

Home Mortgage Disclosure Act: Newly Collected Data and What it Means

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Submitted by:

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Introduction

My name is Janis Bowdler, Housing Policy Analyst for the National Council of La Raza (NCLR). As part of NCLR's Economic Mobility Initiative, I conduct research, policy analysis, advocacy, and program assistance on affordable housing issues. Prior to coming to NCLR, I worked for a large community development corporation (CDC) in Cleveland, Ohio, as a Project Manager developing affordable housing. I am pleased to present our views for the hearing entitled, *Home Mortgage Disclosure Act: Newly Collected Data and What it Means*.

As you know, NCLR is a private, nonprofit, nonpartisan organization established in 1968 to reduce poverty and discrimination and improve opportunities for the nation's Hispanic families. As the largest national Hispanic civil rights and advocacy organization in the U.S., NCLR serves all Hispanic nationality groups in all regions of the country through a network of nearly 300 affiliate community-based organizations.

NCLR has a deep interest in increasing the rate at which Latinos own and build equity in their home and thereby accumulate wealth that will provide financial stability in the years to come. Over the past two decades, NCLR has been a leader in advocating and conducting research on affordable housing issues important to the Latino community. This work focuses on issues such as asset accumulation and barriers to homeownership, access to affordable mortgage products, and programs and legislation that support fair lending. NCLR's most recent relevant publications include *Hispanic Housing and Homeownership; American Dream to American Reality: Creating a Fair Housing System that Works for Latinos*; and *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market*. In addition, NCLR has provided expert testimony before Congress on these issues and, most recently, before the Board of Governors of the Federal Reserve.

Since 1997, NCLR has also been a national intermediary designated by the Department of Housing and Urban Development (HUD) to distribute funding for housing counseling services. The NCLR Homeownership Network (NHN) consists of 38 NCLR Affiliates in 21 states which provide pre-purchase bilingual homeownership counseling to low-income families in predominately Latino neighborhoods. NHN counsels more than 14,000 families each year, more than 2,500 of which become homeowners. NHN has sophisticated partnerships with some of the nation's largest providers of home mortgages such as Bank of America, Countrywide, JPMorgan Chase, Washington Mutual, Wells Fargo, Fannie Mae, and Freddie Mac. Our extensive research and service delivery experience gives us insight into how the homeownership market serves Latino borrowers.

The publication of the 2004 Home Mortgage Disclosure Act (HMDA) data has raised serious public policy concerns. For several years running, research organizations have documented overrepresentation of minorities in the subprime market. The release of the 2004 HMDA data revealed that minorities were also overrepresented in loans that met the Home Ownership and Equity Protection Act (HOEPA) rate spread, the most expensive subprime loans. In my testimony today, I will briefly explain what the HMDA reveals about Latino families' access to homeownership, the market forces driving the racial and ethnic lending disparities, and some limitations on how HMDA data can be used.

HMDA and Latino Homeownership

Like most Americans, the majority of Hispanic families rely on mortgage financing to purchase their home and build equity that will serve as their financial safety net in the future. Detailed information for the vast majority of such mortgages is made publicly available under the HMDA. HMDA data allows the public to evaluate the quantity of loans made available in their neighborhoods as well as judge certain qualitative aspects of those loans. In 2004, in response to a Federal Reserve mandate, information regarding the loan price for certain loans was added to the list of reportable variables. In addition, the classification of "Hispanic or Latino" was updated. The 2004 HMDA data created a new category of "Ethnicity" in which borrowers reported belonging to one of two categories: "Hispanic or Latino" or "Not Hispanic or Latino." In previous years, Hispanic had been an option under the race category. Since Hispanics can be of any race, the distinction between race and ethnicity is an important one, and it improves the quality of the data. NCLR uses the terms "Hispanic" and "Latino" interchangeably.

Broadly speaking, the mortgage market is divided between the prime market, which consists of mostly bank institutions who offer standard and affordable mortgage products, and the subprime market, which was created to serve credit-impaired borrowers. Recent research has documented the overrepresentation of minority families in the subprime market compared to White families.¹ All studies found that the disparity rises as incomes rise. This is certainly the case with Latino families. Latino families are nearly twice as likely as White families to receive a subprime loan. Middle- and upper-income (MUI) Latino families are 2.6 times as likely as MUI White families to receive a subprime loan. A review of the 2004 HMDA data by the Center for Responsible Lending revealed that Latino families are 30% more likely than Whites to receive the highest-cost subprime loans – those that meet the rate spread that triggers the protections of HOEPA – even after controlling for credit scores and loan-to-value ratios.² This disparity grew not only as incomes increased, but as credit scores increased.

NCLR's review of the data revealed that Latinos are more likely than Whites to be denied for loans and that subprime lenders take in a larger proportion of Hispanic loans than prime lenders do.³ We have also had the opportunity to review proprietary HMDA data from select mortgage lenders. These reviews have revealed findings consistent with all previous findings: Latino families are overrepresented in the subprime market and are denied at higher rates than White families, even with credit scores comparable to those of Whites.

These disparities are a clear indicator that the market is not serving Latino families effectively. Having an over concentration of otherwise creditworthy families in the subprime market means disposable income is being misspent on interest and fees, rather than on building equity. In some cases, families pushed into the subprime market are the victims of abusive lending practices that

¹ Bradford, Calvin. *Risk or Race?* Washington, DC: Center for Community Change, 2003; *Separate and Unequal: Predatory Lending in America*, 2004. Washington, DC: ACORN, 2004; and *Homeownership and Wealth Building Impeded*. Washington, DC: NCRC, April 2006.

² *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*. Washington, DC: Center for Responsible Lending, 2006.

³ Bowdler, Janis. *Jeopardizing Hispanic Homeownership: Predatory Practices in the Homebuying Market*. Washington, DC: National Council of La Raza, 2005.

may result in foreclosure. Overall, communities are much better served by a well-functioning market that allows families equal access to credit and wealth-building opportunities.

Market Forces

The racial and ethnic disparities in the home lending market are not an accident. In the case of the Latino community, many Latino borrowers have underwriting variables that pose challenges to modern underwriting systems. For example, according to one study, 22% of Latinos have a “thin” credit file, or no credit history, which usually results in a “0” credit score, compared to only 4% of Whites.⁴ In addition, verifying cash income and documenting employment history can also create challenges for some families. While mortgage prime products exist which use non-traditional credit and other flexible underwriting standards, they generally require manual underwriting that is time and resource intensive for the lender. In addition, loan officer compensation systems tend to make manually underwritten loans less attractive. NHN organizations only prequalify families to prime and FHA/VA loan products, and 88% of their families have incomes below 80% of Area Median Income (AMI), refuting the myth that low-income, nontraditional credit families cannot qualify for prime products. Rather, lenders are motivated to limit the credit made available via such flexible products because of the increased cost of underwriting a family with such barriers. These structural factors effectively bar many Latino families from obtaining prime mortgage financing.

Families that are unable to obtain affordable, flexible products in the prime market are routed to the subprime market. Not unlike the prime market, the subprime market is driven by profit motives that require efficiency and accuracy. However, the subprime market does not refer its “hard-to-serve” clients to another market. Rather, lenders in the subprime market rely on risk-based pricing models to price loans for any risk level. The criteria for gauging risk are discretionary, vary by lender, and are centered on making profits rather than the appropriateness of the loan to the consumer’s financial situation. For a variety of reasons, Latinos and other minorities find themselves channeled toward the products most profitable to the lender, but which are expensive and risky for borrowers.

In an effort to further cut costs and increase profits, many subprime lenders rely heavily on their whole sale units, which – unlike retail branches – are little more than underwriting centers and relying on independent mortgage brokers to deliver their loans. Mortgage brokers serve as market intermediaries between lenders and consumers, and originate two-thirds of the nation’s mortgages by most estimates. To lenders, market intermediaries promote themselves as a less expensive alternative to retail operations which also provide a greater reach into diverse markets. Consumers, especially Latinos, also rely on the services of mortgage brokers. Bilingual and bicultural brokers market themselves as agents who can be trusted to find consumers the best deal. However, discretionary Yield Spread Premiums (YSPs) offered by lenders provide further incentives for brokers to steer borrowers to products that are more profitable for themselves, rather than those most suitable to the client’s needs. This problem is exacerbated by the rise of

⁴ Stegman, M. “Automated Underwriting: Getting to Yes for More Low-Income Applicants.” Presented before the 2001 Conference on Housing Opportunity, Research Institute for Housing America Center for Community Capitalism, University of North Carolina-Chapel Hill.

nontraditional mortgage products, such as interest-only loans, payment-option mortgages, and loans without documentation, where brokers are able to layer subjective pricing criteria to sell mortgage financing that is very high risk to consumers. Recent projections of a rise in foreclosure rates raise legitimate concerns that these products will have long-term consequences for the affected borrowers, communities, and investors.

In fact, many subprime lenders and mortgage brokers are outperforming the prime market in their service to Latino families. Both are more aggressive in marketing directly to Latino consumers via Spanish-language media. Their advertisements contain little information regarding the nature or risks of the products to the consumer, and many do not face competition from providers of standard mortgage products. Mortgage brokers in particular are diversifying their workforce, offering a wider range of products, and adopting a one-on-one style that makes Latino families feel comfortable.

The outcome of this can be seen in the highly-publicized racial and ethnic disparities in products and pricing. For example, new research shows that Latinos are 30% more likely to receive a high-cost loan (one that meets the rate-spread) than Whites when purchasing their home. Other research shows that alternative mortgage products such as Option Adjustable Rate Mortgages (ARMs) and interest-only mortgages are disproportionately concentrated among minority borrowers. Latinos are more than twice as likely as Whites to receive a payment option mortgage.

Limitations of HMDA Data

HMDA data provides advocates, public officials, and lenders critical information about the performance of the market and the distribution of services. However, more information is needed to complete the picture that the mortgage finance industry has created in arguing that market dynamics drive the racial and ethnic mortgage price disparities. In other words, they claim that minorities have riskier profiles; thus, there is nothing to be done about the fact that they receive higher-cost mortgages. However, the public has no way of testing this assertion using solely HMDA data. To make HMDA data more useful to all interested parties, more information is needed. For example, three key data fields missing from HMDA are loan-to-value ratio, debt-to-income ratio, and credit score. In addition, HMDA data should denote whether a mortgage broker was involved in the closing of a loan. These data would give us a clearer picture of the market dynamics between mortgage markets and stakeholders.

In addition, there are some barriers to public use of HMDA data. The general public accesses HMDA data in one of two ways. Researchers and others with sophisticated statistical software at their disposal (such as SAS or SPSS) are able to order the data and upload it into their software or mainframe application. Others are able to download information off the Federal Financial Institution Examination Council (FFIEC) website. Prior to the introduction of the 2004 HMDA data, users could download this information into Microsoft Excel, or similar software, which is much more widely used. Now, the data appear in PDF format, or Portable Document File. This makes it difficult for those that do not use statistical software to examine the information closely. Also, not all publicly available data appear on the website. For example, distinctions between subprime and prime lending institutions are not listed in the tables published on the Internet.

Another example, the data available on the Internet does not always allow the user to examine a lender's national portfolio, usually you must examine them one Metropolitan Statistical Area (MSA) at a time. Such obstacles inhibit the ability of smaller community-based organizations and public institutions from accessing and analyzing the HMDA data.

Conclusion

HMDA data is the principle tool for monitoring the mortgage lending market and the equity of loan distributions. Based on this data we know that Latino and other minority communities are overrepresented in the most expensive products of the subprime market. Deeper analysis of market forces suggests that this is a result of lenders pushing profit margins, rather than the availability of appropriate loan products. Minorities are not just overrepresented in subprime and expensive products, they are also more likely to receive the riskiest of products. And, finally, while the HMDA data has limitations that should be filled-out, it represents the most complete picture we have to gauge the performance of the mortgage market.

In closing, NCLR would like to make the following recommendations:

- **Hold lenders and mortgage brokers accountable.** Lawmakers and regulators should create and enforce a suitability standard with a strong anti-steering provision. Such a standard is necessary to neutralize industry-profit motivations that provide incentives for putting otherwise creditworthy families into expensive or risky loan products.
- **Remove the barriers to HMDA analysis.** To increase the functionality of HMDA, NCLR recommends adding several data fields, including loan pricing information for all loans, product type (30-year fixed, ARM, negatively amortizing, Interest-Only, Stated Income), loan-to-value ratios, and foreclosure information. In addition, data available on the Internet should be made more user-friendly by allowing information to be downloaded into Excel, adding prime and subprime distinctions to Internet tables, and allowing for national or multiple city analysis of lender-specific data.
- **Invest in housing counseling.** Housing counselors are effective market intermediaries that help low- and moderate-income families to access responsible and affordable mortgage products. For example, 88% of NHN clients are below 80% of Area Median Income (AMI) and many require manual underwriting, but all those who achieve homeownership through our network receive prime products. Public entities and private mortgage companies must invest in the infrastructure to ensure it is equipped to meet the demand for its services.