NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Foreclosure in the Nation's Capital:

How Unfair and Reckless Lending Undermines Homeownership

NCRC DISPARITIES IN LENDING SERIES

Executive Summary

The housing crisis has resulted in the loss of housing wealth of $2.7 trillion over the period 2007-2009, according to the U.S. Congress Joint Economic Committee. As the foreclosure crisis continues largely unabated, it is no surprise that homeownership rates have fallen. These effects have been especially pronounced in minority communities.

The housing crisis began with subprime lending. The exact nature of that lending has been much debated. Like the foreclosure crisis nationwide, the Washington, DC area crisis has been driven by subprime and non-traditional lending. This study takes a statistical sample of loans with 2004-2007 vintages, examining the borrower, loan and neighborhood characteristics that drove subprime lending and foreclosure. The study builds on other examinations of subprime lending and provides an expanded and sophisticated understanding of the causes of foreclosure.

Key findings

It is also documented that nearly 35 percent of subprime loans were issued to borrowers who could have qualified for fixed-rate, prime loans. It has been well documented that racial disparities exist in subprime lending. Subprime loans have experienced high rates of foreclosure. This study matches these facts, controlling for credit risk and other factors to isolate the effects that borrower, loan and neighborhood characteristics have on loans. Findings include:

- The econometric analysis of the study confirms that individual African-American and Hispanic borrowers obtained subprime loans more often than white borrowers with similar credit scores, incomes, loan-to-value ratios, and neighborhood characteristics. The study confirms that disparities in lending have a clear racial component that has not been adequately addressed through enforcement of the nation's fair lending laws.
    - Even controlling for other factors, Latinos were 70 percent more likely and African Americans 80 percent more likely than their white counterparts to receive a subprime loan. This finding suggests that race, in and of itself, alters the likelihood of receiving a subprime loan.
    - Previous studies by the National Community Reinvestment Coalition have repeatedly confirmed race disparities in lending nationwide. For example, an NCRC study found that middle and upper-income (MUI) African-Americans were at least twice as likely to receive a subprime loan than MUI whites in 155 metropolitan areas in 2006.
- Minority borrowers are facing foreclosure more often than white borrowers, even after controlling for borrower, loan, and neighborhood characteristics. The study finds that minorities are disproportionately affected by the foreclosure crisis, beyond levels that can be explained by objective criteria.
    - African Americans were almost 20 percent more likely and Latinos were 90 percent more likely than their similarly situated white counterparts to go into foreclosure. This suggests that race, in and of itself, alters the likelihood a borrower will go into foreclosure.
    - A recent survey by the National Community Reinvestment Coalition of borrowers in the loan modification process found that loans held by African Americans went to foreclosure more often than loans held by whites. This emerging area of concern requires additional study.
- Loans purchased by the Government Sponsored Enterprises (GSEs) are going into foreclosure at roughly half the rate of both portfolio loans and privately securitized loans. This suggests that the standards imposed by the GSEs have encouraged the origination of safe and sustainable loans.
- Loan characteristics, especially payment-to-income ratios, adjustable rates, high-costs (subprime) and balloon payments were found to have a significant effect on loan performance. The study breaks down the influence of each of these factors in a regression model.

Methodology

The study examines loans in the Washington, DC Metropolitan Statistical Area (MSA), which in addition to the District of Columbia includes counties in Maryland (Calvert, Charles, Frederick, Montgomery and Prince George) Virginia (Arlington, Clarke, Culpepper, Fairfax, Fauquier, Loudoun, Prince William, Spotsylvania, Stafford, Warren County) and West Virginia (Berkeley and Jefferson). We chose the Washington, DC area because it broadly mimics the procession of the foreclosure crisis elsewhere, led first by subprime and risky loan products. The study sampling is statistically significant and builds on the findings of other studies by Federal Reserve economists, academics and other consumer organizations.

The findings are particularly significant because the study controls for the most important factors used to determine risk during the origination process, including credit score. The study uses regression analysis, which separates out and controls likely causal factors, achieving a greater determination of causation than otherwise possible. The study controls for a number of influential factors, including:

- Loan characteristics: Loan-to-value ratio, loan type (purchase or refinance) adjustable rate mortgage, refinance, high-cost (subprime), extent of documentation, interest-only, pre-payment penalty, balloon term, payment-to-income ratio.
- Neighborhood characteristics: percent owner occupied, median year built, House Price Index, income level of zip code, moderate-income vs. upper-income zip code, middle-income vs. upper-income zip code, minority zip code.
- Investor identifiers: portfolio vs. government sponsored enterprises (GSE), private securitized vs. GSEs, year 2005 vs. 2004, year 2006 vs. 2004, year 2007 vs. 2004.

Recommendations

- The findings of the study clearly indicate risky and unfair lending practices that were not addressed by the banking regulators. We recommend the creation of a strong and independent Consumer Financial Protection Agency, dedicated to ensuring responsible access to capital and credit.
- Ongoing race disparities, which are unexplained by objective criteria, support the expansion and strengthening of the Community Reinvestment Act. The law should be expanded to non-covered financial institutions, which have been associated with higher levels of risky lending and foreclosure.
- The abusive and risky loan characteristics studied are not subject to rigorous oversight under the law, despite their problematic nature. We recommend the creation of a strong, national anti-predatory lending law.
- Reform of the Government Sponsored Enterprises (GSEs) should take into account that they may have a beneficial influence on loan quality and sustainability, as supported by this study.
- Studies conducted by other academics and Federal Reserve economists have found similar patterns lending in other geographic areas. Making the data presented here available publicly would have allowed for examination of subprime trends earlier in the foreclosure crisis. Problematic practices could have been identified earlier and perhaps stopped by stakeholders before spreading and creating a crisis. The financial reform bills being considered in Congress currently contain some data enhancements, but do not go far enough.