

Testimony of

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Regarding:
Building Sustainable Homeownership:
Responsible Lending and Informed Consumer Choice

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Thank you for the invitation to testify at today's hearing. My name is Geoff Smith, and I am Project Director at the Woodstock Institute. Woodstock Institute is a Chicago-based non-profit research and policy organization that for over 31 years has worked locally and nationally to promote reinvestment and economic development in lower-income and minority communities. Woodstock has been extremely active conducting research that illustrates the scope of and harm caused by predatory mortgage lending practices and the impact that concentrated foreclosure have on individuals, neighborhoods, and cities. We have also worked to develop and promote local, state, and federal policy that addresses abusive mortgage lending. My testimony today will focus on disparate mortgage pricing practices seen in the Chicago region and across the state of Illinois; the foreclosure epidemic in the Chicago region; and the impact that foreclosures have on neighborhoods.

For decades community based-organizations, fair housing and consumer rights advocates, and public officials have had substantial concerns about inequities in the home equity lending marketplace. Since the early 1990s many of these concerns have focused on abuses found in the subprime segment of the market. Subprime loans are mortgages to borrowers with impaired credit. Because of the increased risk associated with these borrowers, subprime loans carry higher interest rates and fees than lower cost prime loans. While the growth of risk-based pricing and the subprime segment of the market has increased access to mortgage finance for neighborhoods and borrowers who previously had difficulty accessing housing credit, a substantial body of research has shown that higher cost subprime mortgages have been targeted to minority markets regardless of credit risk. These high cost mortgages have been shown to often contain abusive features such as unnecessarily high fees or restrictive prepayment penalties. They are often poorly underwritten with minimal or even fraudulent documentation of borrower income or ability to afford monthly payments.

The release of 2004 Home Mortgage Disclosure Act (HMDA) data for the first time made available information on the pricing of high cost loans. Analysis of these data has show substantial disparities in mortgage pricing by borrower race. For example in the

Chicago area over 40 percent of conventional single family mortgages to African Americans were high cost, and over 25 percent of similar mortgages to Hispanic borrowers were high cost. However, only 10 percent of such loans to whites were high cost.

These disparities widen as income level increases. In the Chicago area, an African American borrower who was low-income, or earning less than 50 percent of the area median income, was just over 3 times more likely to receive a high cost loan than a low-income white borrower. However, an African American borrower earning at least twice the area median, or over \$135,000 per year, was over 5 times more likely to receive a high cost loan compared to a comparable white borrower. In fact a high income African American borrower earning double the area median income was over twice as likely to receive a high cost loan as a low-income white borrower earning half the area median income.

These patterns play out in lending to minority borrowers and neighborhoods across the Chicago region, the state of Illinois, and the rest of the country. Analysis of 2004 HMDA data by the Federal Reserve Board shows that although gaps in high cost lending between minorities and whites are reduced when controlling for factors such as location, income, and type of lender, not all difference in pricing patterns can be explained.¹ Recent research released by the Center for Responsible Lending uses a dataset of HMDA data enhanced with underwriting variables from a proprietary dataset to examine pricing disparities. Their analysis shows that for certain products significant pricing gaps between races still exist even after controlling for risk factors such as credit score, loan-to-value ratio, and income documentation.²

Concerns about concentrated subprime lending remain directly tied to the wave of foreclosures that have continued to plagued cities, and in particular minority

¹ Avery, Robert B., Glenn B. Canner, and Robert B. Cook. 2005. "New Information Reported Under HMDA and Its Effect on Fair Lending Enforcement." *Federal Reserve Bulletin*. Washington, D.C.

² Bocian, Debbie Gruenstein, Keith Ernst, And Wei Li. May 2006. *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*. Center for Responsible Lending: Durham, NC

neighborhoods, since the 1990s. In the Chicago region, foreclosures have been a staggering problem and have long been the leading housing issue for local government and area community development organizations. In the Chicago region, foreclosures increased by 160 percent between 1995 and 2004. This rapid increase has been driven by increases in conventional foreclosures and has been concentrated in minority communities. In 2004 foreclosures in census tracts greater than 80 percent minority accounted for 37 percent of all regional foreclosures. These same tracts accounted for less than 15 percent of all single family properties in the region.

While the foreclosure problem remains significant in urban areas, suburban communities are also beginning to be hit by a wave of foreclosures. Data from Woodstock Institute's 2004 *Chicago Area Community Lending Fact Book* shows that between 1999 and 2004, foreclosures in city of Chicago declined by 1 percent while foreclosures in the suburban Chicago Six County area increased by over 20 percent.

Woodstock Institute research has show that increases in levels of neighborhood subprime lending contributes rising foreclosure rates to a much greater extent than increases in prime lending. For example, 100 additional subprime home purchase loans in a neighborhood over a given period would be expected to lead to nearly nine additional foreclosures in that community. However, an additional 100 prime home purchase loans in a neighborhood would be expected to lead to only .32 additional foreclosures. An addition of 100 subprime refinance loans would be expected to lead to nearly eight additional neighborhood foreclosures, while the addition of 100 prime refinance loans would actually be expected to lead to a decline in foreclosures.³ With subprime lending highly concentrated in minority communities, it is clear that these neighborhoods will bear a disproportionate share of the cost of foreclosures.

Woodstock Institute research has also shown that foreclosures have a significant impact on local economic development. Each foreclosure within a city block of a property decreases the value of that property by as much as 1.4 percent per foreclosure in lower-

³ Immergluck, Dan and Geoff Smith. 2004. *Risky Business: An Econometric Analysis of the Relationship between Subprime Lending and Neighborhood Foreclosures*. Woodstock Institute, Chicago.

income communities.⁴ In Chicago, the spread of foreclosures has led to cumulative lost property values in the hundreds of millions of dollars each year. This cost to homeowners not in foreclosure is in addition to costs to city governments related to maintaining derelict properties, fire prevention, and crime.

It is clear to us that there has been a foreclosure epidemic in the Chicago region. This epidemic has been largely concentrated in highly minority communities and closely tied to increased levels of high cost lending in these communities. These foreclosures have had a devastating impact on neighborhoods and cities, and the external costs of foreclosure are in the hundreds of millions of dollars each year for large cities such as Chicago.

There are a number of steps the Federal Reserve Board can take to limit abuses in the subprime home equity and home purchaser market and slow the foreclosure problems devastating lower-income and minority neighborhoods across the country:

- Strictly regulate practices that have been shown to have a link to increased likelihood of foreclosures such as onerous prepayment penalties and no documentation loans
- Place increased emphasis on enforcing fair lending laws as they relate to mortgage pricing. In October 2005, the Federal Reserve released a study which identified 200 lenders for closer review regarding pricing. Making the results of these reviews publicly available would add to the transparency of the currently very opaque fair lending review process.
- Coordinate fair lending exams among regulatory agencies. The complex nature of bank holding companies makes it essential that regulatory agencies coordinate fair lending enforcement efforts in order to best monitor steering among prime

⁴ Immergluck, Dan and Geoff Smith. 2005. *There Goes the Neighborhood: The Relationship Between Single Family Mortgage Foreclosures and Property Values*. Woodstock Institute: Chicago.

and subprime affiliates of bank holding companies. As regulator of holding companies, the Federal Reserve Board is positioned to lead this effort by coordinating reviews of holding companies that have entities which are under multiple regulatory agencies or lightly regulated mortgage companies.