

Why Responsible Mortgage Lending Is a Fair Housing Issue

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By

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National Consumer Law Center[®]

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The most certain test by which we judge whether a country is really free is the amount of security enjoyed by minorities.

- Lord Acton, "The History of Freedom in Antiquity" (1877)

Introduction

By now the causes of the subprime mortgage lending boom and bust are generally acknowledged: excessive deregulation, push-marketing, and profit-seeking. An insatiable desire for investment opportunities walked down the aisle of securitization to meet the bride of homeownership in a marriage doomed to fail. Exploiting the worthy goals of homeownership and home improvement, the under-regulated and over-funded subprime lending machine spiraled out of control.

What characterized these loans? High fees and high interest rates. Adjustable-rate mortgages with low teaser rates leading to payment shock. Oppressive terms and features poorly understood by borrowers. Ever more exotic products pushing the edge of the envelope, like interest-only and payment-option loans. Loans issued without verifying income. Brokers or loan officers inflating income to close the deal. A total disregard for the norms of underwriting. In this way, hundreds of billions of dollars of subprime loans were issued and securitized, most of them over-priced and lacking in proper underwriting.

It was only a matter of time before the inevitable happened: historic rates of default and foreclosure,¹ plummeting home values,² and the ensuing economic distress which we are still feeling years after the bust. We have all come to know this basic narrative.

What is not as widely recognized is that the subprime lending crisis was always also a fair housing crisis. The historic legacy of redlining contributed materially to the subprime boom and bust, as subprime lenders and brokers flooded African-American and Latino communities where credit was scarce. Because these communities had been starved for credit for generations, the predatory lenders found easy prey during the boom years. And because the existing historical and intergenerational wealth gap meant that a larger percentage of the wealth of African-American and Latino families was concentrated in their homes, the bust hit these families particularly hard.³ Both

the growth of the higher-cost credit market and its disastrous implosion made things disproportionately worse for communities of color.

The boom and the bust widened the wealth gap: the median wealth of white households is now 20 times that of African-American households and 18 times that of Hispanic households.⁴ In 1984, by comparison, well before either the boom or the bust, the ratios were 12:1 for African-Americans and 8:1 for Latinos.⁵

Advocates, scholars, and policymakers working in the field generally know this. Inhabitants of communities of color certainly know this. But many in the public arena have ignored these connections. This paper documents the connections and makes recommendations to promote fair housing by promoting responsible mortgage lending—something we should all want to do, for many reasons.

Anatomy of Racial Disparate Impact

As examined in detail below, unbridled subprime mortgage lending was bad, and its ill effects during both the boom and the bust had a disparate impact on borrowers of color. This includes borrowers who were African-American, Latino, Native American, and Asian.⁸ Subprime lending caused disparate harm to these communities in a number of ways.

First, subprime products were sold disproportionately to lower-income homeowners.⁹ Studies show that low-income homeowners are denied affordable credit more often than moderate- and high-income homeowners, even after adjusting for credit score.¹⁰ Lower-income families are forced into higher-cost forms of credit, even where their credit scores are as good as or better than higher-income borrowers. A higher-cost product sold overwhelmingly to lower-income homeowners will, by definition, have a disparate impact on borrowers of color, whose incomes lag far behind those of whites.

Second, even adjusting for income, subprime was sold disproportionately to borrowers of color.¹¹ Indeed, moving upward through the income scale,

Not *all* subprime lending is bad. There is a legitimate place for some lending at a rate higher than prime, provided that the loan is fairly priced, devoid of inherently oppressive terms, and offered with full disclosure and on non-discriminatory terms. Subprime lending too often was none of these things; in fact, borrowers with prime credit made up a majority of subprime borrowers in the years leading up to the crash.⁶ The mortgage lending boom and bust were predominantly characterized by *irresponsible* subprime loans (commonly called “predatory loans”).⁷ Because most subprime loans were irresponsible, this paper uses the term “subprime” as shorthand for “irresponsible subprime.”

subprime loans were increasingly likely to be given to borrowers of color: three times as likely for low-income homeowners, four times as likely for middle-income homeowners, and six times as likely for high-income homeowners.¹²

Third, after adjusting for credit worthiness, borrowers of color were still more likely to receive subprime loans.¹³ As with income, the disparity gets worse as credit scores increase.¹⁴

One result of the cumulative disparate impact is that white neighborhoods typically experience housing costs 25 percent lower than similar neighborhoods with a majority of African-American residents.¹⁵ This disparity in turn strips further wealth and equity from African-American homeowners, as they struggle to service larger debt burdens on smaller incomes.

Old-style Redlining Leads to New-style Reverse Redlining

Study after study, nationally and in major metropolitan areas, has shown that members of communities of color received subprime loans disproportionately.¹⁶ One study showed that African-Americans were 30% more likely than whites to get higher-priced subprime loans.¹⁷ A recent Consumer Financial Protection Bureau (CFPB) press release notes that, in 2005 and 2006, during the height of the subprime lending boom, more than 53 percent of loans made to African-American borrowers to purchase homes and more than 49 percent of refinancing loans by African-Americans were higher priced loans.¹⁸ Home Mortgage Disclosure Act (HMDA) data confirms the disparity.¹⁹ The disparity remains true even after adjusting for income²⁰ and credit score.²¹

What is worse, many borrowers who received costly subprime loans qualified for, but did not get, more affordable prime loans—almost half, according to one Fannie Mae report.²² For each such family, the average subprime loan represents a drain of between \$50,000 and \$100,000 of equity that the family would have retained with a prime loan.²³ None of this is surprising. Financial institutions—supported and encouraged by the federal government—have long deprived entire communities of mainstream forms of mortgage credit via redlining.²⁴

Congress passed a series of laws in the late 1960's and 1970's intended to attack this problem. The Fair Housing Act of 1968 (FHA) banned race discrimination in housing and mortgage lending. The Home Mortgage Disclosure Act of 1975 (HMDA) required lenders to report home purchase and

mortgage application information, in part to help ferret out patterns of discrimination. The Community Reinvestment Act of 1977 (CRA) required lenders to serve all income segments of their client communities equally, so as to make credit more accessible to low-income borrowers (who are disproportionately borrowers of color).

Yet, even after explicit redlining was outlawed, and even after the passage of these important laws, banks continued to operate far fewer branches, and to do far less mortgage lending, in communities of color.²⁵

Enter subprime lending. Capitalism abhors a vacuum, and subprime lending was able and willing to fill that vacuum. Congressional deregulation of the mortgage market in the 1980's²⁶ and securitization's facilitation of unfettered investment in mortgage lending beginning in the early 1990's enabled the rapid and reckless surge of subprime lending²⁷

The loans funded by these new sources of capital were disastrous. "Reverse redlining" replaced redlining as high-cost capital flooded underserved markets. As the Pennsylvania Human Relations Commission declared, in some cases, the mortgage credit extended was itself so detrimental, so clearly targeted at borrowers of color and so inherently high-risk, that the mortgage credit itself could constitute a discriminatory practice.²⁸ Another court recognized the phenomenon of reverse redlining where brokers targeted borrowers of color with high-cost loans in Washington, D.C.²⁹ The Justice Department filed and settled several lawsuits against subprime lenders accused of reverse redlining. In one, Delta Funding encouraged brokers to pad interest rates and add junk fees to loans made to African-Americans.³⁰ In a second, Long Beach Mortgage Company caused loan officers and brokers to engage in discriminatory pricing as between whites and African-Americans.³¹

These cases focused on the issue of discretionary pricing, all too often synonymous with discriminatory pricing. Brokers played a large role in facilitating this harmful practice.

The Role of Brokers

Most of the lending that flowed into communities of color during the boom was subprime, and most subprime loans were brokered.³²

During the boom years, de facto redlining continued on the part of large, reputable institutions. Despite the promise of CRA lending in addressing the

credit needs of underserved communities, and the relatively good performance of CRA loans,³³ banks continued by and large not to serve low-income or non-white communities through direct lending. The loans made to communities of color were non-CRA loans, largely made by lenders not covered by CRA requirements or operating outside their CRA catchment area, belying the false claim made by some that the CRA was to blame for pushing bad credit on risky borrowers.³⁴ Instead of direct lending, which was covered by CRA and eligible for CRA-credit, the large banks lent to communities of color through subsidiaries and affiliates and by funding non-bank lenders.³⁵

This risky and abusive lending relied on local mortgage brokers, who were working out of local offices and were familiar with and better able to market themselves in local communities, to reach the communities the lenders refused to serve through their front office operations. With the new wave of subprime lending came a new wave of brokers, who multiplied in numbers eight times over from 1987, when there were only 7,000 in the entire country, to well over 50,000 in 2004.³⁶

Brokered loans are, on average, more costly than non-brokered loans.³⁷ Most of the loans flowing into communities of color were brokered.³⁸ The result was that the price of credit increased in communities of color during the subprime boom, even while it fell in white communities.

Brokers were able to overcharge borrowers of color because of discretionary pricing. Typically, the broker got to choose how much he would get paid by the creditor as a function of what interest rate was charged on the loan. The resulting payment was a yield spread premium (YSP). While brokers typically collected up-front fees from the homeowner and financed them as part of the loan principal, their bread and butter was to rack up hugely profitable YSPs on top of these up-front fees.

As the name suggests, YSPs were “premiums” paid by the lender to the broker based on the “yield spread” of a given loan. The spread was defined as the difference between the “par rate” and the (higher) rate arranged by the broker. The par rate is the interest rate for which the borrower qualifies under applicable lender guidelines, such as credit score, debt-to-income ratio, loan-to-value ratio, and so on. But under the YSP regime the broker was allowed (and, indeed, encouraged) by the lender to close the loan at a higher rate, generating more interest for the lender. In return for brokering a higher-rate loan, the lender paid the broker a commission (YSP) typically set at 1 or 2 percent (or more) of the principal loan amount.

Subprime borrowers almost never realized they were paying a higher-than-necessary rate. YSPs were a much-abused feature of the subprime lending industry, and their use has been curtailed by recent legislation.³⁹ But during the boom, YSPs fueled a huge portion of the industry's business, costing borrowers—especially borrowers of color—an untold amount of excess fees, or “overages.”⁴⁰

Brokers were also paid premiums by lenders to push high-risk products such as payment option adjustable-rate mortgages (“POARMs”) and no-doc loans. POARMs are inherently risky loans featuring low initial payments, negative amortization, payment shock, and high default rates. And yet this was precisely the type of product lenders paid brokers bonuses to peddle.⁴¹ No one thinks that sensible underwriting can be done on no-documentation loans, and these loans foreclose at a far higher rate than documented loans.⁴² Yet some lenders actually encouraged brokers to submit no-doc loans in preference to fully-documented loans.

As a result of these incentive schemes, brokers routinely operated to maximize their (and lenders') profit to the detriment of borrowers' interests. Surveys and interviews of brokers themselves confirm this pattern.⁴³ Borrowers of color were particularly vulnerable: brokers were more likely to include predatory features in loans issued to borrowers of color.⁴⁴

As far back as 2001, the Justice Department stated with respect to interest rate overages: “The use of an employee or broker incentive program such as an overage system is not unlawful per se, but it becomes unlawful if applied in a manner to extract higher prices from minorities or women because of their race, national origin or gender.”⁴⁵

That is exactly what happened on a routine basis for many years.

Discretionary Product Lines

Lenders themselves engaged in discretionary pricing, by choosing which product line they would use to process the application of a prospective borrower. Many major lenders operated separate business lines, and sometimes separate corporate subsidiaries, so that they could channel certain categories of borrowers into subprime loan products. Borrowers of color were steered into more expensive loan products via these discretionary product lines.⁴⁶ In a case

involving Wells Fargo, for example, the expert report demonstrated that African-Americans were consistently assigned to the more costly product line, euphemistically named “Home Credit Solutions.”⁴⁷

The lack of expansive Community Reinvestment Act (CRA) definitions enabled this abuse: lenders were only held to account for loans made in their CRA catchment area, where they had bricks and mortar banks, but they escaped review for their abusive lending in areas without branches. Thus, banks were free to target poor communities and communities of color for abusive lending, so long as they had no bank branches in those communities. As a result, lenders targeted poor communities and communities of color for abusive lending and steered borrowers of color to more costly product lines. Lenders marketed inferior and expensive products to communities of color. Lenders also made juicy payments to brokers for placing borrowers in the subprime pipeline.

Lenders caused borrowers of color to pay higher lending prices through the discriminatory use of divergent product lines—either with or without the help of brokers. These borrowers often found themselves using subprime products even when the lender had a prime product for which they qualified.

Other Predatory Features

Subprime loans are by definition costlier than prime, with higher interest rates. Subprime loans usually contained other predatory features as well, exacting a further financial toll on the communities of color targeted by brokers and lenders for subprime lending.

One of the worst features was prepayment penalties. Few prime loans—only 2%—contain prepayment penalties, but the vast majority (80%) of subprime loans contain prepayment penalties.⁴⁸ Because borrowers of color were much more likely to get subprime loans, they were also much more likely to be stuck with prepayment penalties. Even within subprime loans, however, and controlling for loan and borrower credit characteristics, borrowers of color were more likely to end up with a prepayment penalty than white borrowers.⁴⁹ One survey of 177,000 loans found that 60% of African-Americans got loans with prepayment penalties.⁵⁰

Brokers often led borrowers into expensive subprime loans with the promise, when a borrower discovered the truly high costs of a loan at closing, that the borrower could simply refinance in six or twelve months into a lower

rate. Brokers failed, of course, to mention the high cost borrowers would have to pay were they to refinance (even assuming that there was sufficient equity in the home remaining to support a refinance). Few borrowers entering into mortgage contracts with prepayment penalties had any idea of the price they would have to pay to exit their dangerous and abusive loans. Borrowers often executed mortgage loans having no idea they would have to pay an extra fee of thousands of dollars were they to refinance.

Prepayment penalties cost borrowers millions of dollars when they refinanced, and were associated with higher interest rates and foreclosure rates.⁵¹ Prepayment penalties trapped borrowers into high-cost loans, or made them pay more to get out of them. Like YSPs, prepayment penalties were a much-abused feature of the industry that has belatedly been (mostly) regulated out of existence.⁵² But while they were still around, these penalties played a key role in trapping borrowers—especially borrowers of color⁵³—into higher-cost loans. One study looking at 380,000 loans showed that the effect of a prepayment penalty raised interest rates 40 basis points, costing borrowers almost a billion dollars more in interest payments.⁵⁴ Prepayment penalties also significantly increased rates of default and foreclosure.⁵⁵

Balloon payments also wreaked havoc in communities of color. Loans were amortized (i.e., monthly payment amounts would be calculated) over a longer period of time than the actual period of re-payment. While this lowered the monthly payment during the term of the loan, it resulted in huge lump sum payments due at the end of the loan. Many borrowers had little or no understanding of this feature and were caught unawares and forced to refinance on yet more predatory terms in order to pay off the balloon. Balloon payments thus combined some of the worst elements of predatory lending: (1) monthly payments disguised to look more affordable than they really were; (2) payments which did not help to build up equity; and (3) payment shock—in this case, when it came time to pay off the balloon.⁵⁶ Like prepayment penalties, the presence of a balloon payment in a loan increased the chance of default—by as much as 50%, according to one study.⁵⁷ And, once again, borrowers of color were disproportionately likely to get mortgage loans with balloon payments.⁵⁸

Adjustable rate mortgages, higher loan-to-value ratios, lack of documentation, and piggyback lending (when the initial loan is split into two loans, typically one for 80% of the home's value and the other for 20%) all also lead to increased risk of default, and were pushed disproportionately in communities of color.⁵⁹

Even The Boom Was A Bust

The subprime bust has devastated communities of color. But long before the bust, the boom itself stripped wealth from communities of color. The boom offered little to no benefit to communities of color. Characterized largely by an expansion of high-cost credit into communities of color, it was an expensive “benefit” — all pain and no gain.

The big sell during the boom was that subprime loans were benefiting borrowers who could not otherwise buy into the American Dream. Subprime loans were said to provide access to homeownership for borrowers with imperfect or insufficient credit histories. But it turns out that the big sell was a big lie.

The subprime lending boom was motivated by profit, not by a benign desire to promote homeownership. The underlying profit motive meant that borrowers of color were “losing” even when they were supposedly “winning.” High-cost subprime loans came packaged as a necessary form of credit, but they generated net losses for communities of color. As early as 2001, predatory loans were estimated to cost homeowners \$9.1 billion annually.⁶⁰

Most subprime loans were refinance loans sold to borrowers who were already homeowners.⁶¹ The vast majority of new homeowners added to the rolls during the past ten years did not become homeowners by getting subprime loans.⁶² And of those that did, even *before* the bust, more homeowners defaulted and went into foreclosure and lost their homes than were added to the homeownership rolls.⁶³

African-American and Latino homeowners had more than their fair share of these foreclosure-bound loans.⁶⁴ As early as 2004, it was clear that all that extra subprime credit coming into African-American and Latino communities was not a good thing. In Chicago (one of the largest subprime markets), subprime loans, as compared to prime loans, were almost 30 times more likely to lead to foreclosure.⁶⁵ As of 2006—still before the bust—nationwide figures showed that subprime loans were 9 times as likely to go into default.⁶⁶

By every important measure, even the boom was a bust, especially for the African-American and Latino borrowers who were most heavily targeted by subprime brokers and lenders. These homeowners lost equity. Homeownership

rates did not increase in any sustainable fashion. And the scene was set for the worst, which was yet to come.

The Bust Was *Really* a Bust

In the early to mid-2000's, the states and localities most directly affected by predatory loans passed laws intended to prevent the push-marketing of such loans. Unfortunately, such measures were insufficient to halt the flow of toxic products. In large part this was due to the effects of federal preemption. State and local laws were preempted by federal deregulatory statutes from the 1980's.⁶⁷ Local anti-predatory lending laws were further undermined by federal bank regulators like the Office of the Comptroller of the Currency.⁶⁸

And so, the boom did not end until the bust. When the bust came, defaults and foreclosures devastated many communities of color.⁶⁹ Families lost their homes and their savings. Their credit scores tanked, in some cases reducing access to jobs and rental housing, as well as increasing the price of credit and insurance. Children's health and education were jeopardized as families were sometimes pushed into homelessness.⁷⁰ The concentration of foreclosures drove housing prices down and insurance costs up for blocks around, thereby increasing the risk of foreclosure even for families without subprime loans.⁷¹ Municipal governments faced staggering costs in responding to the foreclosure crisis, as vacant properties were secured and property tax rolls shrank.⁷² Crime increased.⁷³ The concentration of this harm was in communities of color, depleted as they were already by the subprime lending boom. And, of course, those communities, due to the historical legacy of institutional racism, have smaller financial buffers against hard economic times.⁷⁴

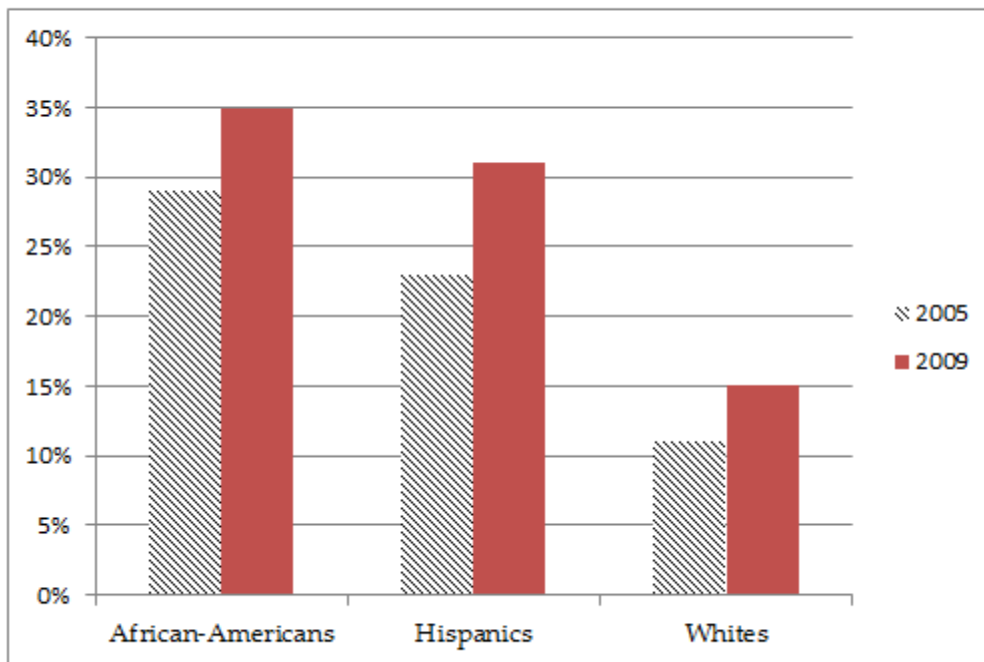
The racial targeting of predatory loans has resulted in an extreme geographic concentration of foreclosures, with a direct correlation between high rates of foreclosures in an area and the share of the population that is non-white.⁷⁵ One recent study finds that African-Americans and Latinos are twice as likely to lose their homes in the current foreclosure crisis.⁷⁶

Some municipalities are now bringing lawsuits challenging reverse redlining in communities of color. The city of Baltimore sued Wells Fargo alleging discriminatory lending practices and seeking compensation for the many public costs which flow from a downward spiral of foreclosures. In 2011, the court refused to dismiss the city's claims and the case is moving forward.⁷⁷

Once the subprime bubble burst, homeownership rates dropped sharply, falling below what they had been prior to the boom.⁷⁸ This adverse effect is exacerbated by the fact that, as between whites and blacks, more black wealth (about two-thirds⁷⁹) is tied up in real property, as opposed to other kinds of assets. A 2008 report concluded that “subprime borrowers of color will lose between \$164 billion and \$213 billion for loans taken during the past eight years,” representing “the greatest loss of wealth for people of color in modern US history.”⁸⁰ Recent research documents that the gap in wealth is now larger than it has been in since before the U.S. government started tracking the gap in the 1980s.⁸¹

Borrowers of color are now even further behind. Communities of color have lost ground in homeownership and in broader economic measures of wealth and security. The wealth gap, significant before the boom and bust,⁸² has only gotten worse.⁸³ The subprime boom and bust widened the gap between our country’s richest and poorest citizens, and it set back the intertwined causes of economic, social, and racial justice by many years.

Percent of Families With Zero or Negative Net Worth in 2005 and 2009



Source: Pew Research Center, *Twenty to One: Wealth Gaps Rise to Record Highs*, p. 2

Recommendations

The devastation left in the wake of widespread mortgage abuse requires a broad and game-changing response. While the urgency of reform is even greater with the onset of the recent foreclosure crisis, change has long been needed. Some recent legislative changes point toward a more equitable lending process, but most of the work is still ahead.

1. End loan steering and strengthen and enforce anti-discrimination laws.

- a. **End Loan Steering.** Brokers and lenders have long steered borrowers into riskier, more expensive loans. The Consumer Financial Protection Bureau should adopt comprehensive, loophole-free anti-steering rules under new authority given it by the 2010 Dodd-Frank Act. After the rules are adopted, the CFPB should monitor the market to ensure that methods of evading this fundamental protection do not arise, and it should enforce the rules vigorously.
- b. **Enforce Broker Compensation Restrictions.** The kickback system gave brokers incentives to steer borrowers in communities of color into higher-cost, riskier loans. The 2010 Dodd-Frank Act (and a set of regulations adopted shortly before that enactment) appears to outlaw the kickback system, but vigorous enforcement and monitoring is necessary.
- c. **Strengthen, Defend, and Enforce Fair Lending Laws.** The Equal Credit Opportunity Act, the Fair Housing Act, and other fair lending laws and regulations should be updated to address “reverse redlining” comprehensively. The Equal Credit Opportunity Act, the Fair Housing Act, and other fair lending laws and regulations should be updated to address “reverse redlining” comprehensively and to make them more effective remedies against discriminatory tactics. Moreover, since the subprime mortgage crisis demonstrates how seemingly race-neutral lending practices can devastate communities of color, all fair lending laws should be interpreted or amended to prohibit acts that have a disparate impact on communities of color. Aggressive enforcement of existing laws should be undertaken by federal and state agencies, in line with the recent action settled by the U.S.

Department of Justice and the Illinois Attorney General with Bank of America.

- d. **Improve Data Collection to Detect Discrimination.** The Home Mortgage Disclosure Act (HMDA) requires mortgage lenders to submit data about the loans they make. While HMDA has long provided increasingly useful information on loan originations, further work is needed to update it for the 21st Century. While changes under the Dodd-Frank Act expanded the required information to include the borrower's age and credit score as well as the origination channel, the CFPB must ensure that this information is made publicly available on the individual loan level in order for researchers to be able to conduct meaningful analysis as to steering. More information on loan characteristics and underwriting is needed, particularly information as to whether the loan is a variable rate loan or a no-doc loan. Information allowing comparison of the primary language of the borrower to the language of the loan documents could be critical in identifying some discriminatory practices. Post-origination information is becoming increasingly important, including foreclosure and default data, as well as whether and to whom the loan is sold and who services the loan. This information must be collected at the loan level, even if published at the census tract level. A national, public, loan-level database on foreclosures and default must be established in a manner consistent with its goals, as required under Dodd-Frank.

2. **Stop the loss of homes and home equity that is exacerbating the wealth gap.**

Because homes make up a disproportionate amount of the wealth of communities of color, the foreclosure crisis will continue to widen the wealth gap unless more effective measures are adopted to save homes from foreclosure. Steps should include:

- a. **Mandate Sustainable Loan Modifications For Qualified Homeowners Instead of Foreclosure.** Many homeowners could still save their homes from foreclosure if their mortgage loans were modified to be fair and affordable. In many cases, homeowners could afford the non-predatory loan for which they initially

qualified, but not the predatory loan into which they were steered. The recent economic downturn, and the collapse of housing values, also means that homeowners may need, and investors may benefit from, further modifications to enable continued payment on the mortgage. Foreclosure should not proceed until the possibility of a loan modification has been fully explored. Sustainable loan modifications and other loss mitigation steps should be available to homeowners no matter what type of loan they have. Loan modification programs to date have been ineffective in addressing the crisis due to a lack of accountability, transparency, and enforceability; more must be done.

- b. **Adopt Clear and Fair National Standards for Servicing of Mortgage Loans that Do Not Drive Homeowners into Foreclosure.** National standards should apply to all mortgage servicers. These standards should require sustainable loan modifications to save homes from foreclosure, and should ban servicers from imposing junk fees that make saving a home impossible. The government should require servicers to report detailed information on loan modifications, including the type of modification, the amount of change in the payment and principal balance, and the race and census tract of the borrower.

- c. **The Dual Track of Foreclosure During Loss Mitigation Must Be Terminated.** No loan modification review process can be properly administered while a homeowner is facing the threat of imminent foreclosure, due to its costs, the resources it demands, and the confusion it creates. A request for a loan modification should automatically halt the initiation or continuation of any judicial or non-judicial foreclosure process. While improvements have been made to the pre-foreclosure outreach and review process under HAMP and under newer GSE rules, the rest of the market lags behind in pre-foreclosure reviews and the key protection of pausing existing foreclosure actions for a modification review is still unavailable.

- d. **Strengthen State Foreclosure Laws and Fund Quality Foreclosure Mediation Programs.** Some state foreclosure laws give homeowners no chance to save their homes. States should build

more protections—including quality foreclosure mediation programs—into their foreclosure laws.

- e. **Permit bankruptcy judges to modify mortgages in distress.** First-lien home loans are the only loans that a bankruptcy judge can never modify.⁸⁴ The failure to allow bankruptcy judges to align the value of the debt with the value of the collateral contributes to the ongoing foreclosure crisis and undermines attempts to restore equity to communities of color. Because African-Americans are more likely to file bankruptcy under a chapter 13 plan, which allows for the possibility of modifying debt, the legislative restrictions on judges exacerbate the racial wealth gap.⁸⁵

3. Prohibit abusive loans that drain equity from homeowners

- a. **Prohibit Unsustainable Loan Terms.** The failure of federal regulators to prohibit abusive loans enabled lenders to strip wealth from communities of color and led to the mortgage meltdown. The Consumer Financial Protection Bureau has the power to adopt strong rules that prohibit abusive, unsustainable loans. To prevent repetition of these abuses in future years, it should exercise this power broadly, without exceptions and loopholes, and should monitor the market for evasions and new equity-stripping techniques.
- b. **Allow States and Municipalities to Protect their Residents.** The subprime mortgage lending abuses that have caused such harm to communities of color would have been curtailed if federal banking regulators had not prevented states and municipalities from protecting their residents from irresponsible lending. The 2010 Dodd-Frank Act repudiated this power grab by federal banking regulators, but the banking agencies have continued to assert broad authority to preempt state and local laws. Federal banking agencies should be required not to interfere with robust protection by states and municipalities.
- c. **Prohibit Unaffordable Lending in All Its Forms.** This report has focused on abusive mortgage lending. But abusive non-mortgage lending, such as payday lending (often at APRs of 400% or higher),

drains away assets, too, and takes money that homeowners could use to save their homes. States should abolish payday lending, and federal regulators should clamp down on bank and credit union involvement in payday and payday-like lending.

4. Make fair and affordable credit widely available

- a. **Provide Prime Credit For As Many As Possible.** Sound, sustainable mortgage lending should be fostered, and homeowners should receive the best loans for which they qualify. As origination in the private market rebounds, it is essential to monitor new products and to promote products that fit the profiles of the spectrum of eligible borrowers.

- b. **Ensure that Government Lending Programs Provide Sustainable and Affordable Loans to Credit Starved Communities.** Far from being the lender of last resort, the U.S. government, through the GSEs, FHA, the VA, and RHS, is now the largest lender of consumer mortgage credit. These programs continue to lack accountability and transparency. The focus of government lending must be on homeowners who would otherwise lack access to credit, and those loans must be affordable. The government should affirmatively promote these safe, government-insured loans in the communities most affected by the crisis and should continue to expand eligibility for government-insured loans to those in high-cost loans or who owe more on their home loans than they are worth. These loans should include rigorous requirements for subsequent loan modifications, both to protect homeowners and to protect the taxpayers' investments. Additionally, the creation of a truly public agency, without private stakeholders, to create liquidity in the mortgage markets for sustainable and affordable loans should be investigated.⁸⁶

- c. **Prioritize Broader Application and Enforcement of the Community Reinvestment Act.** The Community Reinvestment Act should be strengthened, rigorously enforced, and updated for the 21st century. Its provisions should extend to all areas an institution serves, whether with a bricks and mortar branch or via lending. Service requirements should include traditionally underserved communities, including Latino and African-American

communities. CRA loans have historically served the same communities targeted by subprime, on better terms and with lower rates of default and foreclosure.⁸⁷ It was lenders' non-CRA loans that devastated communities and plunged us into a global economic crisis.⁸⁸ Strengthening and enforcing the CRA is one of the ways that fair and affordable credit can be made available to communities of color while protecting our economy.

- d. **Provide Responsible Subprime Credit.** There is a need for responsible subprime credit. Lenders like Self-Help Credit Union in North Carolina have lent hundreds of millions of dollars to subprime borrowers, on fair terms, with low rates of default.⁸⁹ Government and private support for such types of lenders should be a priority. Responsible subprime credit will be a priority especially as we recover from the foreclosure binge, as many credit-worthy homeowners will have blemished credit as a result of having suffered foreclosure after being steered into an unaffordable loan.

- e. **Promote Affordable and Sustainable Homeownership in Low-Income Communities.** The government should not retreat from affordable housing goals or programs that seek to promote responsible and sustainable homeownership among low-income communities or communities of color. These communities have been unfairly blamed for the crisis and are disproportionately impacted by the fallout. When done right, homeownership can be a vehicle for wealth creation in these communities.

5. Put teeth in the laws that require fair lending and protect against foreclosure.

- a. **Provide for Homeowner Enforcement of Lending and Servicing Requirements.** Strong laws are of little use if they are not enforceable. While government enforcement provides some pressure on industry actors, historically private action by homeowners has provided the fastest and fullest access to redress. Individual homeowners must be able to use existing protections to save their homes, both through affirmative suits and in defense to

foreclosure. Governmental actors should protect homeowners' access to redress in legislation, regulation, and enforcement actions.

- b. **Hold All Parties Accountable.** The law should allow homeowners to enforce their rights regardless of who owns their loan—the original lender, an assignee, or a Wall Street trust.
- c. **Support Legal Advocates and Housing Counselors.** A homeowner's best chance for enforcing rights and protecting the family residence is by getting assistance. Ongoing funding and training for legal services attorneys, foreclosure prevention counselors, and fair housing organizations is essential to make the laws work.

Conclusion

Disastrous lending practices have led to the largest rollback of wealth for African-Americans and Latinos ever witnessed in this country's history. Absent intervention, communities of color may take generations to rebuild the wealth stripped from them during the excesses of the last decades. The state of laissez faire has further impoverished some of our country's most vulnerable citizens. Only aggressive enforcement and improvement of existing laws and regulations, coupled with expansion of affordable and responsible credit to historically underserved communities, can begin to level the playing field.

¹ The foreclosure rate for non-farm mortgages peaked in 1933, below 1.4%. The U.S. foreclosure rate at the end of the fourth quarter of 2010 was 4.63%. David C. Wheelock, "The Federal Response to Home Mortgage Distress: Lessons from the Great Depression," *Federal Reserve Bank of St. Louis Review* (2008), p. 133, 138-139 fig. 9 and Mortgage Bankers Association, National Delinquency Survey Q4 2010 (2011), p. 2.

² Home value losses for 2007 and 2008 are estimated at \$5 trillion. Robert G. Schwemm and Jeffrey L. Taren, "Discretionary Pricing, Mortgage Discrimination, and the Fair Housing Act," *Harvard Civil Rights-Civil Liberties Law Review* (2010), p. 381.

³ Melvin L. Oliver and Thomas M. Shapiro, *Black Wealth/White Wealth: A New Perspective on Racial Inequality* (1995), p. 104-108, 113-114, 151-156.

⁴ Rakesh Kochhar, Richard Fry and Paul Taylor, "Wealth Gaps Rise to Record Highs Between Whites, Blacks, Hispanics," *Pew Research Center* (July 26, 2011) (hereafter "Wealth Gaps Rise to Record Highs"), p. 1.

⁵ *Wealth Gaps Rise to Record Highs*, p. 29.

⁶ Rick Brooks & Ruth Simon, "Subprime Debacle Traps Even Very Credit-Worthy: As Housing Boomed, Industry Pushed Loans to a Broader Market," *Wall Street Journal* (December 3, 2007) p. A1 (reporting that 61% percent of subprime borrowers in 2006 were prime eligible based on their credit score).

⁷ Schwemm & Taren, p. 379.

⁸Robert B. Avery, Kenneth P. Brevoort, & Glenn B. Canner, "The 2007 HMDA Data," *Federal Reserve Bulletin* (2008) p. A107, A145 (showing discriminatory lending data for African-Americans, Latinos, and some Asians); Miriam Jorgensen, Sarah Dewees, and Karen Edwards, "Borrowing Trouble: Predatory Lending in Native American Communities," *First Nations Development Institute* (2008) p. 14-16 (American Indians receive subprime loans at roughly twice the rate whites do for the period 1998-2005.). See Elizabeth Renuart et al., *The Cost of Credit*, *National Consumer Law Center* (2009) (hereafter "Cost of Credit"), p. 664-670.

⁹ Debbie Gruenstein Bocian et al., "Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures," *Center for Responsible Lending* (November 2011) p. 26 (hereafter "Lost Ground"); Ira Goldstein, "Bringing Subprime Mortgages to Market and the Effects on Lower-Income Borrowers," *Joint Center for Housing Studies of Harvard University* (February 7, 2004) p. 4; Ginny Hamilton, "Rooting Out Discrimination in Mortgage Lending," Testimony Before the House Financial Services Committee (July 25, 2007), p. 3-4.

¹⁰ Christian Weller, "Access Denied: Low-Income and Minority Families Face More Credit Constraints and Higher Borrowing Costs," *Center for American Progress* (August 2007), p. 1.

¹¹ Lost Ground, p. 5; Schwemm and Taren, p. 399-400.

¹² Dept. of Housing and Urban Development, "Unequal Burden: Income and Racial Disparities in Subprime Lending in America," (April 2000).

¹³ Lost Ground, p. 5; Schwemm & Taren p. 399-400, 401-02; Raul Hinojosa Ojeda, Albert Jacquez, and Paule Cruz Takash, "The End of the American Dream for Blacks and Latinos," *William C. Velasquez Institute* (June 2009)(hereafter "The End of the American Dream"), p. 18; Alan M. White, "Borrowing While Black: Applying Fair Lending Laws to Risk-Based Mortgage Pricing," *South Carolina Law Review* (2009), p. 681.

¹⁴ A study found that African-American borrowers with FICO scores at 680 or above were 2.85 more likely to receive a subprime loan than white borrowers, compared to African-American borrowers with FICO scores below 620, who were 1.26 times more likely to receive a subprime loan than a white borrower for mortgages with an LTV percent between 80-89. Debbie Gruenstein Bocian, Keith S. Ernst, and Wei Li, "Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages," *Center for Responsible Lending* (May 31, 2006) (hereafter, "Unfair Lending,"), p. 10-11.

¹⁵ The End of the American Dream, p. 11.

¹⁶ See, e.g., Jim Campen et al., "Paying More for the American Dream: A Multi-State Analysis of Higher Cost Home Purchase Lending," (March 2007); Schwemm & Taren, p. 382; Cost of Credit, p. 664 note 97; Ira Goldstein and Dan Urevick-Ackelsberg, Subprime Lending, Mortgage Foreclosures and Race: How far have we come and how far have we to go?, *The Reinvestment Fund* (2008), p. 4-6; The End of the American Dream, p. 15-16.

¹⁷ Unfair Lending, p. 16 (reviewing 177,000 loans).

¹⁸ Consumers Union, Fact Sheet: African Americans Deserve a Strong Consumer Bureau to Protect them from Unfair Financial Practices,(August 2011) (citing Federal Reserve data from 2005, "Higher Priced Lending and the 2005 HMDA Data"; Federal Reserve, The 2006 HMDA Data, December 2007).

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- ¹⁹ Naomi Cytron and Laura Lanzerotti, Homeownership at High Cost: Recent Trends in the Mortgage Lending Industry, *Community Investments* (December 2006), p. 7.
- ²⁰ Goldstein, p. 4; Hamilton, p. 7-9.
- ²¹ Schwemm & Taren p. 399-400, 401-02; *The End of the American Dream*, p. 18.
- ²² Fannie Mae, Press Release, (March 2, 2000). See also *Cost of Credit*, p. 663, for a discussion of this and similar reports.
- ²³ National Reinvestment Coalition, "Income is No Shield Against Racial Differences in Lending II: A Comparison of High-Cost Lending in America's Metropolitan and Rural Areas," (July 2008), p. 8; Alan M. White, "Borrowing While Black: Applying Fair Lending Laws to Risk-Based Mortgage Pricing," *South Carolina Law Review* (2009) (hereafter "Borrowing While Black"), p. 680.
- ²⁴ Goldstein, p. 3. Ira Rheingold, Michael Fitzpatrick and Al Hofeld Jr., "From Redlining to Reverse Redlining: A History of Obstacles for Minority Homeownership in America," *Clearinghouse Review* (January-February 2001), p. 643.
- ²⁵ Schwemm & Taren, p. 389-90.
- ²⁶ Goldstein and Urevick-Ackelsberg, p. 5. See also discussion in *Cost of Credit*, p. 59-62.
- ²⁷ Schwemm & Taren, p. 379-80.
- ²⁸ *McGlawn v. Pa. Human Relations Comm'n*, 891 A.2d 757 (Pa. Commw. Ct. 2006) (finding substantial evidence of predatory activities by mortgage broker who targeted African-Americans; rejecting broker's argument that it was providing a public good by assisting credit-impaired homeowners).
- ²⁹ *Hargraves v. Capital City Mortgage Corp.*, 140 F. Supp. 2d 7 (D.D.C. 2000), *further proceedings*, 147 F. Supp. 2d 1 (D.D.C. 2001).
- ³⁰ *United States v. Delta Funding Corp.*, No. CV 00 1872 (E.D.N.Y. 2000) (settlement agreement available at: <http://www.justice.gov/crt/housing/documents/deltasettle.php>).
- ³¹ *United States v. Long Beach Mortgage Co.*, No. CV-96-159DT (C.D. Cal. 1996) (settlement agreement available at: <http://www.justice.gov/crt/housing/documents/longbeachsettle.php>).
- ³² Schwemm & Taren, p. 380.
- ³³ Elizabeth Laderman and Carolina Reid, "CRA Lending During the Subprime Meltdown," *Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act* (February 2009), p. 122.
- ³⁴ *Lost Ground* p. 9 (examining reasons why CRA argument fails); Campen et al. (most subprime loans were not made by CRA-covered lenders); Neil Bhutta and Glenn B. Canner, "Did the CRA cause the mortgage market meltdown?" *Federal Reserve Bank of Minneapolis* (March 1, 2009).
- ³⁵ Many of the large banks originated subprime loans through affiliates or subsidiaries (e.g., Long Beach Mortgage Company, owned by Washington Mutual). And, in many cases, large banks such as Deutsche Bank, U.S. Bank, and Bank of New York played key funding and trustee roles in the securitized loan pools that fueled the boom.
- ³⁶ Schwemm & Taren, p. 380.
- ³⁷ Marsha J. Courchane, "The Pricing of Home Mortgage Loans to Minority Borrowers: How Much of the APR Differential Can We Explain?" *29 Journal of Real Estate Research* (2007), p. 399, 416, 418, 430. See also Keith Ernst, Debbie Bocian & Wei Li, "Steered Wrong: Brokers, Borrowers, and Subprime Loans," *Center for Responsible Lending* (2008) (prime borrowers sometimes save by using a broker but the magnitude of their savings is small compared to the costs imposed on borrowers in the subprime market).
- ³⁸ It is, however, even worse. Even among brokered loans, specifically, borrowers of color were charged more. African-Americans and Hispanics pay more, on average, in broker compensation

than whites. Howell E. Jackson and Laurie Burlingame, "Kickbacks or Compensation: The Case of Yield Spread Premiums," *12 Stanford Journal of Business & Finance* (2007), p. 289, 350.

³⁹ Dodd-Frank Wall Street Reform and Consumer Protection Act. Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010), § 1403, to be codified at 15 U.S.C. § 1639B.

⁴⁰ As early as 2001, it was estimated that predatory loans were costing homeowners \$9.1 billion annually, much of it due to YSPs. Center for Responsible Lending, "Report to Be Released to U.S. Senate: Predatory Lending Annual Toll is \$9.1 Billion," Press Release (July 25, 2001) (hereafter "CRL Press Release").

⁴¹ Written Testimony of Center for Responsible Lending, Consumer Federation of America, and National Consumer Law Center (on behalf of its low-income clients) on Proposed Rules Regarding Regulation Z: §§ 226.36 (d) and (e), Docket No. R-1366 74 Federal Register 43232, August 26, 2009 (December 24, 2009), p. 6.

⁴² Sumit Agarwal et al., "Thy Neighbor's Mortgage: Does Living in a Subprime Neighborhood Effect One's Probability of Default?" (October 4, 2010), p. 16.

⁴³ Ira J. Goldstein, "Lost Values: A Study of Predatory Lending in Philadelphia," *The Reinvestment Fund* (2007) (hereafter "Lost Values"), p. 21-22; Goldstein p. 21.

⁴⁴ Lost Ground, p. 21.

⁴⁵ Schwemm & Taren, p. 394.

⁴⁶ See Cost of Credit, p. 664-670.

⁴⁷ Borrowing While Black, p. 695.

⁴⁸ Debbie Gruenstein Bocian and Richard Zhai, "Borrowers in Higher Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans," *Center for Responsible Lending* (January 2005) (hereafter "Borrowers in Higher Minority Areas"), p. 1.

⁴⁹ *Ibid.* p. 6.

⁵⁰ Unfair Lending, p. 3.

⁵¹ Lost Ground.

⁵² 15 USCA § 1639c.

⁵³ Schwemm & Taren, p. 399-400.

⁵⁴ Borrowers in Higher Minority Areas, p. 1.

⁵⁵ Roberto G. Quercia, Michael A. Stegman, and Walter R. Davis, "The Impact of Predatory Loan Terms on Subprime Foreclosures: The Special Case of Prepayment Penalties and Balloon Payments," *Center for Community Capitalism* (January 25, 2005) (hereafter "The Impact of Predatory Loan Terms"), p. 1.

⁵⁶ All of these features were eventually replicated—and arguably exacerbated—by interest-only and payment-option loans.

⁵⁷ The Impact of Predatory Loan Terms, p. 1.

⁵⁸ Schwemm & Taren, p. 399-400.

⁵⁹ Cost of Credit, p. 671-672, notes 147-48.

⁶⁰ CRL Press Release.

⁶¹ Alan M. White, "The Case for Banning Subprime Mortgages," *University of Cincinnati Law Review* (Winter 2008), p. 621.

⁶² *Ibid.* p. 621-622.

⁶³ *Ibid.* p. 622.

⁶⁴ Schwemm & Taren, p. 382, note 44.

⁶⁵ Specifically, while a tract with 100 additional prime home purchase loans from 1996 to 2001 was expected to have only 0.3 additional foreclosures in 2002, a tract with 100 additional subprime home purchase loans was expected to have almost 9 additional foreclosures. Risky

Business – An Econometric Analysis of the Relationship Between Subprime Lending and Neighborhood Foreclosures, Woodstock Institute (2005), p. ii.

⁶⁶ Cytron and Lanzerotti, p. 6.

⁶⁷ Cost of Credit, p. 53-55.

⁶⁸ Cost of Credit, p. 58-59; Immergluck, p. 134.

⁶⁹ Schwemm & Taren, p. 382.

⁷⁰ Phillip Lovell and Julia Isaacs, "The Impact of the Mortgage Crisis on Children and Their Education," *First Focus* (April 2008); Tony Cox, "Foreclosures Can Be Chaotic For Children," *National Public Radio* (August 9, 2010).

⁷¹ Dan Immergluck, "The Local Wreckage of Global Capital: The Subprime Crisis, Federal Policy and High-Foreclosure Neighborhoods in the US," *International Journal of Urban and Regional Research* (January 2011) (hereafter "The Local Wreckage of Global Capital"), p. 135.

⁷² The Local Wreckage of Global Capital, p. 143.

⁷³ Ryan M. Goodstein and Yan Y. Lee, "Working Paper No. 2010-05: Do Foreclosures Increase Crime?" *FDIC Center for Financial Research* (May 2010), p. 4-5.

⁷⁴ The End of the American Dream, p. 11.

⁷⁵ Ibid. p. 19.

⁷⁶ Lost Ground, p. 4.

⁷⁷ Mayor and City Council of Baltimore v. Wells Fargo, 2011 WL 557759 (D. Md. April 22, 2011).

⁷⁸ Schwemm & Taren, p. 377-378, 381.

⁷⁹ Borrowers in Higher Minority Areas, p. 1.

⁸⁰ Amaad Rivera et al., *Foreclosed: State of the Dream 2008, United for a Fair Economy* (January 15, 2008), p. vii.

⁸¹ Wealth Gaps Rise to Record Highs.

⁸² Borrowing While Black, p. 697

⁸³ David Lynch, "Widening U.S. Income Gap Could Have Far-reaching Effect," *Chicago Tribune*, (November 3, 2011) p. B3; Wealth Gaps Rise to Record Highs.

⁸⁴ Second liens can be modified if they are, as many are in the current market, completely unsecured because the amount of the first lien equals or exceeds the market value of the property.

⁸⁵ Jean Braucher, Dov Cohen, and Robert Lawless. "Race, Attorney Influence, and Bankruptcy Chapter Choice," *Arizona Legal Studies Discussion Paper No. 12-02* (2012).

⁸⁶ See Dan Immergluck, "Fannie, Freddie, and the Future: The secondary mortgage market worked better when it was a true public institution," *American Prospect* (June 20, 2011), p. A20.

⁸⁷ Cost of Credit, p. 660, 672.

⁸⁸ Bhutta and Canner.

⁸⁹ Self-Help, "Subprime Response," (2007).