to serve the credit needs of all communities, including low- and moderate-income neighborhoods. Federal examiners issue a publicly available rating to banks with assets over $250 million based on how many loans, investments, and services they make available to low- and moderate-income neighborhoods. CRA should be rigorously enforced and strengthened by applying it to minority neighborhoods and all geographical areas lenders serve. CRA exams must also scrutinize subprime lending more rigorously.*

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- *GSEs Must Abide by Anti-Predatory Safeguards*. The Government-Sponsored Enterprises (GSEs), including Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, purchase more than half of the home loans made on an annual basis in this country. It is vitally important, therefore, that the GSEs have adopted adequate protections against purchasing predatory loans.

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[1] National Community Reinvestment Coalition, The Opportunity Agenda, and Poverty & Race Research Action Council, *Homeownership and Wealth Building Impeded*, April 2006.
[2] Ibid.
[3] Ibid.
[4] Ibid.
[5] Ibid.
[6] Ibid.
[7] Ibid.
[8] Ibid.
[9] Ibid.
[10] Randall M. Scheessele, *Black and White Disparities in Subprime Mortgage Refinance Lending*, April 2002, published by the Office of Policy Development and Research, the U.S. Department of Housing and Urban Development.
[11] Anthony Pennington-Cross, Anthony Yezer, and Joseph Nichols, *Credit Risk and Mortgage Lending: Who Uses Subprime and Why*? Working Paper No. 00-03, published by the Research Institute for Housing America, September 2000.
[12] Based on use of a mortgage calculator from Bankrate.com, http://www.bankrate.com/brm/mortgage-calculator.asp, accessed March 2006.
[13] Government Accountability Office, *Large Bank Mergers: Fair Lending Review Could be Enhanced with Better Coordination*, November 1999, GAO/GGD-00-16.

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