

**Risk or Race?
Racial Disparities and
the Subprime
Refinance Market**

A Report of the
Center for Community Change

Prepared by

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The Neighborhood Revitalization Project (NRP) is a special project of the Center for Community, based in Washington, D.C. The Project provides training and technical assistance and also advocates for public policies on behalf of community groups and others seeking to expand the availability of responsible lending and banking services for low-income, minority, and other underserved urban and rural areas.

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Risk or Race?

Racial Disparities and the Subprime Refinance Market

Executive Summary

African-Americans and Hispanics are disproportionately represented in the subprime home refinance mortgage market. Surprisingly, this study finds that the disparity between whites and African-Americans and other minorities actually grows at upper-income levels and is greater for higher-income African-American homeowners than for lower-income white homeowners.

High levels of subprime mortgage lending represent markets where borrowers are paying unusually high costs for credit, while often depleting their home equity. Of particular concern are the consistent and pervasive racial disparities and concentration of subprime lending in communities of color and to borrowers of color at all income levels. The persistent racial patterns found in this analysis raise questions as to whether factors other than risk alone account for them.

These patterns exist in all regions and cities of all sizes, thereby raising concerns about the absence of prime conventional mortgage loans in these geographic areas. The subprime market is fertile ground for predatory lending, a disturbing part of the explosive growth in this market. Abusive credit practices in the subprime segment of the mortgage market are stripping borrowers of home equity they may spend a lifetime building. Thousands of families end up facing foreclosure, which destabilizes communities and often shatters families.

The subprime market provides loans to borrowers who do not meet the credit standards for borrowers in the prime market. Most subprime borrowers use the collateral in their homes for debt consolidation or other consumer credit purposes. The growth in subprime lending has benefitted credit-impaired borrowers, those who may have blemishes in their credit records, insufficient credit history, or non-traditional credit sources. When undertaken responsibly, subprime lending offers the opportunity to further expand lending markets to underserved populations.

However, research by the U.S. Department of Housing and Urban Development (HUD) and others has documented the wave of foreclosures occurring in the subprime market. High foreclosure rates for subprime loans indicate that many subprime borrowers are entering into mortgage loans they cannot afford. Thus, high levels of subprime lending indicate markets where borrowers have unusually high risks of losing their homes. The sheer geographic concentration of these loans, therefore, may have a significant negative impact not just on individual borrowers, but on entire neighborhoods. Foreclosed homes frequently remain vacant for extended periods, during which they are neglected. These vacant homes can depress property values and lead to neighborhood deterioration and disinvestment.

This study represents some important differences from previous work. It is national in scope, analyzing lending patterns in all 331 metropolitan statistical areas (MSAs), and ranking metropolitan areas by a variety of measures of subprime lending. It also includes a regional analysis, looking at the variations in lending patterns in different geographic regions within the

country. The study focuses on single-family conventional refinance loans, where subprime lending is most concentrated, using 2000 data provided by the Federal Home Mortgage Disclosure Act. In addition to looking at lending patterns based on the race and income of the borrower, the study also analyzes the way these patterns play out at the neighborhood level and identifies the types of neighborhoods in which subprime loans are most concentrated. Finally, in conjunction with this study, the Center for Community Change is making available an important new national database on subprime lending, which is posted on our website at www.communitychange.org.

Our analysis is based on two key measures. One is the percentage of home refinance loans made to any given racial or ethnic group that are subprime. The second is a comparison between this figure and the percentage of subprime refinance loans made to white borrowers in the same geographic market. This comparison is expressed as a ratio, the “racial disparity ratio.” A ratio of 1.0 indicates no disparity, a ratio above 1.0 indicates that minorities are receiving a higher proportion of subprime loans than whites. The higher the ratio, the greater the disparity between white and non-white borrowers.

Key Findings

This study documents the pervasive racial disparities in subprime lending. Placed in the context of previous research, this study supports the position that risk alone does not explain these racial disparities. Our three major findings are as follows:

1. There are significant racial disparities in subprime lending, and *these disparities actually increase as income increases* (Graph 1, page 6.)
 - Lower-income African-Americans receive 2.4 times as many subprime loans as lower-income whites, while upper-income African-Americans receive 3.0 times as many subprime loans as do whites with comparable incomes.
 - Lower-income Hispanics receive 1.4 times as many subprime loans as do lower-income whites, while upper-income Hispanics receive 2.2 times as many of these loans.
 - At a level of 5.93, St. Louis has the nation’s highest disparity ratio between upper-income African-Americans and upper-income whites. It was one of five metropolitan areas where this disparity ratio was greater than 4.0. In another 18 cities, this ratio was between 3.0 and 4.0. (Table 10, page 59).
2. High concentrations of subprime lending and racial disparities in subprime lending exist in all regions of the nation. (Graphs 3-8, pages 11-17.)
 - Each region contains metropolitan areas where the level of subprime lending is above the national average of 25.31%.
 - In 17 MSAs, the level of subprime lending is more than 1.5 times the national norm. Fourteen of these are in the Southeast or Southwest, 7 are in Texas. El Paso has the highest overall level of subprime loans in the nation: 47.28%.

- For African-Americans, Hispanics and Native Americans, disparities exist in all regions of the country, reaching as high as 3.25 or more in the Midwest and Great Plains.
3. High concentrations of subprime lending and racial disparities occur in metropolitan areas of all sizes. (Graphs 9-12, pages 20-23.)
- Twelve of the 17 metropolitan areas that have concentrations of subprime lending more than 1.5 times the national norm have populations below 500,000. For example, Enid, Oklahoma, the nation's smallest metropolitan area, ranks #12 in percentage of subprime lending. On the other hand, 4 of these 17 metropolitan areas are above 1 million in population.
 - When we examined disparity ratios for cities in different size categories, we found the highest disparity ratios for African-Americans, Hispanics and Native Americans in cities under 250,000 in population. For example, the highest disparity ratio for African-Americans is found in Kankakee, Illinois, with a population of 103,833 and a disparity ratio of 6.10. For Asians, the highest disparity ratios are generally found in cities between 500,000 and 1 million in population.

Additional Racial Impacts

In examining the racial dynamics of subprime lending, our research identified three distinct dimensions to the patterns: a) high overall percentages of subprime loans made to African-Americans and Hispanics; b) high disparity ratios when these percentages are compared to white borrowers; and, c) high disparity ratios for neighborhoods with significant African-American and Hispanic residents as compared to white neighborhoods. Examples of these patterns include:

African-Americans

- In every single metropolitan area, the percentage of subprime loans made to African-American borrowers was higher than the national norm of 25.31%. (Note: certain metropolitan areas were excluded from this calculation because they had fewer than 100 loans to African-Americans, which was the number we set as the threshold for this calculation.)
- Buffalo, New York had the highest percentage of subprime loans to African-Americans, 74.53%. (See Table 3, page 37.)
- There were no metropolitan areas where the disparity ratio for African-Americans fell below 1.64.
- The highest disparity ratio for African-Americans was Kankakee, Illinois, at 6.10. This was followed by Albany, Georgia, (5.69) and Dothan, Alabama (5.23). (See Table 6, page 47.)
- Chicago had the highest disparity ratio for African-American census tracts: 4.12. It was followed by Milwaukee (4.04) and Philadelphia (3.40). Eight metropolitan areas had

disparity ratios above 3.0 for African-American census tracts; another 65 cities had disparity ratios above 2.0. (See Table 16, page 69.)

Hispanics

- The highest percentages of subprime loans to Hispanic borrowers were found in El Paso, Texas, (52.36%) and San Antonio, Texas, (51.46%). (See Table 4, page 42.)
- San Jose, California, had a disparity ratio for Hispanics of 2.45, the highest in the nation. Fourteen metropolitan areas had disparity ratios above 2.0. (See Table 7, page 51.)
- In Corpus Christi, Texas, 75.48% of refinance loans in Hispanic census tracts were subprime, the highest percentage of subprime loans in Hispanic tracts in the nation. (See Table 15, page 68.)
- Albuquerque, New Mexico, had the highest disparity ratio for Hispanic census tracts, 2.59. (See Table 17, page 73.)

Conclusion

The persistent racial disparities in levels of subprime lending found in this analysis do not, in and of themselves, constitute conclusive proof that there is widespread discrimination in the subprime lending markets. These disparities do, however, raise serious questions about the extent to which risk alone could account for such patterns. Discrimination has been a persistent problem in the home finance markets in the United States. The history of mortgage lending discrimination adds weight to the need to explore more fully the role that discrimination plays in the subprime markets through either differential treatment of individual minority borrowers or through the effects of industry practices.

The issue of whether there is racial exploitation in the subprime markets essentially rests on two issues. First, are the disparities in subprime lending related to race? Second, can these disparities be fully explained by legitimate risk factors? Recent research suggests that risk alone does not explain the huge racial disparities that this study found across all income levels. Among the factors that influence the racial disparities in subprime lending:

- The absence of active mainstream prime lenders in minority markets has increased the chances that borrowers in these communities are paying a high cost for credit. For example, the finding that racial disparities actually increase as income increases suggests that a portion of subprime lending is occurring with borrowers whose credit histories would qualify them for lower-cost, conventional, prime loans.
- Both Fannie Mae and Freddie Mac, the publicly chartered secondary mortgage market enterprises, have questioned whether risk explains the use of subprime loans. Freddie Mac has estimated that from “10 to 30 percent of borrowers who obtained mortgages from the subprime market could have qualified for a conventional loan through Loan Prospector” (Freddie Mac’s automated underwriting system). (See Freddie Mac, “*We Open Doors for America’s Families*,” Freddie Mac’s Annual Housing Report for 1997).

- Subprime refinance lending tends to be “sold” to customers rather than “sought” by them. Subprime lenders aggressively market their loans to potential borrowers. These marketing techniques disproportionately target minority market segments, often to homeowners with considerable equity in their homes. Since mainstream prime lenders are absent from many of these same communities, homeowners are more susceptible to being persuaded that the more expensive subprime loans are all that is available to them.
- There is other evidence that risk factors do not explain racial differences in the use of subprime lending. A recent study by the Research Institute for Housing America concluded, “after controlling for borrower income, debt, and credit history, racial groups behave differently.” (See Pennington-Cross, Yezer, and Nichols, *Credit Risk and Mortgage Lending: Who Uses Subprime and Why?*, Research Institute for Housing America (2000).) Specifically, the study noted that minorities are more likely to use subprime lending than whites.

Subprime lending may provide certain borrowers with access to credit they could not otherwise obtain in the prime market. However, the wide disparities in subprime lending to African-Americans and Hispanics at all income levels, suggest that factors other than risk may be at work. Further, the pervasiveness of subprime lending in communities of color, in all regions and in metropolitan areas of all sizes, raises important public policy concerns about possible adverse implications stemming from these heavy geographic concentrations. It also suggests that minority homeowners may be particularly vulnerable to predatory lenders, which by most accounts, target communities with high levels of subprime lending.