Statement of Lisa Rice
National Fair Housing Alliance

For the

US Commission on Civil Rights
Public Briefing

"An Examination of Civil Rights Issues with Respect to the Mortgage Crisis: The Effects of Predatory Lending on the Mortgage Crisis"

March 20, 2009

Introduction

The foreclosure and financial crisis and its impact on the global economy have been at the forefront of the country's domestic and foreign policy issues. What has been greatly overlooked, in the federal government's legislative and administrative reaction to and the media reports about this crisis, is its roots in the historical discriminatory housing and lending practices in our nation. Biased practices in the housing, insurance and lending markets have resulted in segregated residential patterns in America. These patterns of residential isolation have been exploited by many housing industry players and have helped to spur the growth of predatory lending practices. Predatory lending practices are the precursor to the American foreclosure crisis, the implosion of the subprime lending market and, ultimately, today's financial markets crisis. Unfortunately, the federal government did not take actions to curtail predatory lending practices until it was too late. And then, the actions taken were too little. The sad result is that American taxpayers are paying the price for the failure to adequately reign in abusive practices. Even sadder, is that African-American and Latino borrowers and communities are bearing a disproportionate portion of this crisis.

What began as an implosion in the subprime market has evolved into what may be the greatest financial crisis since the Great Depression. Indeed, when it is all said and done, this crisis may trump the Great Depression. This issue has consumed a number of our federal agencies including the Department of the Treasury, the Federal Reserve, the Department of Housing and Urban Development, the Department of Commerce, and federal regulatory agencies. It has monopolized the attention of the Congress and presidential administrations as they have made herculean efforts to save the financial markets.

US taxpayers have spent trillions of dollars to rescue troubled financial institutions and address the foreclosure crisis. Moreover, legislators are poised to spend or commit trillions more of taxpayer dollars. According to a Bloomberg article, taxpayers stand to shell out $9.7 trillion to address this catastrophe. "The $9.7 trillion in pledges would be enough to send a $1,430 check to every man, woman and child alive in the world. It's 13 times what the U.S. has spent so far on wars in Iraq and Afghanistan, according to

Congressional Budget Office data, and is almost enough to pay off every home mortgage loan in the U.S., calculated at $10.5 trillion by the Federal Reserve."[1]

Much emphasis has been placed on shoring up financial institutions and preventing further deterioration of the financial markets. Legislators and administrative officials keenly watch stock market indices, unemployment, GDP, and other indicators to try and gauge how well the markets may be responding to rescue and bailout initiatives. The Congress has passed a stimulus package meant to drive employment and buttress the economy. Cries to help homeowners facing foreclosure may soon be met by legislators in the form of a comprehensive foreclosure bill.

The American people will spend an unprecedented amount of money to address a problem that has its roots in systemic discriminatory lending practices and residential segregation. Lenders were able to develop and perfect lending models and lobby for legislative changes that facilitated unscrupulous lending practices arguing. While civil rights and consumer advocacy groups pushed for more stringent regulations of subprime and non-traditional credit vehicles, the lending industry argued that tightened regulation would curtail lending to under-served communities and stifle credit. Lenders warned that government should not restrict what was an evolving market and that regulations, particularly in the subprime sector, would not lend to consumer protections but rather dry up credit and hamper market innovations. Ultimately, the lack of oversight helped fuel predatory lending practices.

What is Predatory Lending?

While predatory lending can exist in any segment of the marketplace, it was concentrated in the subprime market largely due to the lack of regulation and oversight that existed in that sector. Predatory lending is simply lending that places the best interests of the lender above those of the consumer. It is a set of unfair and unethical practices that often put the borrower at risk of losing their home.

It might be easier to identify the characteristics of predatory lending practices which include:

- aggressive or targeted marketing to financially vulnerable households
- unreasonable loan terms
- eligibility based on property value/equity as opposed to ability to pay
- excessive fees
- credit insurance
- yield spread premiums (kick-backs)
- basing loan values on inflated appraisals
- mandatory arbitration clauses

[1] Pittman, Mark and Ivry, Bob, U.S. Taxpayers Risk $9.7 Trillion on Bailout Programs (Update 1). March 10, 2009, http://www.bloomberg.com/apps/news?pid=washingtonstory&sid=aGq2B3XeGKok

- pre-payment penalties that offer little or no benefit to the borrower
- repeated refinancing that does not benefit the borrower and often jeopardizes his or her property (flipping)
- steering borrowers to more costly loans
- bait and switch tactics
- equity-stripping practices
- practices that are fraudulent, unfair, coercive, or deceptive
- loan terms and conditions that make it difficult or impossible for a borrower to reduce their indebtedness
- originating a loan that is unsustainable for the borrower

The Root of Predatory Lending Practices

The present crisis grows out of a series of discriminatory actions similar to those over the last century. Many systemic discriminatory practices and the disparities and inequities they create are possible because America is so segregated. It is a Catch 22 and perpetual cycle. Segregation helps foster systemic discrimination and exacerbates its ill effects. Simultaneously, systemic discrimination perpetuates residential segregation.

Systemic discrimination has abounded in our financial markets for centuries. America has a bifurcated lending system that has negative effects on African-Americans and Latinos. It always has. There has never been a time in our history when African-Americans and Latinos have participated in the financial mainstream to the same degree as their White counterparts.

Beginning immediately after the Civil War and the passage of the 13th Amendment, Congress established a separate financial system for newly freed slaves. The Freedman's Bank came about initially because African-American soldiers, who had risked their lives to preserve the United States, had no place to deposit their savings and no safe place to transact their financial business. Since African-Americans were not welcomed, and in some cases forbidden by law, to conduct business in so-called White financial establishments, several Union generals, including General Oliver Howard, for whom Howard University was named, urged Congress to set up a financial institution for Blacks. From the beginning, our financial markets have been separate and unequal. This pattern continues today.

As mortgage lending began to take root in the early 1900s, Black Codes and Jim Crow laws made it difficult for people of color to utilize the financial mainstream. With the failure of the Freedman's Bank due to fraud and speculation, ironically largely perpetrated by the White Trustees of the Freedman's Bank, people of color had no viable resource. A series of private and public practices severely impaired the rights of persons of color to fully participate in the American economy and advance their lives.

In the private sector, housing providers promoted practices that restricted the rights of racial minorities. Real estate agents practiced block-busting and steering, preventing natural integration. Real estate professionals promoted the idea that racial integration would lead to a devaluation of property helping to prompt homeowners in predominately White communities to resist integration. Lenders and insurers redlined communities that were not predominately White. Real estate, lending and appraisal manuals readily embraced the idea that racial homogeneity was key to sustaining home value and that the racial characteristics of the neighborhood affected real estate value and, therefore, loan risk. In one appraisal treatise, the author indicated the signifigance race played in property valuation. Frederick Babcock wrote in chapter 7, "Influence of Social and Racial Factors on Value" of his appraisal manual, *The Valuation of Real Estate* (New York: McGraw, 1932)

> "Among the traits and characteristics of people which influence land values, racial heritage and tendencies seem to be of paramount importance. The aspirations, energies, and abilities of various groups in the composition of the population will determine the extent to which they develop the potential value of the land." (pg. 86)

> "Most of the variations and differences between people are slight and value declines are, as a result, gradual. But there is one difference in people, namely race, which can result in a very rapid decline. Usually such declines can be partially avoided by segregation and this device has always been in common usage in the South where white and Negro[sic] populations have been separated." (pg. 91)

Homer Hoyt and Arthur Weimer, who wrote several editions of the appraisal book, *Principles of Urban Real Estate*, (New York: Ronald Press; 1939, 2nd ed., 1948; 3rd ed., 1954) stressed the importance of race throughout their texts. They warned, in the section entitled "Other Forms of Private Regulation", of "persons other than of the Caucasian race" negatively impacting property values and promoting neighborhood decline. In the section entitled "Types of Deed Restrictions", they advise that the Supreme Court's decision declaring that racial restrictive covenants are unenforceable[2] can be bypassed by using private clubs to screen residents. (Weimer & Hoyt, 2nd ed., pg. 196-197) The authors also describe people of color as "inharmonious groups". They state in the 3rd edition of the textbook that "Suburbs at a sufficient distance from the transition of uses or of inharmonious groups maintain a high character for very long periods of time, if not indefinitely . . . " (pg. 371)

Principles of Urban Real Estate was frequently used as an instructional manual or school book. As such, there are questions at the end of each chapter. The end of Chapter 7 in the second edition features the following question:

"In which of the following neighborhoods would you prefer to invest?"

For Neighborhood A, the description is as follows: "The area is zoned for single-family residences. No deed restrictions are in force." For Neighborhood B, the description is as follows: "Deed restrictions have been established controlling the types of houses which may be built and restricting occupancy to member of the Caucasian race."

---

[2] The U.S. Supreme Court issued a decision in Shelley v. Kraemer on May 3, 1948.

The former dean of the American Institute of Real Estate Appraisers, Arthur May, wrote in his appraisal manual, *Valuation of Residential Real Estate* (New York: Prentice-Hall, 1942), that property values are dependent on the homogeneity of a residential community. He even declared that in some neighborhoods, the threat of African-Americans moving into the area caused property values to decline by 25%.
May also makes reference to the "infiltration of minority racial or nationalistic groups" as a "nuisance" contributing to property devaluation. He further states that "The encroachment of the antipathetic racial or nationalistic group brings with it, first, the threat, and ultimately, the effect of decreased values."

Indeed appraisal manuals created by the American Institute of Real Estate Appraisers listed a ranking of races and nationalities to indicate their impact on real estate value. The most favorable groups were listed at the top. The least favorable groups were listed at the bottom. One of the rankings appeared as follows:

1. *English, Germans, Scotch, Irish, Scandinavians*
2. *North Italians*
3. *Bohemians or Czechs*
4. *Poles*
5. *Lithuanians*
6. *Greeks*
7. *Russians, Jews (lower class)*
8. *South Italians*
9. *Negroes*
10. *Mexicans*

This concept was not only embraced and perpetuated by the private sector but, was fully adopted by the government as both the Home Owners Loan Corporation, the Federal Housing Administration, and the Veterans Administration based their underwriting guidelines on these biased viewpoints.

The Home Owners Loan Corporation, founded in 1932, created a series of color-coded maps indicating the level of risk presented by each neighborhood. Race was a clear factor in determining the risk level of neighborhoods evaluated by the HOLC.[3] The HOLC institutionalized the practice of lending redlining within the federal government. This served to sanction discriminatory policies and practices that were already being perpetuated by the private sector. Because racially mixed neighborhoods and predominately African-American communities were graded as the areas with the highest degree of risk, very few loans were approved in these areas.

By the time the FHA and VA programs were established, lending redlining was a systemic function of the federal government. The FHA and VA utilized the same restrictive and discriminatory policies that had been cemented by the HOLC. The FHA referenced minorities as adverse influences upon a neighborhood.

---

[3] Hillier, Amy, *Residential Security Maps and Neighborhood Appraisals: The Home Owner's Loan Corporation and the Case of Philadelphia*, Duke University Press, 2005.

Indeed, Homer Hoyt, brought the same racial prejudices that he exhibited in his appraisal manuals to the FHA. Hoyt joined the FHA in 1934 as Principal Housing Economist. He applied his property valuation theories to the underwriting guidelines developed at the FHA. Indeed, Hoyt's influence can be seen in the FHA's 1939 Underwriting Manual which declared that "if a neighborhood is to retain stability, it is necessary that properties shall continue to be occupied by the same social and racial classes".[4] The FHA even promoted the use of racially restrictive covenants as a means of securing residential homogeneity. Here again, we see Hoyt's influence. Hoyt clearly believed in the importance of racially restrictive covenants as a means of promoting racial isolation and neighborhood homogeneity. It is not hard to conceive, since he promoted ways of circumventing the Supreme Court's decision in Shelley v. Kraemer in his appraisal manual[5], that he would probably have utilized multiple measures to promote the use of restrictive covenants while he was at FHA.

The obvious result is that very few FHA and VA loans went to borrowers of color. Fewer than 1% of all African-Americans were able to obtain a loan from 1930 – 1960[6] This is a critical point because it was the lending programs operated by the HOLC, FHA, and VA that allowed a mass of Americans to become homeowners. Prior to the advent of these programs, purchasing a home was profoundly difficult. Most mortgages required very large down-payments of up to 50%, were not fully amortizing, and included a balloon payment after a relative short period of time – often only 3-5 years.[7] This of course, made it prohibitive for most families to purchase homes. In 1920, the homeownership rate was about 40%. The rate dipped below this figure during the Great Depression. [8] But the federal lending programs allowed more generous lending terms and helped to spur homeownership. These programs also helped to support the suburbanization of America. For example, the VA program enabled borrowers to obtain a loan at an interest rate of 4% amortized over 20 years.

However, African-Americans and Latinos could not access these lending vehicles that were enabling so many Americans to obtain, not only the dream of homeownership, but of wealth creation. Lending institutions and the federal government employed underwriting guidelines that favored racially White, homogenous neighborhoods and led to the creation of a separate and unequal lending and financial system. Because African-Americans and Latinos could not access these advantageous programs, they were

---

[4] Carr, James and Kutty, Nandinee, *Segregation: The Rising Costs for America*, Routledge, 2008, pg. 8.

[5] Hoyt joined the FHA in 1934 however, Shelley v. Kraemer, which struck down racially restrictive covenants, was not decided until 1948. Hoyt wrote in his 1948 edition of *Principles of Urban Real Estate,* that the Supreme Court's decision could be circumvented by using private clubs as a screening mechanism.

[6] powell, john, *Wealth, Housing and the Gap: How can we Understand and Close the Wealth Gap?* , July, 2007, available at: http://4909e99d35cada63e7f757471b7243be73e53e14.gripelements.com/presentations/2007_07_09_NAACP_Natl_Convention_Panel.ppt

[7] Monroe, Albert. *How the Federal Housing Administration Affects Homeownership*. Harvard University Department of Economics. Cambridge, MA. November 2001.

[8] US Department of Commerce, *Housing Construction Statistics,* 18 Wright; *Building the Dream*, 240; Wendt, *Housing Policy*, 160.

relegated to the residual lending market. The fringe lending market became the source of credit for borrowers of color. It included:

- Loans through finance companies,
- Seller-financing,
- Loans through church organizations,
- Loans through local business people,
- Person-to-Person borrowing, and
- Rent-to-own contracts/Land Contracts

All of these options were through unregulated mechanisms and often came at high costs to the borrower. Moreover, there were very limited resources for these types of funding systems. Lenders did crop up, primarily in major urban hubs like Los Angeles, to fill the credit gap for borrowers of color. However, these lenders charged excessively high rates for their loans. Even if a borrower was a very good credit risk, they paid exorbitant prices because they had little options and there was little to no competition in the market place.

In the late 1970s, fringe lenders gained access to multiple streams of funding, largely made available from the junk bond markets. Securitization was on the scene and lenders were able to tap Wall Street to fund lending schemes to borrowers in under-served communities. Eventually, federal deregulation in the 1980s and changes to federal regulations and federal laws opened up securitization even more spurring rapid and voluminous growth of the subprime market. Substantial lending deregulation in the 1980s greased the wheels for lending in minority communities desperate for credit because of historic redlining. The Depository Institutions Deregulatory and Monetary Control Act (1980) removed usury restrictions on first lien mortgage rates; the Alternative Mortgage Transaction Parity Act (1982) permitted variable interest rates and balloon payments while preempting local government controls; and the Tax Reform Act (1986) eliminated interest deductions for consumer credit, encouraging homeowners to replace consumer debt with mortgages.[9] Moreover, in 2000, Congress prohibited regulation of most derivatives with the passage of the Commodity Futures Modernization Act. The Act excluded swap agreements from regulation by the Commodity Futures Trading Commission. This act spurred even more infusions into the subprime market because swap derivatives were a primary vehicle in hedging the financial position of investors in subprime securities.

Many lenders who peddled subprime loans were non-depository financial institutions who were not regulated at the federal level and who were not covered by the Community Reinvestment Act. Where there was federal regulation, bank regulatory agencies failed to reign in abusive practices at the lending institutions. Even worse, agencies like the OCC and OTS passed regulations preempting their member institutions from state anti-

---

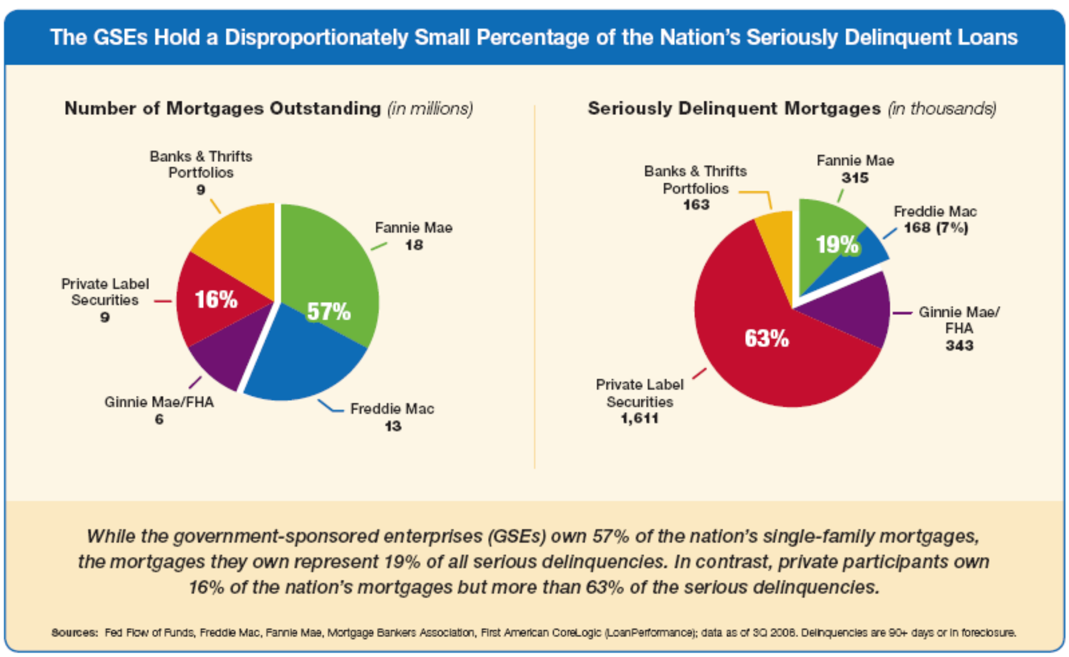
[9] Testimony of Jesus Hernandez (Los Angeles) before the National Commission on Fair Housing and Equal Opportunity. Commission Report available at http://www.nationalfairhousing.org/Portals/33/reports/Future_of_Fair_Housing.PDF.

predatory lending laws, thereby preventing states from effectively challenging predatory lending activities.

Not surprisingly, the highly unregulated subprime market exploded growing at voluminous rates. The Federal Reserve Bank of St. Louis noted that the B&C lending market grew from $65 billion in originations in 1995 to $332 billion in originations in 2003[10].

In fact, the market grew so large that it quickly began out-pacing mainstream lenders in terms of growth. Subprime lenders began encroaching on GSE lending and subsumed FHA-based lending. FHA's market share dropped precipitously with the advent of subprime lending. This is not so much because consumers requested subprime loans but rather because lenders pushed subprime loans – largely because the profit and commission schemes were more desirable.

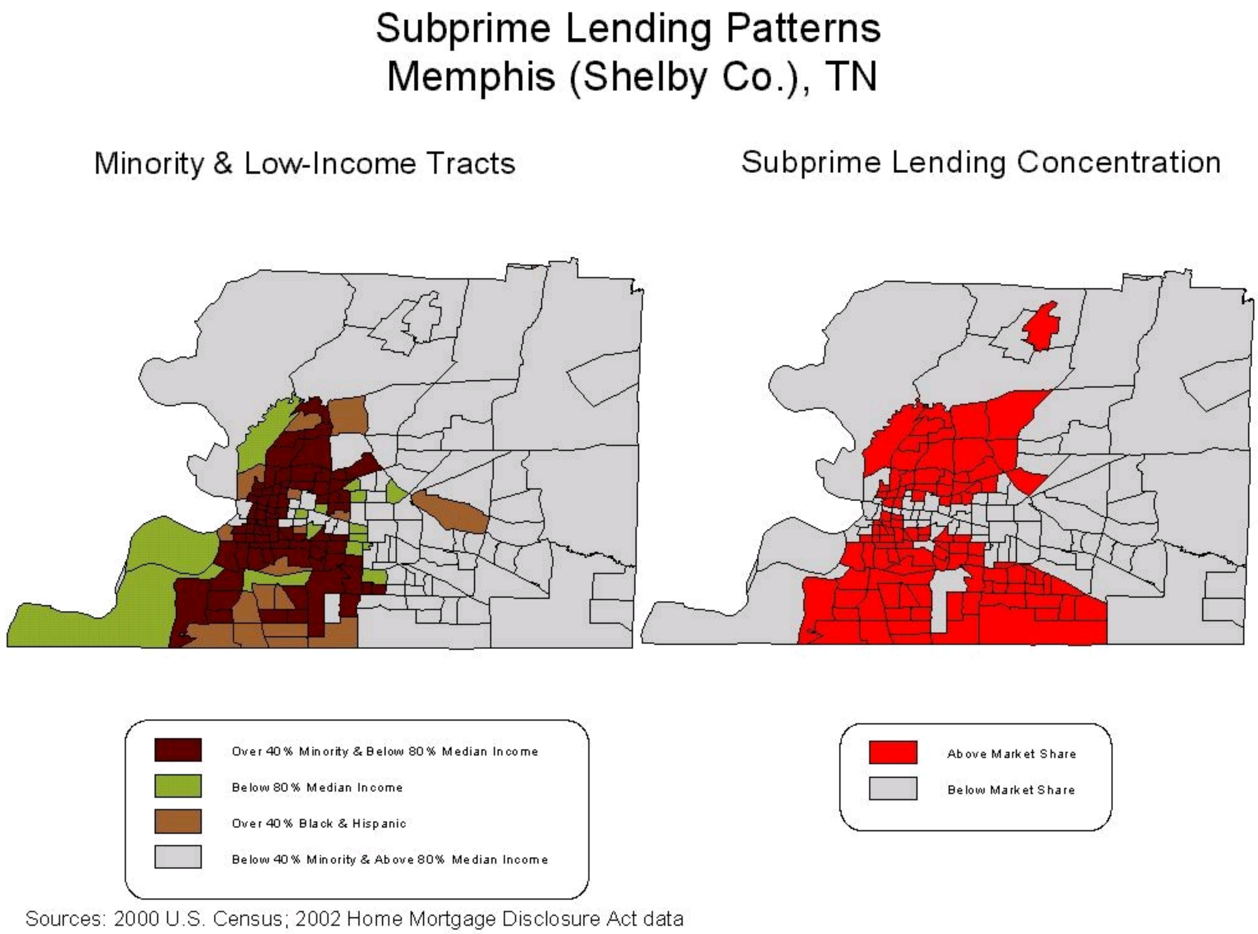
The lack of adequate regulation and oversight, particularly in the subprime market, is born out in the disastrous results our nation is facing. As the chart below, developed by Freddie Mac, indicates, while the GSEs hold a majority (57%) of the nation's outstanding mortgages, they only hold a relatively small percentage (19%) of the nation's seriously delinquent mortgages. Conversely, while Private Label Securities hold a smaller percentage of the nation's outstanding mortgages (16%), they hold the majority of the nation's seriously delinquent mortgages (63%).



[10] Chomsisengphet, S. and Pennington-Cross, A.; "The Evolution of the Subprime Mortgage Market", Federal Reserve Bank of St. Louis Review, January/February, 2006.

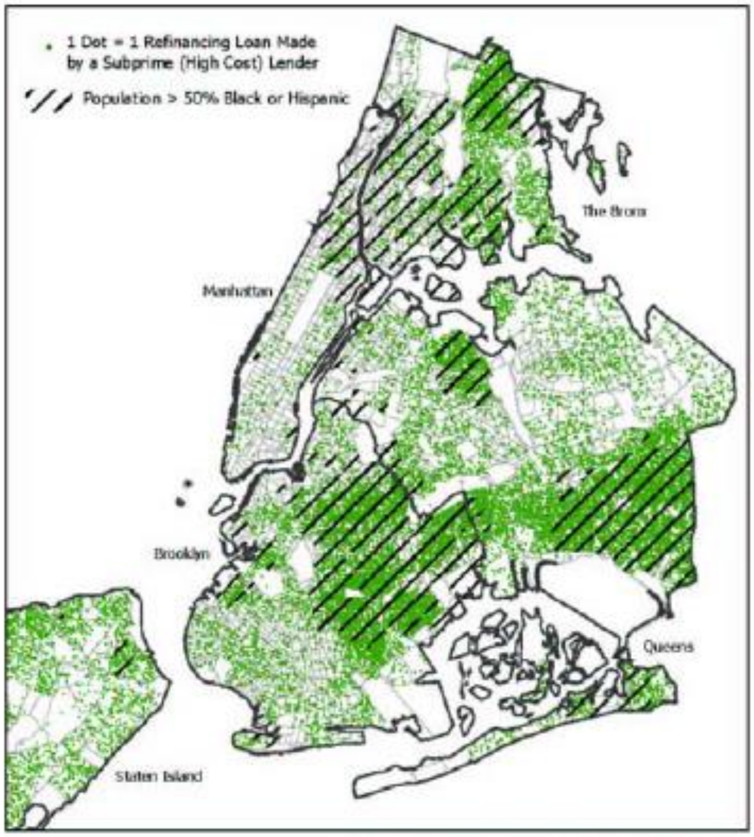
This discrepancy is even more troubling when one considers that African-Americans and Latinos received a disproportionate percentage of subprime loans. Subprime loans have a much higher propensity to default and this is a major reason why the foreclosure crisis has negatively impacted African-American and Latino neighborhoods.

As the maps for Memphis and New York below indicate, a disproportionate number of subprime loans were generated in racially minority neighborhoods.



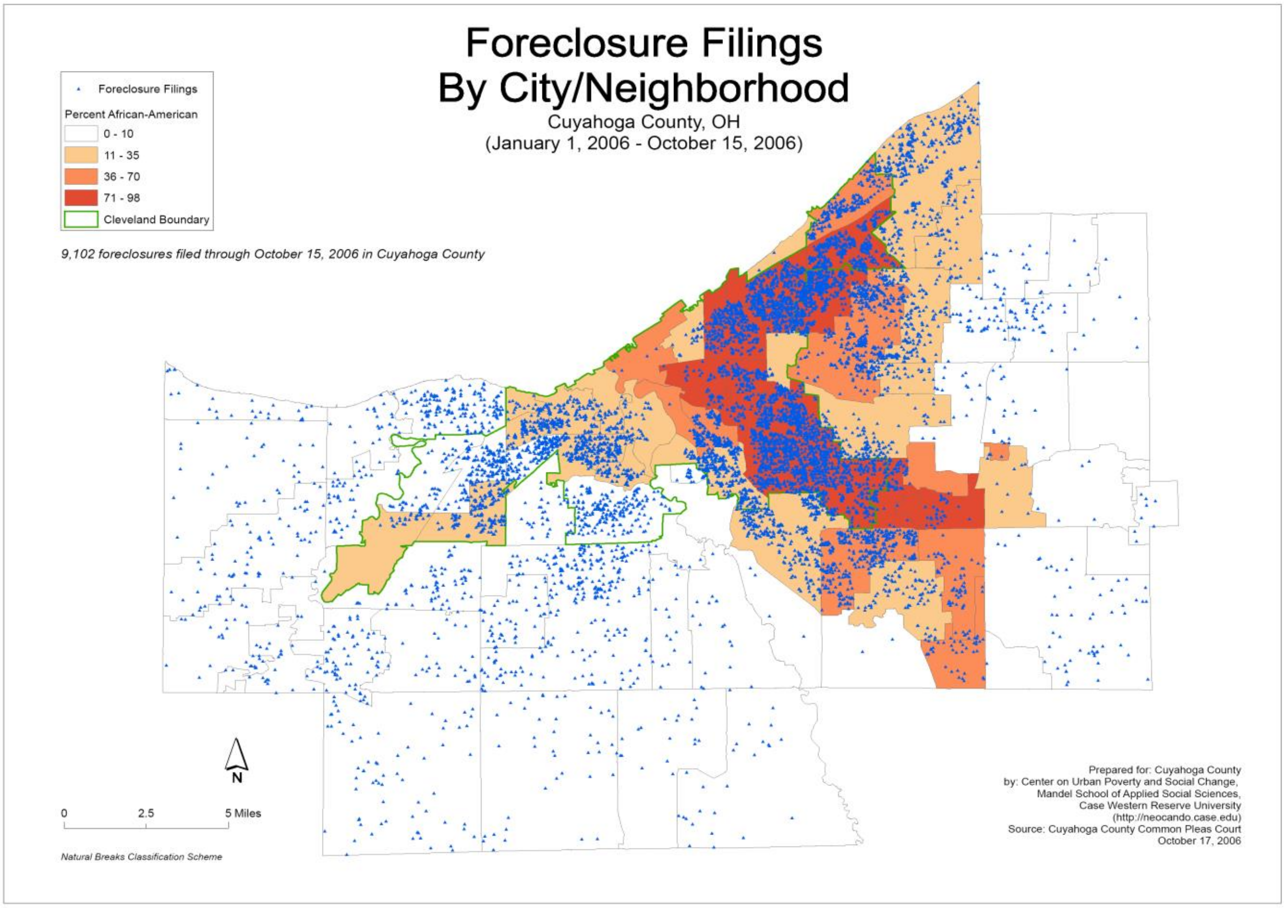
HIGH-COST REFINANCING MORTGAGES

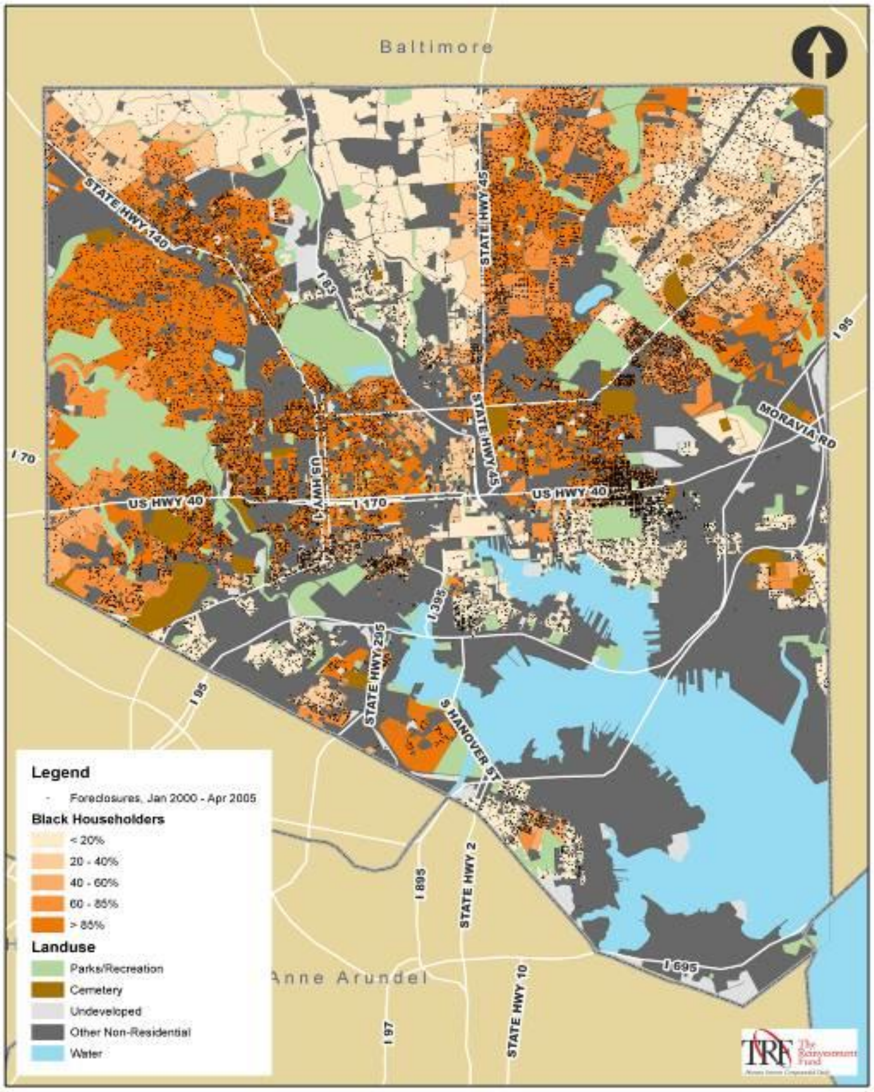
New York City

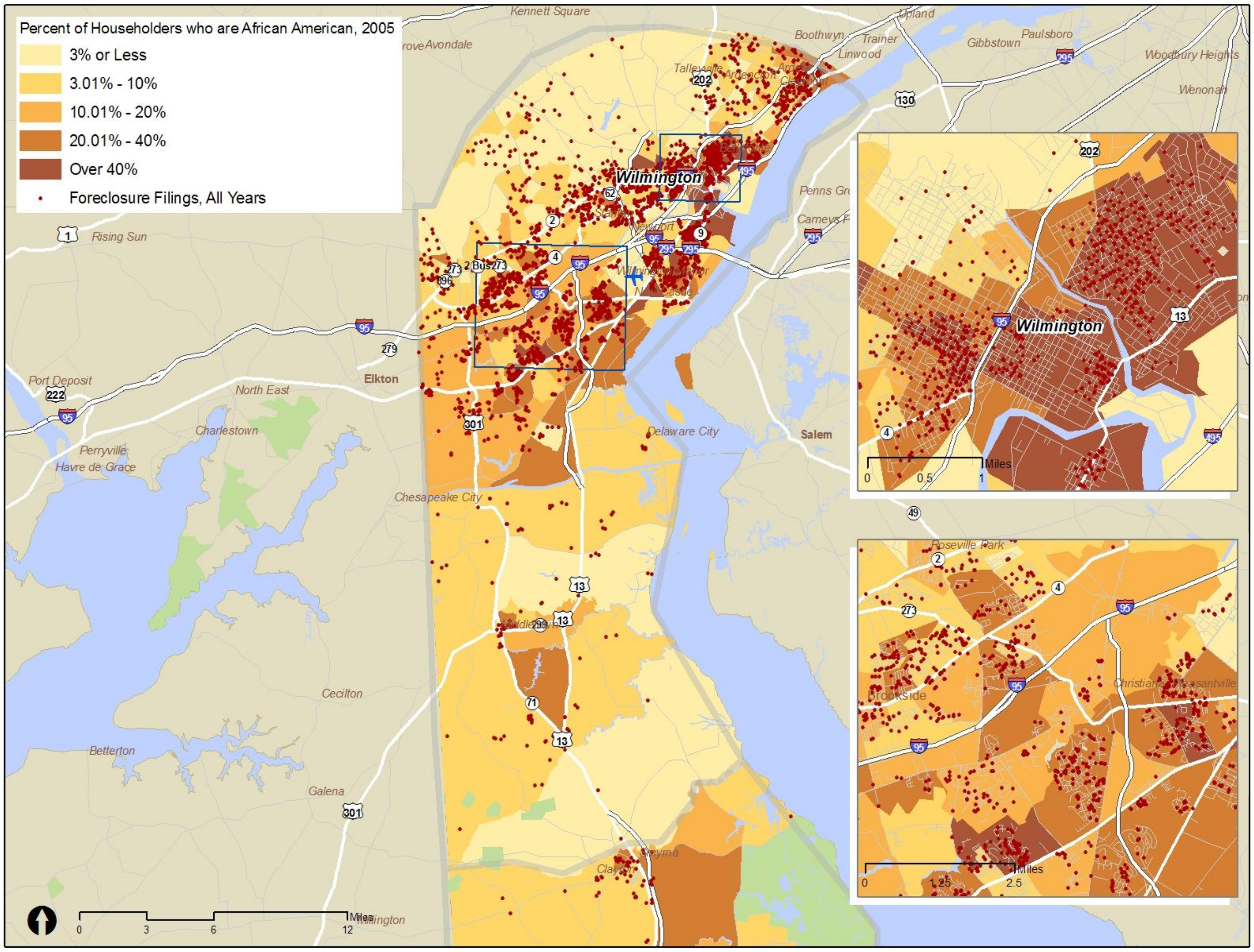


Sources: U.S. Census (2000); Home Mortgage Disclosure Act data (2003); HUD List of Subprime and Manufactured Home Lenders

The following maps illustrate the disproportionate effect subprime lending and the foreclosure crisis have had on African-American and Latino communities.


Foreclosure Filings
By City/Neighborhood
Cuyahoga County, OH
(January 1, 2006 - October 15, 2006)
Foreclosure Filings
Percent African-American
0 - 10
11 - 35
36 - 70
71 - 98
Cleveland Boundary
9,102 foreclosures filed through October 15, 2006 in Cuyahoga County
N
0
2.5
5 Miles
Natural Breaks Classification Scheme
Prepared for: Cuyahoga County
by: Center on Urban Poverty and Social Change,
Mandel School of Applied Social Sciences,
Case Western Reserve University
(http://neocando.case.edu)
Source: Cuyahoga County Common Pleas Court
October 17, 2006

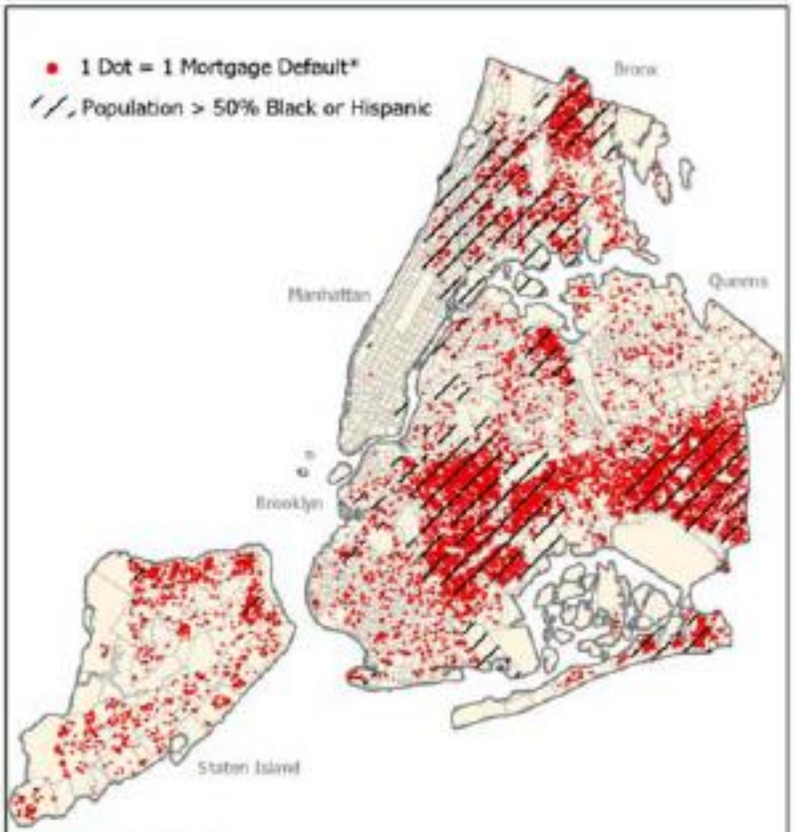

Baltimore
Anne Arundel
STATE HWY 140
I 83
STATE HWY 45
I 95
MORAVIA RD
I 70
US HWY 40
US HWY 1
I 170
STATE HWY 45
US HWY 40
I 395
STATE HWY 295
I 95
S HANOVER ST
I 895
STATE HWY 2
I 695
STATE HWY 10
I 97
Legend
Foreclosures, Jan 2000 - Apr 2005
Black Householders
< 20%
20 - 40%
40 - 60%
60 - 85%
> 85%
Landuse
Parks/Recreation
Cemetery
Undeveloped
Other Non-Residential
Water
TRF The Reinvestment Fund



The Reinvestment Fund

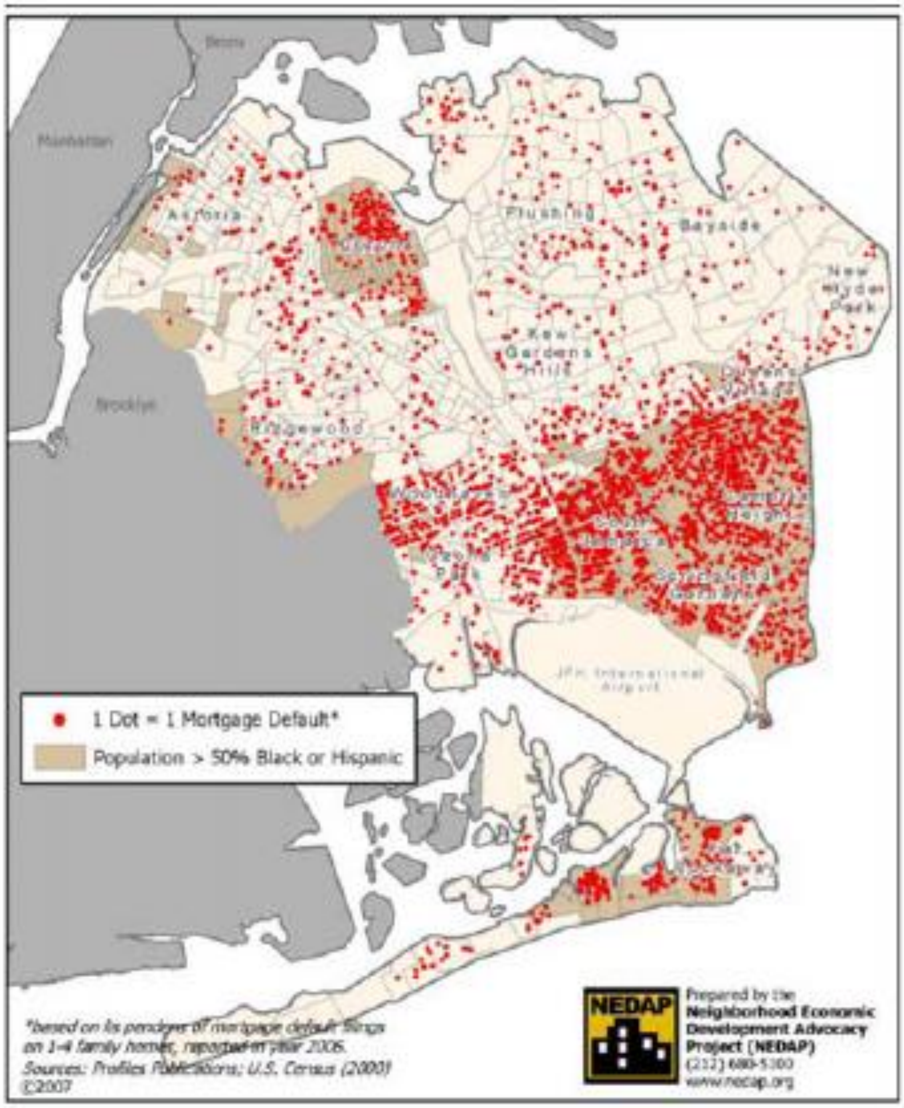
FORECLOSURE PATTERNS - 2006

New York City



Prepared by the
Neighborhood Economic Development Advocacy Project (NEDAP)
(212) 680-5100
www.nedap.org

**based on lis pendens of mortgage default filings on 1-4 family homes, reported in year 2006.*
Sources: Profiles Publications; U.S. Census (2000)



As these maps illustrate, not only have subprime loans been concentrated and disproportionately originated in predominately African-American communities, but, as a result, the incidence of seriously delinquent loans and foreclosures have disproportionately occurred in these areas.

Indeed, subprime lenders argued to the Federal Reserve Board and to federal legislators that they were filling a gap left by federally regulated lending institutions. They posited that their lending programs were making homeownership possible to record numbers of racial minorities.

These lenders were right in some respects. Subprime lenders did target African-American and Latino communities. In fact, one 2004 study conducted by the Federal Reserve Board and Wharton found that, even after controlling for credit risk, the rate of subprime lending in a census tract increased as the percentage of African-Americans in the census tract increased.[11] The truth is that financial institutions exploited the lack of presence of mainstream lenders in minority markets through the perpetuation of high cost loans, the use of tenuous housing schemes and other vehicles that one housing researcher termed "the underworld of real estate finance."[12]

Bias perpetuated by both the private and public sectors created and fostered the separate and unequal financial system that still exists today. Racism is still present in the American marketplace and it is inextricably tied to inequality in our lending and financial markets. We have a systemic problem, as a clear look at our financial landscape reveals.

- African-American and Latino homebuyers "face a statistically significant risk of receiving less favorable treatment than comparable Whites when they ask mortgage lending institutions about financing options."[13]
- African-Americans are much more likely than their White counterparts to receive a loan denial.[14]
- African-Americans and Latinos are more likely to receive payment-option and/or interest-only mortgages than their White counterparts. [15]
- African-Americans and Latinos are much more likely to receive a subprime loan than their White counterparts according to HMDA data. Roughly 54% of African-Americans and 47% of Latinos received subprime loans compared to approximately 17% of Whites.
- Even higher income African-Americans and Latinos receive a disproportionate share of subprime loans. According to one study that analyzed more than 177,000 subprime loans, borrowers of color are more than 30 percent more likely to receive a higher-rate loan than white borrowers, even after accounting for differences in creditworthiness.[16]

---

[11] Calem, Paul, et. al. *Neighborhood Patterns of Subprime Lending: Evidence from Disparate Cities, Housing Policy Debate* 15 (2004).
[12] Testimony of Calvin Bradford (Atlanta), and Testimony of Ira Goldstein (Atlanta), before the National Commission on Fair Housing and Equal Opportunity. See Commission report at http://www.nationalfairhousing.org/Portals/33/reports/Future_of_Fair_Housing.PDF.
[13] Turner, et al. *All Other Things Being Equal: A Paired Testing Study of Mortgage Lending Institutions.* The Urban Institute, 2002.
[14] Carr and Megboulugbe. "The Federal Reserve Bank of Boston Study on Mortgage Lending Revisited." *Journal of Housing Research*, Volume 4, Issue 2, Fannie Mae, 1993.
[15] *Exotic or Toxic? An Examination of the Non-Traditional Mortgage Market for Consumers and Lenders*. Consumer Federation of America, May, 2006.
[16] See Bocian, D. G., K. S. Ernst, and W. Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, Center for Responsible Lending, May 2006, p. 3.

- An analysis by the Center for Responsible Lending shows that borrowers residing in zip codes whose population is at least 50 percent minority are 35 percent more likely to receive loans with prepayment penalties than financially similar borrowers in zip codes where minorities make up less than 10 percent of the population.[17]
- Moreover, an ACORN study revealed that high income African-Americans in predominantly minority neighborhoods are three times more likely to receive subprime loans than low-income whites.[18]
- *A study of payday lending in Illinois revealed that payday lenders are much more concentrated in zip codes with high African-American and Latino populations[19]. Yet another study conducted in North Carolina revealed that payday lenders were disproportionately concentrated in African-American neighborhoods[20]. Slide #9 depicts the disproportionate concentration of payday lenders in Latino and African-American neighborhoods in Washington, D.C.*
- According to a HUD study analyzing homeownership sustainability patterns among first-time homebuyers, it takes African-Americans and Latinos longer to become homeowners. However, once homeownership status is attained, these groups lose their status the quickest. The study reveals that the average homeownership stay for Whites, Latinos and Blacks is 16.1 years, 12.5 years and 9.5 years respectively.
- After foreclosure, the duration of renting or living with relatives is 10.7 years for Whites, 14.4 years for African-Americans and 14.3 years for Latinos.[21]

The subprime industry's assertion that they were providing a much needed service to underserved communities must be rejected. Subprime lenders have long argued that their financing has made home possible for millions of consumers who would otherwise not be able to obtain homeownership status. However, a close examination of the subprime lending market reveals the contrary. Roughly 80% of the subprime market was comprised of 2/28s and 3/27s hybrid adjustable rate mortgages that were not sustainable.

Subprime lenders assert that the higher fees they charge are required due to the added risk that their borrowers present. However, both Fannie Mae and Freddie Mac have reported that a significant number of borrowers who received subprime loans would have qualified for a prime loan. Moreover, Federal Reserve Governor Edward Gramlich noted that half of subprime borrowers had credit scores of 620 or higher. (At the time of his statement, a score of 620 would qualify a borrower for a prime loan.) Even the subprime industry

---

[17]Bocian, D.G. and R. Zhai, *Borrowers In Higher Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans*, Center for Responsible Lending, January 2005.
[18] *The Impending Rate Shock: A Study of Home Mortgages in 130 American Cities*. ACORN 2006.
[19] The Woodstock Institute. Reinvestment Alert No. 25, Chicago, Il. (April, 2004). http://woodstockinst.org/document/alert_25.pdf.
[20] Davis, D., et al. *Race Matters: The Concentration of Payday Lenders in African-American Neighborhoods.* Center for Responsible Lending, Durham, NC., 2005
[21] Donald R. Haurin and Stuart S. Rosenthal, *The Sustainability of Homeownership: Factors Affecting the Duration of Homeownership and Rental Spells.* U.S. Department of Housing and Urban Development Office of Policy Development and Research, December, 2004.

itself boasted to its investors that a substantial portion of its borrowers were prime borrowers. According to a study conducted by the Wall Street Journal, this number may be as high as 61 percent.[22]

It is clear that borrowers of color are targeted by subprime lenders. However, traditional lenders operating in the financial mainstream are guilty of not targeting these same borrowers for prime lending products. Traditional lenders often do not locate bank branches in predominately African-American and Latino neighborhoods. They also have loan commission incentives that do not foster penetration of under-served communities. This is because lenders often are paid based on a percentage of the loan amount. This compensation policy encourages loan officers to focus their efforts on higher cost markets where they will make larger commissions. Unfortunately, the median and average housing values in predominately African-American and Latino communities are well below the median and average housing values in predominately White communities. This means, that for loan officers looking to maximize their profits, they will not focus their attentions and efforts on developing business in under-served areas.

While compensation structure works at cross purposes for the development of lending business in under-served areas for traditional, federally regulated lending institutions, it does just the opposite for non-traditional lenders. Because these lenders operate outside of the federal regulatory scheme, they can and have developed commission schemes that are onerous and work to strip equity from borrowers. These lenders, largely subprime lenders, utilize onerous prepayment penalty policies, yield-spread premiums, stacked fees, and excessive fees to generate their compensation. They can get away with these predatory and abusive practices because 1) they operate outside of federal regulatory oversight, 2) state agencies often do not have enough resources to effectively police non-federally regulated financial institutions; 3) federal regulators such as the OCC have pre-empted the institutions that they regulate from state laws and the pre-emption has been extended to the subsidiary, affiliate and holding companies of those regulated entities; and 4) the Federal Reserve only recently implemented more restrictive guidelines for non-traditional mortgages.

Latinos and African-Americans are also discriminated against when they seek loans at mainstream financial institutions. In the mid-1990s, NFHA conducted fair lending investigations that revealed discrimination based on race or national origin in two-thirds of almost 600 tests conducted in eight cities, including Boston. In two-thirds of the tests, whites were favored over African Americans and Latinos; in only 3 percent of the tests, African American and Latino testers were favored over white testers. In all cases, the African American and Latino testers were better qualified for the loans than their white counterparts.

NFHA's lending testing uncovered multiple ways in which Latinos and African-Americans were denied lending opportunities in the financial mainstream markets including: 1) differences in the qualitative and quantitative information provided to African-American and White loan seekers with African-Americans receiving inferior

---

[22] "Subprime Debacle Traps Even Very Creditworthy," *Wall Street Journal*, December 3, 2007.

treatment; 2) lenders' urging African-American customers but not white customers to go to another lender for service; 3) lenders' indicating to African-American but not White customers that loan procedures would be long and complicated; 4) African-Americans' being more likely than their equally qualified white counterparts that they would not qualify for a loan; and 5) White customers' being much more likely to be coached on how to handle the lending process and deal with problems in their financial profiles. A study and analysis of NFHA's testing concluded that NFHA's testing provided "convincing evidence of significant differential treatment discrimination at the pre-application stage."[23]

The Justice Department began investigating the prime and subprime markets in the 1990s and entered into important consent decrees in lending discrimination cases beginning with Decatur Federal Bank.

Up until 1999 the Department of Justice played an active role in successfully challenging discriminatory lending practices. There are a number of examples of effective fair lending enforcement including United States v. Long Beach Mortgage Company in which the Department alleged that Long Beach discriminated against African Americans, Latinos, women and older borrowers by charging these groups higher prices for loans. The DOJ's analysis in this case revealed that younger White men received the most favorable rates while older African-American female borrowers received the highest rates[24]. Other pricing cases included Untied States v. Fleet Mortgage Corp. and United States v. The Huntington Mortgage Corp.[25] In March, 2000, DOJ joined forces with HUD and the Federal Trade Commission to bring a predatory lending case against Delta Funding. A number of the victims identified by DOJ in this case were African-American senior females who had a lot of equity in their homes but who were cajoled into refinancing into high debt mortgages with excessive fees[26]. The Department also filed an amicus brief in the first reverse redlining case brought by private counsel and the Federal Trade Commission. This case, filed against Capital Cities Mortgage Corp. was the first case in which a court held that lenders who target minority communities to originate unsustainable mortgages violate the Fair Housing Act.[27]

However, the vigorous fair lending enforcement of the 1990's has evaporated. Unfortunately, the number of fair lending cases brought by DOJ has fallen precipitously and none of the cases brought has concerned predatory lending practices despite extensive research demonstrating the discriminatory patterns so prevalent in the subprime market. Furthermore, despite the 1992 Interagency Policy Statement on Fair Mortgage Lending Practices stating that violations of fair lending laws could be proven by application of a disparate impact analysis and despite support for such a standard in many court of appeals decisions, the Department of Justice announced in 2003 that it would no

[23] Turner and Skidmore. *Mortgage Lending Discrimination: A Review of Existing Evidence*. The Urban Institute, 1999.
[24] United States v. Long Beach Mortgage Company, Case No. CV-96-6159DT(CWx) (C.D. Cal. 1996).
[25] United States v. Fleet Mortgage Corp., Case No. CV 96 2279 (E.D.N.Y. 1996) and United States v. The Huntington Mortgage Company, Case No. 1:95 CV 2211 (N.D. Ohio 1995.
[26] United States v. Delta Funding Corp., Case No. CV 00 1872 (E.D.N.Y. 2000).
[27] Hargraves v. Capital City Mortgage Corp. C.A. No. 98-1021 (U.S. District Court, D. D.C.

longer apply that standard. The rejection of this well established standard greatly reduces the ability to vigorously enforce fair lending laws.

There has been a dearth of enforcement at the federal level. Thus efforts to combat discriminatory lending have fallen on civil rights agencies, private attorneys and municipalities dealing with the effects of the crisis. While they have little resources to combat the onslaught of abusive lending practices, they have been initiating innovative litigation strategies. For example, the City of Baltimore recently sued Wells Fargo for discriminatory lending practices alleging that the discrimination resulted in an unusually high number of foreclosures in Baltimore's minority neighborhoods. Unfortunately, without the attention and focus of the federal government on predatory, redlining and discriminatory lending practices, prospects for meaningful redress appear dim. The federal government has the enforcement resources necessary to fulfill the litigation needs of such cases and its absence from the enforcement effort has hindered legal efforts to attack the discrimination underlying the foreclosure crisis.

Justice gained important insights into subprime lending, but failed to use this information to initiate in-depth investigations into the largest subprime lenders such as Countrywide Home Loans, The Associates and others. Neither did DOJ share its knowledge of how these lending markets functioned with HUD, FHAP agencies or private fair housing centers that could have initiated local investigations. As a result, we saw the subprime market expand from less than 50 companies in the early 1990s to more than 400 companies capable of exploiting and flipping the homes of seniors with equity, refinancing homeowners of color into exploding ARM mortgages and finally targeting middle income homeowners and pushing exotic and unsustainable loan products.

There appears to be little knowledge sharing between DOJ and federal regulatory agencies. Neither seems to have made concerted efforts to join forces and resources to combat predatory and discriminatory practices. Federal regulators made few referrals of fair lending issues to Justice. But of the referrals made, few of those have seemed to result in enforcement actions. America might still be facing a foreclosure problem today, but it would not be a crisis if regulatory agencies, HUD and Justice had vigorously investigated fair lending violations.

Sadly, government entities do not work in a coordinated effort to address systemic discrimination housing issues. This country desperately needs an entity with the authority, resources, knowledge and mandate to conduct and direct coordinated systemic investigations utilizing both the private and public sectors in enforcing this nation's fair housing laws. It is imperative that we fix this problem and we must do it now. Many of our society's ills, whether it be environmental discrimination, predatory lending, educational and health disparities or neighborhood disinvestment, can be directly and inextricably linked to residential segregation.

The Community Reinvestment Act

Looking for a scapegoat, some have attempted to blame the foreclosure crisis on the Community Reinvestment Act, claiming that it forced lenders to make risky loans to uncreditworthy borrowers, and in particular, racial minority borrowers. Nothing could be further from the truth.

In the 1970s, coalitions of community organizations played an important role in the passage of some of the most powerful financial reform legislation, including the Home Mortgage Disclosure Act of 1975 ("HMDA") and the Community Reinvestment Act of 1977 ("CRA"), legislation which helped local community organizations begin rebuilding neighborhoods that had been devastated by discriminatory disinvestment and redlining. Through HMDA, academics, regulators and advocacy groups developed a large body of research, most of which showed significant lending disparities when comparing whites with African Americans and Latinos.

The CRA requires depository lending institutions to meet the credit needs of their entire delineated communities in a way that comports with safety and soundness standards. It has resulted in billions of dollars of quality credit investments being made in under-served communities. Community advocates have used the CRA to increase lending levels in historically redlined areas, develop customized lending programs that resulted in sustainable, affordable mortgages for disinvested areas, garner full-service bank branches, broaden loan and financial services offered in under-served communities, provide for much needed small business lending in disinvested communities, and halt bank branch closures. It has served as a much needed tool and incentive for mainstream lenders to meet the credit needs of a broader range of consumers and to provide quality, affordable, sustainable credit to communities that most need it.

The following lists a number of reasons why placing blame for the foreclosure crisis on the CRA is absurd.

- The CRA applies only to depository institutions regulated by the Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation, and the Office of Thrift Supervision with assets of $1.033 billion or more. Most subprime lenders were not subject to the legislation because they were not depository institutions. Researchers have noted that at the most, CRA covered entities only originated 1 in 4 subprime loans[28] and when they did, they were typically at lower rates than loans made by non-regulated entities and they were less likely to be sold[29].
- The CRA requires covered financial institutions to meet the credit needs of their entire delineated communities in a manner that is consistent with safe and sound lending practices.

[28] Barr, M. February 13, 2008. "Prepared Testimony of Michael S. Barr before the United States House Committee on Financial Services.

[29] Traiger & Hinckiley LLP. (2008). The Community Reinvestment Act: A Welcome Anomaly in the Foreclosure Crisis.

- The CRA was passed in 1977. The last legislative change to the Act occurred in 1999, long before the financial crisis hit. Indeed, the most problematic subprime loans were the 2006 and 2007 vintages. The timeline does not fit to lay even partial blame for the financial crisis at the feet of the CRA.
- The argument that CRA forced lenders to provide mortgages to unworthy borrowers does not hold water since multiple studies have revealed that many subprime borrowers actually qualified for prime mortgages.
- The argument that CRA forced lenders to provide mortgages to unworthy borrowers does not hold water because the CRA does not have private right of action. It is "soft" law used by community groups and regulators to encourage covered institutions to provide loans to borrowers in under-served communities. That the majority of loans originated in under-served communities – even up until 2007 – were originated by non-covered, unregulated financial institutions points to the "softness" of the law.
- The CRA does not, and never has, required lenders to provide subprime loans, or any type of loans, to unworthy borrowers. Nor does the CRA impose harsh penalties on lenders for not doing so. In fact, the CRA requires lenders to make loans in a safe and sound manner.

The Impact of Predatory Lending

As a result of past and present lending discrimination African Americans own less property today than they did more than 80 years ago. African-Americans owned about 15 million acres of land in 1920. Today, they hold just over 1.1 million acres.[30]

Despite legal gains in civil rights, asset inequality in America has actually been growing rapidly during the last 20 years. The assets that are owned by current generations are heavily dependent on the legacies of their families. Latinos and African-Americans still suffer from historical discrimination that prohibited them from accessing and gaining wealth. Indeed, patterns of racial discrimination and residential segregation have contributed to deflated property values in minority communities. It has also contributed to the inability of African-Americans, Latinos and other racial minorities to obtain quality credit. Because Whites were helped by the homeownership development policies of the '30s, '40s, and '50s and African-Americans, Latinos and other minorities were not, Whites have had a longer time to build and sustain wealth. The wealth that Whites have been able to accumulate and sustain has compounded so that White wealth is quite diversified.

Home equity is crucial to net financial wealth. However, it is less crucial for Whites than it is other racial minorities. This is because home equity comprises a smaller percentage of net worth for Whites as compared to African-Americans and Latinos. About 2/3 of the wealth for Latinos and African-Americans is held in housing equity. Because Latinos and African-Americans hold a disproportionate percentage of their wealth in home

[30] Testimony of James Carr (Atlanta) before the National Commission on Fair Housing and Equal Opportunity. The Commission report is available at http://www.nationalfairhousing.org/Portals/33/reports/Future_of_Fair_Housing.PDF

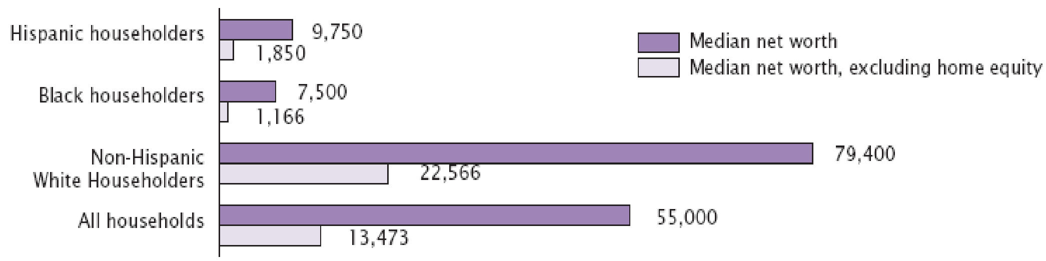
equity, the foreclosure crisis will have an even greater impact on these consumers. According to a HUD study analyzing homeownership sustainability patterns among first-time homebuyers, it takes African-Americans and Latinos longer to become homeowners. However, once homeownership status is attained, these groups lose their status the quickest. The study reveals that the average homeownership stay for Whites, Latinos and Blacks is 16.1 years, 12.5 years and 9.5 years respectively. After foreclosure, the duration of renting or living with relatives is 10.7 years for Whites, 14.4 years for African-Americans and 14.3 years for Latinos.[31]

Loss of wealth will be one of the most critical fallouts of the foreclosure crisis for African-Americans and Latinos. These groups start out at a disadvantage when it comes to median net worth. On average, for every dollar in net worth held by Whites, Latinos have about 12 cents of net worth and African-Americans have about 9 cents. If home equity is excluded, for every dollar in net worth held by Whites, Latinos have about 8 cents of net worth and African-Americans have about 5 cents.

Figure 6.

Median Net Worth and Median Net Worth Excluding Home Equity of Households by Race and Hispanic Origin of Householder: 2000

(2000 dollars)



Source: U.S. Census Bureau, Survey of Income and Program Participation, 1996 panel.

Source: "Net Worth and Asset Ownership 1998-2000". Household Economic Studies. U.S. Census Bureau (2003)

In his testimony before the National Commission on Fair Housing and Equal Opportunity, Melvin Oliver discussed the profound effects of predatory lending practices and the foreclosure crisis on borrowers of color:

> "No other recent economic crisis illustrates better the saying "when America catches a cold, African Americans and Latinos get pneumonia" than the subprime mortgage meltdown. African Americans, along with other minorities and low-income populations have been the targets of the subprime mortgage system. Blacks received a disproportionate share of these loans, leading to a "stripping" of their hard won home equity gains of the recent past and the near future. To understand better how this has happened we need to place this in the context of

---

[31] Donald R. Haurin and Stuart S. Rosenthal, *The Sustainability of Homeownership: Factors Affecting the Duration of Homeownership and Rental Spells.* U.S. Department of Housing and Urban Development Office of Policy Development and Research, December, 2004.

> the continuing racial wealth gap and its intersection with the new financial markets of which subprime is but one manifestation.
>
> Family financial assets play a key role in poverty reduction, social mobility, and securing middle class status. Income helps families get along, but assets help them get and stay ahead. Those without the head start of family assets have a much steeper climb out of poverty. This generation of African Americans is the first one afforded the legal, educational, and job opportunities to accumulate financial assets essential to launch social mobility and sustain well-being throughout the life course.[32]"

The Report goes on to state, "Mr. Oliver's testimony is even more poignant when it is considered that the subprime market was not a home purchase market until more recently. For over a decade, the majority of loans originated in the subprime market were refinance loans. Thus the loans were not contributing appreciably to homeownership development. Moreover, first time homebuyers only comprised about 10% of the subprime market. This lead the Center for Responsible Lending to accurately project that we would realize a sharp decline in homeownership particularly among African-American and Latino homebuyers and that subprime lending would result in a net drain on homeownership[33]. A very unfortunate result of this crisis has been the loss of homeownership for thousands of minority seniors who had worked so hard to build equity and financial security only to see it stripped away.[34]"

There is no doubt that we are financial markets are in crisis and that we are in the midst of a foreclosure catastrophe. The Mortgage Bankers Association recently released figures illustrating that the US has not seen this level of mortgage defaults since 1953[35]. Entire communities have been decimated by rampant foreclosures, essentially destroying the communities' stability and wiping out individual wealth accrual that had occurred since the passage of the Community Reinvestment Act.

Predatory lending practices and foreclosures do not just affect the individual borrower or homeowner. The entire community is harmed. This crisis has lead to a decline in property values, a drop in foreclosure rates, restrictive lending policies, seizing of the financial markets, loss of consumer confidence, abandoned homes, increased risk of vandalism, theft, crime, drugs and fire, increases in homelessness – particularly among children, increased maintenance costs for municipalities, deterioration of schools,

---

[32] The Future of Fair Housing: Report of the National Commission on Fair Housing and Equal Opportunity, 2008, pg. 34-35. Available at: http://www.nationalfairhousing.org/Portals/33/reports/Future_of_Fair_Housing.PDF

[33] Center for Responsible Lending, March 27, 2007. Subprime Lending: A Net Drain on Homeownership; CRL Issue Paper No. 14.

[34] The Future of Fair Housing: Report of the National Commission on Fair Housing and Equal Opportunity, 2008, pg. 35. Available at: http://www.nationalfairhousing.org/Portals/33/reports/Future_of_Fair_Housing.PDF

[35] Harney, Kenneth, *Severity of mortgage-foreclosure crisis depends on type of loan, where you live.*, The Seattle Times, September 15, 2007.

unemployment, and neighborhood destabilization. As described in the introduction of this paper, it has caused taxpayers unprecedented levels of funds.

If we do not take seriously both of the purposes of the Fair Housing Act, the elimination of housing discrimination and the achievement of residential integration, this country will be doomed to repeating multiple cycles of discrimination, segregation and the disinvestment and stifling of racially isolated communities.

NFHA along with several other civil rights organizations met with Chairman Ben Bernanke in July, 2007 to discuss fair lending and fair housing concerns as it related to the lending and foreclosure crisis. Among other things, the group renewed its call for a foreclosure moratorium and the need for the Federal Reserve to use its authority under the Home Ownership and Equity Protection Act to prevent further abuses in the mortgage market. The group also expressed its concern that the problems replete in the subprime market would affect other segments of the financial market including the prime mortgage market, the auto lending market and even the global economy. The Chairman strongly disagreed stating that the problems would be contained in the subprime market. The Chairman reiterated this position the following month again asserting that the crisis "has been restricted only to the sub-prime market". The Chairman also predicted moderate growth for the economy in the remainder of 2007 and a turnaround in the economy in 2008.

Stewart Douglas, *Federal Reserve Warns on Subprime Impact*, August 3, 2007, Finance Markets, available at: http://www.financemarkets.co.uk/2007/08/03/federal-reserve-warns-on-sub-prime-impact/

Recommendations for foreclosure relief and addressing predatory lending practices

The following recommendations are cited from the report of the National Commission on Fair Housing and Equal Opportunity entitled, The Future of Fair Housing. The Report and the following recommendations can be found at:
http://www.nationalfairhousing.org/Portals/33/reports/Future_of_Fair_Housing.PDF

1. No rescue funds should be provided to financial or housing institutions with fair housing cases pending against them with DOJ, HUD, or a HUD approved FHAP agency until the complaint has been resolved.

2. Improve fair lending enforcement by the federal government by (1) improving coordination between the new independent agency[36] to administratively enforce the Fair Housing Act, the Department of Justice, the bank regulatory agencies and private fair housing groups; (2) prioritize fair housing and fair lending litigation to identify and eliminate discriminatory predatory lending practices and policies; (3) ensure legal standard for violation of FHA and ECOA includes the long standing judicial support of the disparate impact standard.

---

[36] The Report calls for the establishment of a new independent agency to enforce the Fair Housing Act.

3. Federal regulators should [sic] examine policies like the yield spread premium which provide incentives to predatory lending practices and take necessary steps to eliminate them through regulation or legislation.

4. The Secretary of HUD should urge the President to re-convene the President's Fair Housing Council as set forth in Executive Order 12892 and specifically order the Council to review fair lending violations in the marketing, underwriting, origination, and servicing of mortgage loans. Moreover, the Council should review fair lending violations in the implementation of homeownership preservation, foreclosure prevention and loss mitigation efforts.

5. HUD should implement a special fair lending initiative to fund the investigation and redress of discriminatory practices in the lending sector. HUD should also make funding available,, as a part of this initiative, for partnership efforts among multiple Qualified Fair Housing Organizations.

Additional Recommendations:

6. The federal government should insure that each entity receiving TARP funds or other federal dollars abides by the requirement to affirmatively further fair housing as set forth in the Fair Housing Act and Executive Orders 11063 and 12892.

7. The federal government should set aside funds for the specific purpose of conducting research into the nature and extent of lending discrimination and predatory lending practices and the present day impact they are having on under-served communities as well as the larger society. Research initiatives should also include the impact of the foreclosure crisis.

8. Congress should implement regulatory reforms that will help strengthen civil rights and consumer protections and eliminate the current two-tiered financial system that puts minority and low and moderate income consumers at risk. Regulatory reforms should also: 1) effectively manage risk, 2) require sufficient transparency in the financial markets, and 3) ensure fair dealings.