



# REINVESTMENT ALERT

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## New Mortgage Pricing Data Sheds Light on Subprime Market

### Introduction<sup>1</sup>

An analysis of new federal mortgage lending data confirms that high cost subprime lending tends to be concentrated in minority communities and to African American and Hispanic borrowers. Subprime loans are mortgages to borrowers with tarnished or limited credit that are priced higher than “prime” loans to compensate lenders for the increased risk associated with the borrower. As the subprime lending industry expanded during the 1990s, there was a growing concern that these loans were being targeted to minority communities and borrowers regardless of borrower credit quality. Although responsible subprime lending has been credited with expanding access to mortgage finance in previously underserved markets, the growth of abusive, predatory subprime lending, has been blamed for stripping hard earned equity from lower-income, minority, and elderly homeowners and for the foreclosure epidemic plaguing lower-income and minority communities in cities across the country.

For years, researchers have shown that subprime lenders disproportionately target minority communities and borrowers regardless of income,<sup>2</sup> but available data limited these analyses to the characteristics of the lender rather than the actual pricing of the loan. However, new data collected by federal regulators under the Home Mortgage Disclosure Act (HMDA) provide for the first time information on the pricing of subprime loans. Starting with data collected in 2004 data, lenders are now required to report the spread (or difference) between a loan’s annual percentage rate (APR) and the U.S. Treasury rate for securities of comparable maturities if that spread is equal to or greater than 3 percentage points for first lien mortgages or equal to or greater than 5 percentage points for junior lien mortgages. Rather than confining analysis of the subprime market to those lenders who specialize in subprime lending, the new data will allow for analysis of all lenders who make subprime loans including banks, thrifts, and mortgage companies previously classified as “prime” lenders.

### Findings

Although the complete 2004 HMDA dataset will not be available until late summer 2005, Woodstock Institute has obtained 2004 HMDA data from most of the Chicago area’s top 20 mortgage lenders and their affiliates.<sup>3</sup> For the purposes of this report, we classify any loan where an APR spread was reported

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<sup>1</sup> The author would like to thank Tim Westrich for his assistance in the production of this Alert.

<sup>2</sup> For example, see Immergluck, Dan and Marti Wiles. 1999. *Two Steps Back: The Dual Mortgage Market, Predatory Lending, and the Undoing of Community Development*. Woodstock Institute: Chicago, IL; California Reinvestment Coalition. 2005. *Who Really Gets Home Loans? Year Eleven*. California Reinvestment Coalition: San Francisco, CA; National Community Reinvestment Coalition. 2003. *Broken Credit System: Discrimination and Unequal Access to Affordable Loans by Race and Age*. National Community Reinvestment Coalition: Washington, D.C.

<sup>3</sup> In 2003, these lenders made over 50 percent of Chicago area single-family loans. The dataset includes over 240,000 conventional mortgages on single-family properties. The appendix lists all lenders whose data was included the study. The data provided to Woodstock Institute has not been cleaned by banking regulators and may contain errors.

as “subprime” and any loan for which the spread was not reported as “prime.” An analysis of conventional single-family mortgage lending for the Chicago six-county area shows:

- **Minority borrowers were more likely to receive subprime loans.** Table 1 shows that in the Chicago region, 13 percent of conventional first lien mortgages were subprime. However, over 34 percent of African American borrowers received subprime loans and 16 percent of Hispanic borrowers received subprime loans. Examining junior lien mortgages<sup>4</sup>, roughly 35 percent of the area’s conventional junior mortgages were subprime. However nearly 60 percent of junior lien mortgages to African American borrowers were subprime, and 57 percent of these loans to Hispanics were subprime.

**Table 1.**

**Share of Conventional Single-Family Mortgages  
That are Subprime by Race of Borrower, 2004**

	White	African American	Hispanic	Other	Total
First Liens	7.1%	34.1%	16.0%	5.1%	11.6%
Junior Liens	25.0%	58.7%	57.0%	31.6%	34.7%
First and Junior Liens	8.3%	36.1%	20.1%	6.6%	13.3%

- **Minority borrowers are more likely to get subprime loans regardless of income.** Table 2 shows that African American and Hispanic borrowers are more likely than white borrowers to get subprime loans at all income levels. For example, nearly 29 percent of upper-income African American borrowers and 19 percent of upper-income Hispanic borrowers received subprime loans compared to 6 percent of upper-income white borrowers. In other words, upper-income African American borrowers were nearly five times more likely to receive a subprime loan than upper-income white borrowers, and upper-income Hispanics were over twice as likely to get a subprime loan as upper-income whites.

**Table 2.**

**Share of Conventional Single-Family Mortgages that Are  
Subprime By Income and Minority Level of Borrower, 2004<sup>5</sup>**

	White	African American	Hispanic	Other	Total
Low-Income	11.8%	39.3%	15.3%	8.2%	20.2%
Moderate-Income	11.4%	42.0%	21.7%	8.0%	19.3%
Middle-Income	11.0%	37.7%	22.5%	7.9%	16.3%
Upper-Income	6.1%	28.9%	18.7%	5.4%	8.5%
Total	8.3%	36.1%	20.1%	6.6%	13.3%

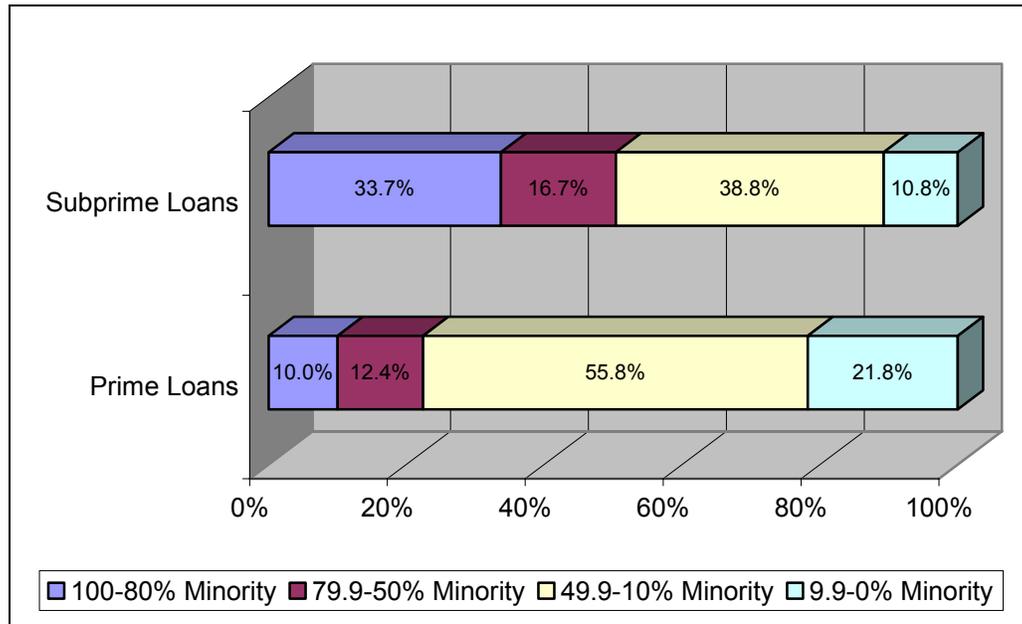
<sup>4</sup> Because junior lien mortgages are subordinate to first lien mortgages, and there is a greater risk that a junior lien holder will not be repaid. Thus, junior lien mortgages generally have a higher cost.

<sup>5</sup> A low-income borrower had an income of less than 50 percent of the area median income; moderate-income borrowers had an income between 50 and 79 percent of the area median income; middle income borrowers had an income between 80 and 119 percent of the area median income; and upper income borrowers had an income greater than 120 percent of the area median income.

- Subprime loans are concentrated in minority census tracts.** Chart 1 illustrates that nearly 34 percent of the Chicago area's subprime loans were in census tracts with populations 80 percent or greater minority. Conversely, only 10 percent of the area's prime loans were in these tracts. Over 50 percent of the area's subprime loans were in census tracts 50 percent or greater minority, while less than 23 percent of the area's prime loans were in these tracts. Figure 1 maps the Chicago area by the share of loans in each census tract that were subprime. It shows that tracts on the south and west sides of Chicago and in south and west suburban Cook County have high shares of subprime loans relative to the rest of the region. Sections of Lake County around Waukegan and in Kane County around Aurora also have high shares of loans that are subprime. Not surprisingly, most of these areas are 80 percent or greater minority. Communities with the lowest share of loans that are subprime are located in the north side of Chicago, north suburban Cook County, Lake County, and Dupage County. These areas are primarily middle- and upper-income and predominantly white.

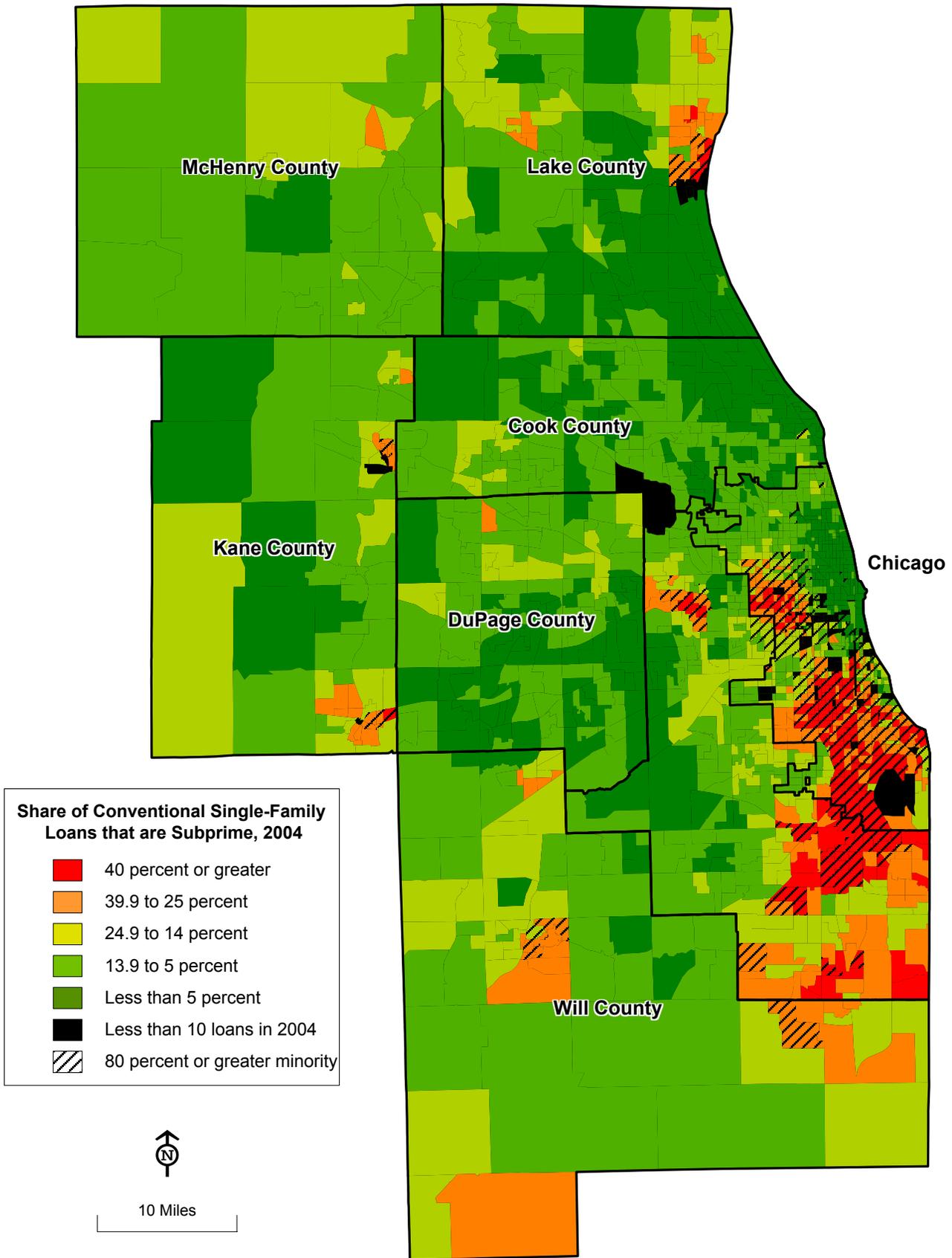
**Chart 1.**

**Distribution of Chicago Area Conventional Prime and Subprime Single-Family Mortgages by Minority Level of Census Tract, 2004**



- Middle-income, minority census tracts have the lowest share of prime loans.** The concentration of subprime loans in minority communities is not strictly related to income. An examination of area census tracts by income and minority level (Table 3) shows that nearly 38 percent of loans to middle-income census tracts that are 80 percent or greater minority were subprime. This was the highest subprime lending share in any type of census tract. Overall, roughly 15 percent of loans in middle-income census tracts were subprime and just over 34 percent of loans in highly minority census tracts were subprime. In tracts between 80 and 50 percent minority, middle-income areas also had the highest share of subprime loans, nearly 19 percent. Middle- and upper-income minority communities consistently have a higher share of subprime loans than non-minority, middle- and upper-income areas.

**Figure 1. Distribution of Chicago Area Subprime Lending, 2004**



**Table 3.****Share of Conventional Single-Family Mortgages that Are Subprime By Income and Minority Level of Census Tract, 2004**

<b>Income Level</b>	<b>Tract Minority Share</b>				<b>Total</b>
	<b>100-80%</b>	<b>79.9-50%</b>	<b>49.9-10%</b>	<b>9.9-0%</b>	
Low-Income	34.5%	9.3%	1.5%	NA	30.7%
Moderate-Income	33.2%	16.8%	14.2%	17.6%	24.1%
Middle-Income	37.8%	18.8%	12.6%	11.6%	14.7%
Upper-Income	28.4%	13.2%	6.2%	4.9%	5.9%
<b>Total</b>	<b>34.2%</b>	<b>17.2%</b>	<b>9.7%</b>	<b>7.1%</b>	<b>13.3%</b>

**Conclusion**

The above analysis uses newly available HMDA data on the pricing of subprime loans to confirm what most have long suspected: subprime loans are concentrated in minority census tracts and to minority borrowers regardless of income. The cost of subprime and predatory mortgage lending can be significant to both an individual borrower and the surrounding community. Borrowers with prime credit who receive higher cost subprime loans can end up paying tens to hundreds of thousands of dollars in additional interest over the life of a mortgage. Subprime loans are also more likely to have high fees and features such as onerous prepayment penalties that prevent a borrower from getting out of a high cost loan and into a better priced one. Because of their high cost, risky nature, and onerous terms, subprime mortgages are more likely to enter into default and foreclosure than prime loans. If these loans, and subsequent foreclosures, are concentrated in lower-income or minority communities, these neighborhoods will bear a disproportionately high portion of the economic, social, and emotional costs related to foreclosures.

The new HMDA data will shed increased light on the nature of the subprime market, but missing underwriting variables such as credit scores limit its use in holding lenders publicly accountable for apparent disparities in their loan pricing. As the full 2004 HMDA dataset becomes available, government regulators, researchers, and fair lending advocates will be able to utilize it to gain further insight on the nature of the subprime market and be able to better target lenders who may be discriminating not only in terms of to whom or where they lend, but also by how they price the loans they originate. Government regulators have a responsibility to enforce fair lending laws and ensure that borrowers who qualify for prime loans are getting appropriately priced mortgages. However, the best way to effectively ensure that financial institutions are pricing loans equitably is to require them to publicly disclose credit scoring data used in underwriting. This will add transparency to the mortgage lending process, hold lenders publicly accountable for their pricing decisions, and better ensure that all borrowers are receiving fairly priced loans.

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### Appendix

#### **Distribution of Subprime Lending by Race/Ethnicity of Borrower for Top Chicago Area Lenders, 2004**

Lender Group	African				Total
	White	American	Hispanic	Other	
American Home Mortgage	4.2%	15.3%	10.2%	5.2%	5.6%
Ameriquest	49.5%	59.6%	47.5%	46.1%	52.6%
Bank of America	0.1%	0.2%	0.1%	0.2%	0.1%
Charter One*	0.1%	0.0%	0.0%	0.0%	0.1%
Citigroup	8.3%	37.2%	20.8%	6.8%	12.8%
Countrywide	11.1%	41.9%	20.5%	5.4%	15.8%
Flagstar Bank	1.6%	7.5%	1.2%	0.3%	2.0%
GMAC	3.6%	27.2%	15.6%	5.1%	6.5%
Harris	1.9%	4.8%	2.4%	1.0%	2.3%
J.P. Morgan Chase	2.6%	14.4%	6.1%	2.0%	4.4%
Lasalle Bank	0.4%	2.8%	1.2%	0.3%	0.6%
MidAmerica Bank	0.0%	0.4%	0.1%	0.0%	0.0%
National City	10.6%	36.6%	20.0%	11.5%	16.8%
New Century Mortgage*	53.0%	43.9%	51.5%	52.4%	50.3%
Option One	42.7%	61.3%	44.5%	40.8%	49.4%
RBC	0.8%	2.1%	0.0%	0.0%	0.9%
Washington Mutual	3.9%	29.7%	16.0%	4.3%	8.4%
Wells Fargo	6.5%	30.4%	10.5%	2.8%	9.8%
<b>Total</b>	<b>9.9%</b>	<b>36.5%</b>	<b>20.5%</b>	<b>9.4%</b>	<b>14.6%</b>

\*Lending not reflected in regional totals

Multiple lending affiliates included in analysis

#### **Description of the New HMDA Data**

On January 1, 2004, the Federal Reserve enacted changes to its Regulation C that implements the Home Mortgage Disclosure Act. These changes require lenders to report additional data including:

- For originated loans, the difference between a loan's annual percentage rate and the yield on comparable Treasury securities if that difference exceeds 3 percentage points for first liens and 5 percentage points on junior liens;
- Whether a loan is subject to the Home Owner Equity Protection Act;
- Whether a loan is secured by a first lien, junior lien, or unsecured;
- Whether a loan or application is for a manufactured home
- Whether there was a request for preapproval on a home purchase loan

There were also changes implemented that modify the definition of refinance and home improvement loans. There was an additional field added to identify an applicant's ethnicity as Hispanic. Lenders were also required to identify applications where information on ethnicity and/or race was not provided by an applicant in a telephone, internet, or mail application.

## Lending Institutions and Affiliates Included in Analysis\*

### American Home Mortgage

#### Ameriquest

Ameriquest  
Argent  
Bedford  
Olympus  
Town and Country Credit Corp

#### Bank of America

Bank of America  
Fleet

#### Citigroup

Citibank, FSB  
Citimortgage  
Citibank (West), FSB  
Citifinancial  
Citicorp Trust Bank  
Citifinancial Mortgage Company  
Associates Housing Finance  
Principal Residential Mortgage

#### J.P. Morgan Chase

Chase Manhattan Bank USA NA  
Chase Manhattan Mortgage Corp  
J.P. Morgan Chase Bank NA

#### Countrywide

Countrywide Home Loans  
Countrywide Bank  
Countrywide LLC

#### Flagstar Bank

#### GMAC

GHS Mortgage  
GMAC Bank  
GMAC Mortgage  
Homecomings Financial

#### Harris

Harris Bank Argo  
Harris Bank Arlington Heights  
Harris Bank Aurora  
Harris Bank Barrington  
Harris Bank Bartlet  
Harris Bank Batavia  
Harris Bank Cary Grove  
Harris Bank Elk Grove Village  
Harris Bank Frankfort  
Harris Bank Glencoe  
Harris Bank Hinsdale  
Harris Bank Hoffman Estates  
Harris Bank Huntly  
Harris Bank Joliet  
Harris Bank Libertyville  
Harris Bank Marengo

#### Harris continued

Harris Bank NA  
Harris Bank Naperville  
Harris Bank Oakbrook Terrace  
Harris Bank Palatine  
Harris Bank Roselle  
Harris Bank St Charles  
Harris Trust and Savings  
Harris Bank Westchester  
Harris Bank Wilmette  
Harris Bank Winnetka  
Harris Bank Woodstock  
Mercantile National Bank of Indiana  
New Lenox State Bank  
Suburban Bank of Barrington

#### Lasalle Bank

#### Midamerica Bank

#### National City

National City Bank  
National City Bank of the Midwest  
National City Bank of Indiana  
National City Bank of Pennsylvania  
Provident Bank

#### Option One

Option One  
H & R Block

#### RBC Mortgage

#### Washington Mutual

Long Beach Financial  
Washington Mutual Bank  
Washington Mutual Bank, FA

#### Wells Fargo

Wells Fargo Bank, NA  
Wells Fargo Financial  
Wells Fargo Funding  
Wells Fargo Home Mortgage  
APM Mortgage, LLC  
Belgravia Mortgage Group, LLC  
Deluca-Realen Mortgage, LLC  
Edward Jones Mortgage, LLC  
Home Loan Express, LLC  
Naperville Mortgage, LLC  
PCM Mortgage, LLC  
Personal Mortgage Group, LLC  
Real Living Mortgage, LLC  
UBS Mortgage, LLC

\*Charter One Bank and New Century Mortgage submitted HMDA data after the regional sample was created, and their lending is not included in the regional analysis.