

Mortgage Lending Discrimination

INVESTIGATING LENDING PRACTICES IN TODAY'S MARKET

Presented by

Erin Kemple
Executive Director
Connecticut Fair Housing Center
221 Main Street
Hartford, CT 06106
(860)247-4400
erin@ctfairhousing.org



Introduction

- Lending has changed since 2008
 - Fewer local lenders
 - More types of lenders
 - Fewer loan officers in fewer locations
- Result is lending is supposed to be about numbers
 - Income, credit, quality of the home, savings
- Investigating to see if that's true

Background

- Real estate bust of 2008 hit people of color hard
 - People of color targeted for loans that were designed to fail
 - Neighborhoods of color targeted for loans that were designed to fail
 - Loan servicers made money foreclosing on mortgages rather than modifying
 - Servicers failed to maintain REO properties in neighborhoods of color in the same way as in White neighborhoods

Background

- 2016 homeownership rates:
 - African-Americans lowest in the country at 41.7%
 - Latinos second lowest at 46.3%
 - Whites highest in the country at 72.2%
- African-American homeownership rate is lower than the national rate during Depression
- Need to make sure people of color are not victimized again

Common forms of lending discrimination

- Three types of behavior led to the 2008 real estate collapse
 - Redlining
 - Different terms and conditions
 - Targeting neighborhoods of color for subprime or predatory loans (reverse redlining)

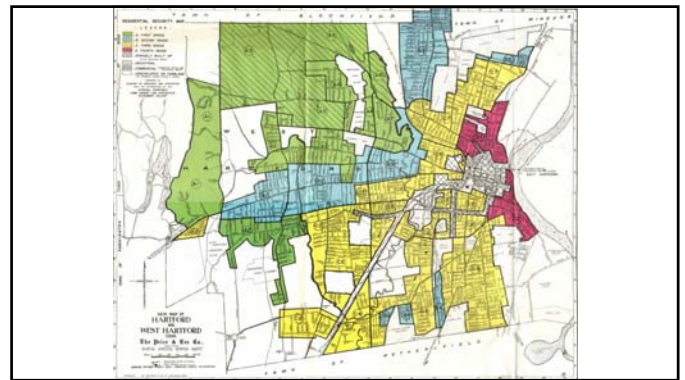
Redlining

Redlining

- Started by the Federal Home Owners' Loan Corporation and private bankers in 1930s
- Rating system to assess mortgage risk by neighborhood
- Rating system used a coding structure where areas shaded green were most stable and areas shaded red were least stable

Redlining

- System used the presence of people of color and certain people who were new to the country as an indication of instability
- As a result, between 1934 and 1968, 98% of the loans approved by the federal government were made to Whites
- Redlining still effects neighborhoods today
- In Hartford, neighborhoods that were redlined in the 1930s are the poorest in the region



Area B5

Area C9

Area	B5	C9
SecurityGrade	Second	Third
Location	Hartford	Hartford
TrendNextDecade	Stable	Stable
Occupation	Shopkeepers and white collar	Factory workers and clerks
Estimated Family Income	\$1,800	\$1,500
Foreign born families	5%	20%
Predominant foreign group	Italians	Italians
NegroYN	No	Yes
Negroes	0%	1%
Relief Families	None	Quite a few
Primary Building: Type	2-Family	2-Family
Construction	Frame	Frame
Average Age (yrs)	15	20
Repair	Good	Fair
Occupancy	98%	97%
Home ownership rate	85%	85%
Price Range (1937)	\$7,500 to 12,000	\$7,500 to 11,000
Sales Activity	Poor	Almost None
Rental Range (1937)	\$40 to 50/month	\$32.5 to 55/month
Rental Activity	Good	Good
Mortgage Availability	Ample	Limited

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Redlining Today

- Hired an expert to review HMDA data
 - Home Mortgage Disclosure Act data
 - Collected by the federal government from lenders with assets of more than \$10 million
 - In 2018, credit scores will be added to HMDA information
 - Data is available at www.ffiec.gov

Redlining

- HMDA is designed to determine if lenders are serving the housing needs of their communities
- HMDA collects data on
 - Applications for residential loans on 1 – 4 family dwellings
 - Applications for refinancing
 - Applications for home equity lines of credit (HELOC) and home improvement loans
 - Action taken on the loan application

Redlining

- Data collected from each lender includes:
 - Race/national origin/sex of borrower
 - Income
 - Amount of loan requested
 - Census tract of property
 - Interest rate if it is a high cost loan

Redlining

- Began by looking at lending patterns in the state to determine if there were any gaps in lending
- Looked at both conventional and government-backed loans
 - Government-backed loans tend to be more expensive over the life of the loan because of interest rates and fees
 - Government-backed loans seem to be new subprime loans
- Looked at home purchase and refinance loans
 - Refinance loans help a family make needed repairs or pay tuition
 - Refinance loans are as much as four-fifths of the market

Redlining

- Looked at whether all racial groups fare worse in neighborhoods of color
- Found that non-origination rates increased as the racial composition of the census tract increased
- High and very high income Whites, Blacks and Latinos had non-origination rates as high as 38% in neighborhoods that were 50% or more people of color

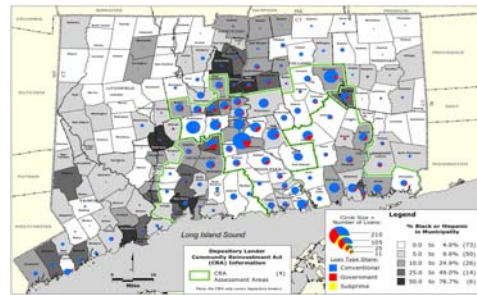
Investigation in Connecticut

- Looked at lending over time for one bank
- One of the top 15 lenders by volume in the state
- Made over \$10M in special financing available at a half-percent discount over market rate
 - Able to trace only two loans to black or Latino borrowers
 - Approx. \$250K or 1.25% of available vehicles
 - No expansion in minority lending

Explanations for lending pattern

- Placement of bank branches
- Location of loan officers
- Proximity to neighborhoods of color
- CRA assessment area
- Income
- None explained the differences in lending

What redlining looks like



Controlling for income

- Shortfall analysis
 - Shortfall is an estimation of the numbers of loans which would be made in any census tract given the incomes of people living in the census tract
 - Calculation controls for income
 - All lenders had shortfalls

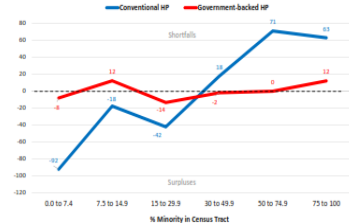
Actual Loans Made

Surplus/Shortfall in Expected vs. Actual Loans

Loans by Minority Percentage in Census Tracts*

Minority %:	Conv. H. Purchase	Gvnt. H. Purchase	Home Improve.	Home Refinance
0 to 7.4%	519	78	186	1,331
7.5 to 14.9%	648	89	171	1,403
15 to 29.9%	567	104	116	1,037
30 to 49.9%	224	48	27	312
50 to 74.9%	44	23	3	54
75 to 100%	10	4	1	7
Total	2,012	346	504	4,144

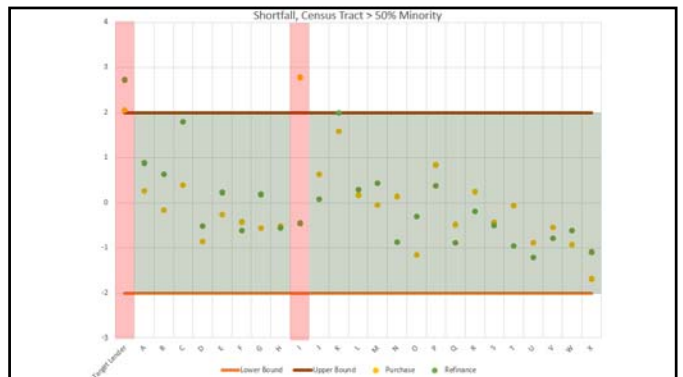
Shortfalls in Home Purchase Loans by Type, 2010 to 2014



* where income of applicant and location of loan are known.

Shortfall Analysis

- Expert then created a statistical rank of shortfalls to determine which bank's was the worst
- Created a chart using +/- 2 to see if any banks fell far outside the norms
- Shortfall analysis a good proxy for debt service and credit scores
- Found one bank with higher shortfalls than others



Differential Treatment

Treating people differently

- Using HMDA data were able to learn
 - African-Americans twice as likely to be given government-backed mortgages as Whites, even when controlling for income
 - Latinos are more likely to be given government-backed mortgages than Whites, even when controlling for income
 - Very high income African-Americans are denied loans nearly twice as often as low-income Whites

Chart 6: Connecticut Statewide Conventional Home Purchase Loans Denied or Other Not Originated

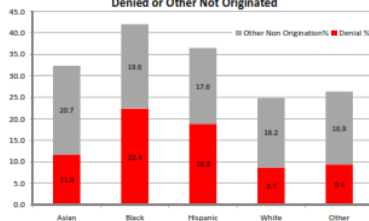
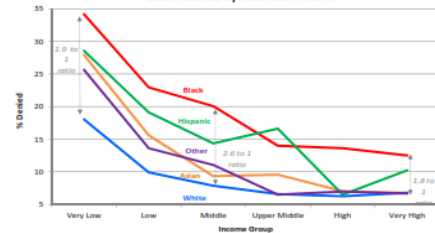


Chart 7: Connecticut Statewide: Conventional Home Purchase Loans Denied by Race and Income



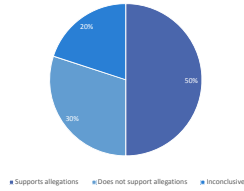
Treating people differently

- Treating people different based on race, national origin, sex
 - Ability to get an appointment
 - Different loan amounts
 - Different incentives
 - Steered toward or away from a particular type of loan product

Investigating differential treatment

- Fair lending testing based on race/national origin
 - Designed to see if people treated differently based on protected characteristics
 - Testers given similar financial characteristics and are interested in buying similar homes
 - Compare treatment to see if they are given the same or similar information and treated similarly

Testing Results



Testing Results

- African-American tester was treated less favorably than White tester in 50% of the tests
- The African-American tester referred to a program for people with credit problems even though she told the loan officer she had a credit score that was higher than average. The White tester was not referred to a program for people with credit problems

Testing Results

- The White tester was given a breakdown of closing costs in writing while the African-American tester was not
- In 40% of the tests the African-American tester was told she qualified for a smaller mortgage or a higher interest rate even when she had more income than the White tester

Testing Results

- Latino tester not given any information on loans when stopping in a bank branch; White tester given extensive information and referred to a loan officer
- Loan officer did not allow the African-American tester to take notes while White tester was given information in writing
- Black tester quoted a much higher interest rate than White tester

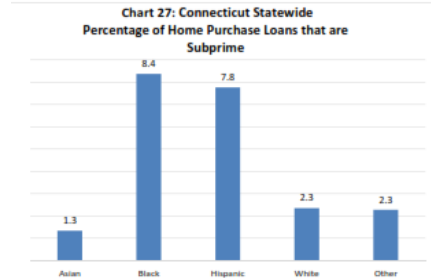
Reverse Redlining

Reverse redlining

- Targeting a neighborhood of color for subprime loans
- Subprime lending is defined as lending at rates 3 points higher than conventional loans with additional fees and costs such as PMI for the life of the loan
- Prior to 2008, high cost and predatory loans were concentrated in communities of color

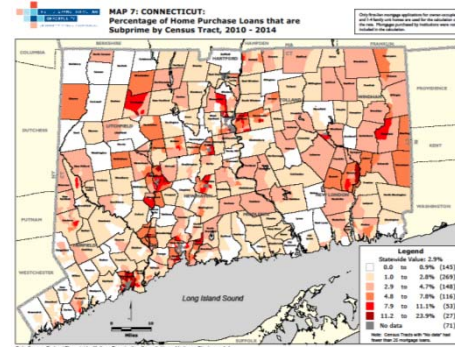
Reverse redlining

- In Connecticut, subprime lending has increased dramatically in the last four years from .8% in 2010 to 7.1% in 2014
- Majority non-white tracts are three times as likely to receive subprime loans as the Whitest tracts
- Majority of subprime loans are government-backed
- Are qualified people of color being steered away from conventional loans?



Reverse redlining

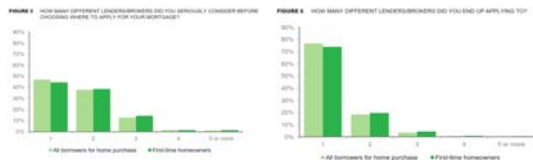
- Subprime lending more concentrated in low income neighborhoods that are majority people of color
- Percentage of homes purchased with subprime loans are as high as 24%, nearly 8 times the statewide average in neighborhoods of color
- Subprime lending in neighborhoods of color is higher than average even when controlling for income



Reverse redlining

- More difficult to test because differential treatment is more likely to occur after application for credit
- CFPB study indicated about 75% of people only apply to one lender for a mortgage
- Failure to shop around can lead to higher rates of discrimination

Number of Lenders Considered by Applicants



http://files.consumerfinance.gov/f/201501_cfpb_consumer-mortgage-shopping-experience.pdf

Testing for Reverse Redlining

- Investigation by testing
 - Both testers qualified for conventional mortgage
 - Both interested in buying a house in a neighborhood of color
 - Will they be offered similar loan products
 - If offered similar loan products, are the terms similar—interest rates, fixed v. arm, PMI, etc.

Early results of testing

- AA tester steered from state loan product for first time homebuyer toward an FHA loan
 - Loan officer told AA tester many banks won't help Black people
 - Loan officer referred to an FHA loan as "Obama" v. the state loan product which was "George Bush"
 - State loan product .5% lower interest rate than FHA
 - State loan product has no upfront insurance payment which usually costs between \$2,500 - \$5,000

Conclusions

Conclusions

- Analysis of HMDA data is an important place to start but other forms of investigation are important also
- Analyze data in several different ways—controlling for income, controlling for neighborhood composition, etc.
- Investigation should also include examining where marketing is taking place, types of loan products offered, where branches are located, where loan officers are located

Conclusions

- Testing can tell part of the story
 - Treated similarly when getting an appointment
 - Offered similar loan products
 - Offered same amount of coaching
- Testers cannot fill out applications
 - Cannot get approved for a mortgage
 - Do not know what the underwriting process is like
 - Although shortfall analysis can help with this

Conclusions

- CFBP/DOH brought case against Kleinbank based solely on HMDA data
- 2018 data (released in 2019) is supposed to include credit scores, unless changed by current administration
- Data analysis should include comparison of types of loans
- Does lender deny high income AA home purchase loans but doesn't deny high income AA refinance loans, more likely to be random error in data rather than discrimination

Questions? Comments?