CAPITAL ACCESS 2002:
LENDING PATTERNS IN BLACK AND WHITE NEIGHBORHOODS
TELL A TALE OF TWO CITIES

Summary

One of the most important factors affecting the health of any neighborhood is the ability of its residents to access the capital they need to buy a home. In New York City and across the United States, two major types of private lending institutions offer mortgages. The first, a depository or mortgage company that offers conventional prime and government-insured mortgages, is the route most families take to purchase a home or refinance a mortgage. The second, subprime lenders, offer home purchase and refinance loans at a higher interest rate and with higher up-front fees than a conventional loan, usually to compensate for lending to higher-risk borrowers.

In recent years, a shift has occurred in the types of lenders serving New York City's predominantly black communities, with subprime lending becoming almost as common as prime lending. Although subprime lending can serve a legitimate purpose in the marketplace by providing access to homeownership for those with impaired credit, the predominance of subprime lending in black communities indicates that many who would qualify for prime loans are instead accepting subprime loans – in other words, a significant proportion of black residents in New York City are being unnecessarily channeled into more expensive financing. In addition, some subprime lenders have a history of abusive and predatory practices that result in increased foreclosures and for many, loss of life savings.

The 2002 Schumer report found that predominantly black neighborhoods are over four times as likely to rely on subprime lending as predominantly white communities. In fact, forty-three percent of loans issued in predominantly black communities are subprime, compared to 10% for predominantly white communities. While those figures may not be entirely surprising, the prevalence of subprime loans in black communities, regardless of their economic characteristics, is. In fact, 39% of all home purchase and refinance loans issued in higher income black communities are subprime, compared to 9% for white communities.

This trend is evinced by the lending patterns in communities with identical economic characteristics but different ethnicities. The Schumer report analyzed six sets of neighborhoods identical in income but different in race–the Bronx communities of Baychester, Morris Park and Gun Hill, Throgs Neck, the Queens communities of Laurelton, Bayside and St. Albans, Glendale as well as the Brooklyn communities of East Flatbush, Bensonhurst and Rugby, Sheepshead Bay. The conclusion is that the lending patterns in the City's black and white communities are diametrically opposite: white communities rely on conventional sources for home loans; black communities rely on subprime lending.

And as a result, many in black communities are spending much more for a home. For a 30-year fixed mortgage of $150,000, the difference in total costs between a 7% prime rate and a low subprime rate of 9% is $75,232. For a higher-cost subprime loan at 11%, the cost is an additional $154,994–the original cost of the mortgage. This additional financing cost, which might have gone toward a child's college tuition or as savings for retirement, in fact often takes homeownership out of the reach for many who could otherwise afford mortgage payments.

After an investigation into lending patterns in New York City in 2000, Senator Schumer, prominent reverends from some of the City's black communities and the New York Bankers Association came to the conclusion that the best way to address the inequities in the mortgage lending market was to build trust between New York's banks and its predominantly black communities by increasing access for residents of black communities to conventional lenders. The result was the Housing Equity Lending Project (HELP). HELP connects parishioners of the many ministries throughout the city to participating banks through a hotline (1-877-297-7179), which provides access to conventional loans and credit counseling. The key to HELP's success is its underlying philosophy: never say "no" to applicants. Applicants are either provided conventional rate loans or are provided credit counseling if their credit is impaired. The program, which will be marketed by participating ministers through their churches, will be launched citywide upon release of this report.

Subprime Lending in New York City's Black and White Neighborhoods

In New York City, residents of predominantly black communities are over four times as likely to rely upon subprime lenders for a loan for home purchase and refinance mortgages than residents of a predominantly white community. The chart below provides an overview of subprime lending in New York City.

Subprime Loans Share of Market – by ethnicity and type of loan
Home Purchase and Refinance Loans in New York City, 2000

	Subprime Loans	Prime Loans	Subprime Share
Predominantly Black Neighborhood	2,990	3,887	43%
Predominantly White Neighborhood	3,446	32,633	10%

Subprime lending in black communities is pervasive, regardless of economic characteristics. So although black residents climb the economic ladder of success, they are still denied access to lower-cost financing, as the chart below indicates.

Subprime Loans Share of Market – by ethnicity and income
Home Purchase and Refinance Loans in New York City, 2000

	Lower Income	Middle Income	Higher Income
Predominantly Black Neighborhood	44%	44%	39%
Predominantly White Neighborhood	16%	15%	9%

Other statistics detailing subprime lending in New York City:

- 39% of the home purchase and refinance mortgages issued in upper-income predominantly black neighborhoods were issued by subprime lenders (774 of 1,962). Only 9% of the home purchase and refinance loans were issued by subprime lenders in comparable white neighborhoods (2,700 of 31,270).

- <u>Middle-income predominantly black neighborhoods were nearly three times as likely to rely on subprime lenders as comparable predominantly white neighborhoods</u> (80% to 120% of area median).

- 44% of home purchase and refinance mortgages originated in middle-income predominantly black neighborhoods were issued by subprime lenders (1,113 of 2,530). Only 15% of the home purchase and refinance mortgages were issued by subprime lenders in comparable white neighborhoods (709 of 4,593).

- <u>Subprime lending is prevalent in predominantly black neighborhoods with incomes less than 80% of the New York metropolitan area median but barely registers in comparable white neighborhoods</u>..

- 44% of the home purchase and refinance mortgages originated issued in low-income predominantly black neighborhoods were issued by subprime lenders compared to 16% in comparable white neighborhoods.

<u>Twelve Neighborhoods, Six Black and Six White: Similar Economic Characteristics, Dissimilar Lending Patterns</u>

The perversion of subprime lending is evident in its prevalence in black communities and virtual absence in white communities with identical economic characteristics. The report compared the following communities with similar income levels:

- The Bronx: Baychester and Throgs Neck, Morris Park and Gun Hill
- Queens: Laurelton and Bayside, St. Albans and Glendale
- Brooklyn: East Flatbush and Sheepshead Bay, Bensonhurst and Rugby

Reflecting the overall trend in the City, lending patterns in these communities demonstrate a City divided. The following chart summarizes the disparities in lending patterns in these neighborhoods:

Subprime Loans Share of Market – by ethnicity
Home Purchase and Refinance Loans in Comparable Communities, 2000

Borough	Community (ethnicity)	Subprime Share
Brooklyn	East Flatbush (B)	46%
	Sheepshead Bay (W)	14%
	Rugby (B)	39%
	Bensonhurst (W)	18%
Queens	Laurelton (B)	36%
	Bayside (W)	8%
	St. Albans (B)	47%
	Glendale (W)	17%
Bronx	Baychester (B)	34%
	Throgs Neck (W)	15%
	Gun Hill (B)	31%
	Morris Park (W)	31%

Prime Lenders and Lending Patterns Among Black and White Applicants

In addition to the prevalence of subprime loans, higher rejection rates by conventional lenders also characterize black communities. In 2000, denial rates at prime depositories and mortgage companies for blacks were double those for whites. The following chart details the denial rates for blacks and whites by prime lenders in New York City:

Denial Rates--by ethnicity
Conventional Home Purchase and Refinance Loans in New York City, 2000[1]

	Low Income	Middle Income	Higher Income
Black Applicant	30%	27%	26%
White Applicant	19%	15%	12%

Overall, black applicants for a home purchase or refinance mortgage were twice as likely to be denied a loan at a prime depository or mortgage company than white applicants (28% denial rate for blacks compared to 14% for whites). Across the income spectrum, black applicants were more likely to be denied a loan at a prime depository or mortgage company than whites. In fact, black applicants with incomes greater than $67,440 were more likely to be rejected for a home purchase or refinance mortgage (26% denial rate) than white applicants with incomes that did not exceed $44,960 (19% denial rate).

Solutions: Improving Capital Access for Predominantly Black Communities

1) Housing Equity Lending Project (HELP)

In May 2000, Schumer, along with the Reverend Flake of Allen AME and Reverend Cousins of Bridge Street Baptist Church, in conjunction with New York Bankers Association, created the Housing Equity Lending Project (HELP) – a project to improve access to traditional lending sources for residents of predominantly black communities by bringing together parishioners and participating banks. HELP links borrowers to banks that offer conventional home purchase and refinance loans and offers residents free credit counseling and educational materials.

Ministers inform their congregation of the program during Sunday services, providing information and materials about the program that have been supplied by participating banks. Parishioners interested in home purchase or refinance loans contact the program through a "hotline" – 1-877-297-7179 -- which is staffed by the New York Bankers Association. The representative

[1] HUD defines "Low Income" as less than $44,960--80% of area median income, "Middle Income" as between $44,960 and $67,440-- 80%-120% of area median income and "Higher Income" as greater than $67,440-- 120% of median income.

accepts the parishioner's information and forwards it to participating banks, which then contact each interested parishioner to initiate an application for loan origination. The program puts at least three banks in contact with each applicant, so that the borrower has the opportunity to comparison shop. Subsequently, a parishioner either receives a loan or, if credit is impaired, is provided credit counseling and outlined the steps necessary to qualify for a conventional loan.

In short, ministers are responsible for marketing the program and providing feedback; banks are responsible for funding the program and ensuring quality control.

The key to HELP's success is its underlying philosophy: never to say "no" to applicants. Much of the distrust initially expressed by participating ministers towards banks was based on a belief that banks did not want to make loans to black applicants. As a result, the HELP program's goal was to bridge the gap between communities of color and New York's financial institutions by creating a prime source of funding for potential black homeowners–one that would offer conventional loans or at least provide applicants with the tools necessary to qualify for a conventional, rather than a subprime, loan at a future date.

The program also includes:

- Outreach campaigns by faith-based institutions participating in the project.
- Consumer seminars hosted by the participating banks to educate residents on the lending process.
- A resource clearinghouse to link potential applicants with information on available lending products to consumers
- A financial literacy handbook specifically for faith-based institutions developed by the Faith Center for Community Development and funded by a $50,000 Fannie Mae grant.

Initially launched in the Southeast Queens and Central Brooklyn, HELP became available to parishioners of participating churches throughout New York City on Monday, March 24, 2002. The citywide program will be publicized at an event with Schumer and many of the ministers on Wednesday, April 3, 2002, along with the release of this report.

(2) Federal criminal penalties for predatory lenders

A subset of subprime lenders engage in predatory and abusive practices, but currently there are no criminal federal penalties to deter them. Efforts to sanction predatory lenders by the Federal Trade Commission have utilized general statutory authority against fraud and deceptive practices. Adding statutory criminal penalties would provide prosecutors with the authority for to go after bad actors and stop predatory lending before it starts.

(3) Modernize fair lending laws

While the marketplace for financial services has evolved, the laws intended to guard against disparities in lending – the Community Reinvestment Act (CRA), the Home Mortgage Disclosure

Act (HMDA), the Truth in Lending Act (TILA) and Home Ownership Equity Protection Act (HOEPA) – have largely remained the same. As a result, our fair lending laws have lost some potency.

A number of proposals to modernize our fair lending laws should be enacted, including the following:

- Adoption of S. 1242, the "Consumer Credit Score Disclosure Act of 2001." This legislation introduced by Senator Schumer and Senator Wayne Allard (R-WY), would require lenders to provide consumers with the credit score used to determine their creditworthiness as well as factors used to determine their score. This would empower consumers to "comparison shop" among lenders for the best possible interest rate.

- Inclusion in HMDA reports of credit scores and interest rates (including points and fees) – allowing for better analysis of an institution's lending practices.

- Applying HMDA to small business loans. Communities need businesses as well as residents, so by applying HMDA to small business loans, regulators would have a more complete picture of an institution's reinvestment in the community.

- Inclusion of loans of subprime affiliates and a "fair lending exam" in CRA exam process.

Notes About Sources:
All loan data were supplied by the Department of Housing and Urban Development using data collected by the Federal Financial Institution Examination Council (FFIEC) through the Home Mortgage Disclosure Act disclosure requirements.

The 2002 Schumer study analyzed 196,473 New York City conventional home purchase and refinance applications by race, neighborhood, income, and lender. 86 percent of home purchase and refinance loans in New York City were issued by conventional prime depositories or mortgage companies

HMDA data does not include a field that identifies subprime loans. HUD produces an annual list of lenders who specialize in subprime lending and report HMDA data.

Other Notes:
The proportion of subprime loans in New York City is probably an underestimate given that HMDA coverage of subprime lending is lower than coverage of prime lending. For one, prime lenders have increasingly originated subprime loans. Also, many subprime lenders are not required to report under HMDA but may be picked up by the purchasing lender. Purchased loans are not included in this study.

The 2000 HUD median family income was $56,200 (source: HUD) and the 1989 median family income was $37,515 (source: 1990 Census).

A predominantly black census tract is defined as one with a black population of at least 75%. A predominantly white neighborhood is one with a white population of at least 85%. The data deliberately excludes home purchase and refinance loans made through federal government agencies such as the Federal Housing Administration, Rural Housing Service, and the Veterans Administration.

The slight decline in subprime lending in 1999 and 2000 was partially due to the reorganization of the subprime industry and partially due to the increase in interest rates which affected all segments of the mortgage market.