Communities in Crisis: Race and Mortgage Lending in the Twin Cities

Institute on Race and Poverty

The impact of the foreclosure crisis on poor neighborhoods and communities of color in the Twin Cities highlights how much race still matters in home mortgage lending. Studies of housing markets have shown that mortgage institutions have continued to disinvest in neighborhoods that are predominately people of color.[1] These trends mimic past patterns of bank and government sanctioned redlining of neighborhoods, where lenders withheld credit from segregated neighborhoods—a practice that helped shape the geography of segregation and concentrated poverty in the U.S.[2] One difference between the mortgage market 30 years ago and the mortgage markets today is that non-bank lenders, usually subprime or predatory lenders, rushed in to fill the mortgage market void in communities of color. This meant that more mortgage dollars were available to people of color than in the past, but this nonbank credit was much more expensive than the prime credit that was more available in white communities.

It is no accident that high rates of subprime lending and foreclosures are concentrated in segregated neighborhoods of color – and the reason for this disparity is not simply individual discrimination against people of color. Instead, racial and economic segregation set the stage for concentrated subprime lending. A major factor leading to high subprime lending rates in these areas is the relative lack of access to credit in segregated neighborhoods. Despite the Community Reinvestment Act's mandate to provide equal access to credit across communities, people who live in segregated communities are substantially less likely to have easy access to a bank branch with lending facilities than people who live in predominantly white communities.[3] The lack of access means that people who live in segregated communities of color are much more likely to rely on mortgage brokers. Mortgage brokers who operate in these segregated communities are more likely to offer customers subprime loans, regardless of the person's actual risk profile.

The Twin Cities has Some of the Nation's Largest Lending Racial Disparities

Prior work by other researchers shows that the Twin Cities metropolitan area has had some of the nation's worst racial disparities in mortgage outcomes, particularly in home purchasing.[4] The region has typical levels of subprime lending for a U.S. metropolitan area. However, racial disparities in mortgage lending are stark—in 2006 the Twin Cities region had the seventh largest difference among 63 large metros between white and black borrowers in the percentage of home purchase loans that were subprime. For Hispanics, the difference was eleventh largest.[5]

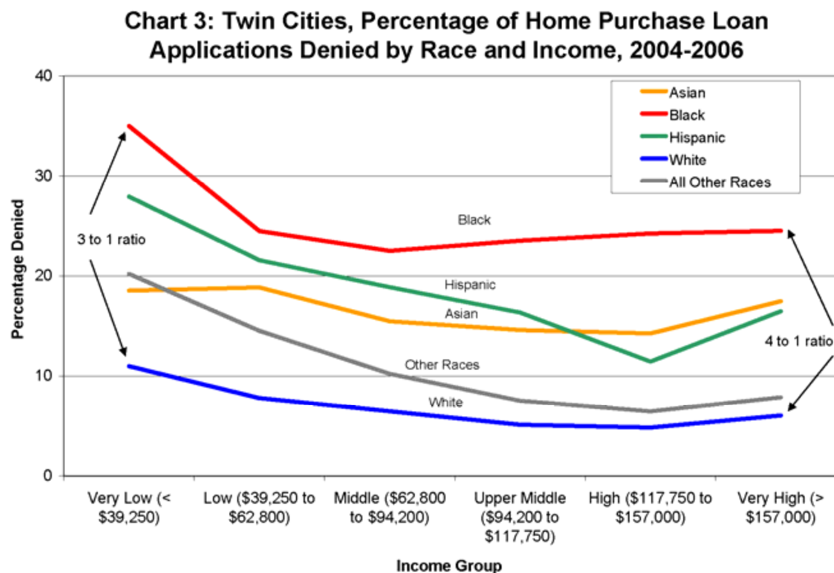
---

[1] See E.G. United States v. Old Kent Financial Corp., CV 04-71879 (E.D. Mich. May, 19, 2004)
[2] Douglas S. Massey & Nancy A. Denton, 1993
[3] National Community Reinvestment Coalition, 2007, p. 15
[4] ACORN, 2007, Foreclosure Exposure.
[5] ACORN, 2007. The comparison is for the sixty-three metropolitan areas and metropolitan divisions with over 1 million people included in the study.

Race, Income and Mortgage Denials

The Twin Cities lending data show large mortgage denial disparities by race. People of color are denied home purchase and refinancing loans at much higher rates than white applicants, even after controlling for income. Chart 3 shows these differences for home purchase loans. Overall, loan denial rates are highest for black applicants, followed by Hispanics, Asians, other races and whites. In general, denial rates are lower for applicants with higher incomes, regardless of race—each of the lines in Chart 3 slopes downward on average.

However, the most striking results in the chart are the differences across races. Denial rates are higher for black, Hispanic and Asian applicants than for whites, *regardless of income.* Very high income black, Hispanic and Asian applicants (applicants with incomes more than $157,000 per year) show denial rates higher than whites in the lowest-income category (less than $39,250 per year). The disparities are greatest for black borrowers. The denial rate for blacks with incomes above $157,000 was 25%, while it was just 11% for Whites making less than $39,250. There are similar disparities with refinancing loans. [6]



Source: Federal Financial Institutions Examination Council, 2004-2006 HMDA

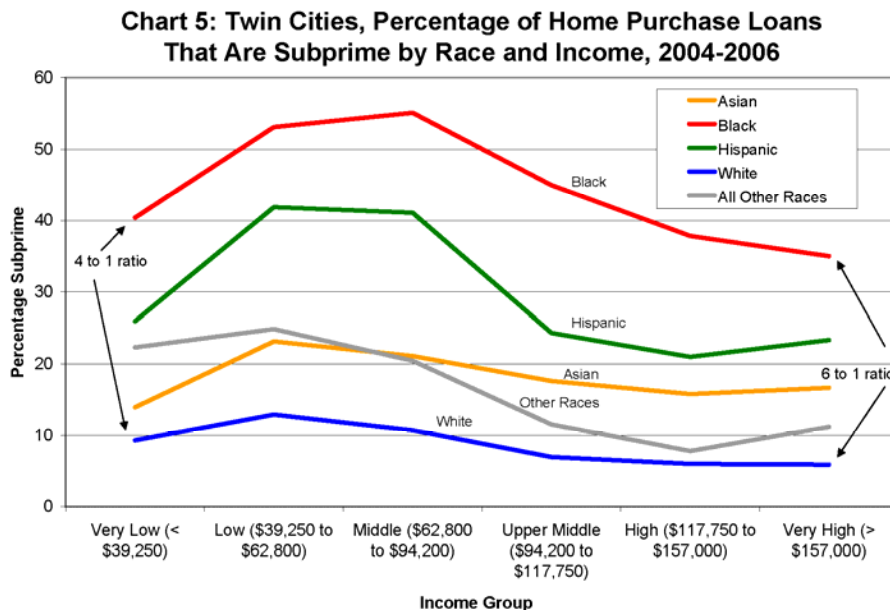
Income is not a perfect proxy for credit-worthiness. For instance, lenders also use credit scores to judge risks. It is possible that non-white and white applicants with identical incomes have different credit scores on average. This could happen if white incomes were more stable over

[6] Statistical analysis of the HMDA data confirm that race and income each have independent effects on denial rates after controlling for the other. A logistic regression of the likelihood that an application was denied on the 213,680 purchase loans applications in 2004-2006 HMDA data for the Twin Cities shows this. Non-white applicants—measured by separate categories for black, Hispanic, Asian and other—show higher denial rates than whites after controlling for inflation-adjusted income (which is negatively associated with likelihood of denial, as expected), inflation-adjusted amount of the loan, type of lender (prime or not), gender of the applicant, minority share of the census tract of the home, and median family income of the census tract. An identical regression using data for the 253,370 refinance applications in the data set gives the same conclusions.

time, for instance. However, other studies have shown that controlling for credit scores or other factors does not eliminate racial differences in credit markets[7] and the differences in Chart 3 are stark. It is hard to view differences of this magnitude as anything except indicators of real differences in the way the credit markets treat applicants of color.

Subprime Lending Rates by Race and Income

Income alone does not account for racial disparities in participation in the prime and subprime markets. In the Twin Cities, blacks are five times more likely to receive a subprime home purchase loan than whites, followed by Hispanics (a 4 to 1 ratio) and Asians (a 2 to 1 ratio). There are similar disparities with refinancing loans.



Source: Federal Financial Institutions Examination Council, 2004-2006 HMDA

Lending Patterns by Neighborhood Type

Neighborhoods in the Twin Cities are highly segregated by race. This creates potential for geographic disparities in two ways. Entire neighborhoods in the core cities and inner suburbs with high non-white shares of residents are likely to show much higher than average rates of subprime loans because they are populated by racial groups most likely to receive those types of loans. Even more important, however, is the possibility that loan applicants will be treated differently by the lending market depending on the neighborhood they live in, rather than based on the individual merits of their application.

The data in fact show that there is a strong relationship in the Twin Cities between the racial composition of a neighborhood and the distribution of applications across prime, near prime and subprime lenders. Applicants are less likely to access prime lenders when attempting to acquire

---

[7] Avery, Canner and Cook 2005; Bocian, Ernst and Li, 2006; Boehm, Thistle and Schlottmann 2006; Courchane Surette and Zorn 2004; Dietrich, 2005; Munnell, et.al.,1996; Pennington-Cross, Et al. 2000.

or refinance homes in neighborhoods with larger shares of people of color than in white neighborhoods, and they are less likely to do so regardless of the race or income of the applicant.

Table 4 shows that in predominantly white neighborhoods (neighborhoods that are less than 30 percent people of color) 72 percent of all loan applications are prime home purchase lenders. This is significantly greater than the 52 percent of applicants in integrated neighborhoods (with 30 to 49 percent people of color) and 34 percent of applicants in segregated non-white neighborhoods (with 50 percent or more people of color).

The differences are also evident for refinance applicants. As the racial composition of the neighborhood shifts towards greater shares of people of color, the application rates at prime lenders drop, regardless of the race and income of the applicant.

Table 4: Percentage of Home Mortgage Applications at Prime Lenders by Racial Characteristic of Neighborhood and Applicant

				High and Very High Income	
	Total %*	White %	People of Color %	White %	People of Color %
Home Purchases					
Racial Composition of Neighborhood:					
0 to 29% People of Color:	72	78	49	81	54
30 to 49% People of Color:	52	69	29	70	24
50 to 100% People of Color:	34	55	22	50	14
Refinances					
Racial Composition of Neighborhood:					
0 to 29% People of Color:	42	47	31	55	38
30 to 49% People of Color:	29	35	22	35	18
50 to 100% People of Color:	20	26	18	24	16

* Includes mortgage applications without racial information

Source: Federal Financial Institutions Examination Council, 2004-2006 HMDA; 2000 U.S. Census Bureau

Both people of color and whites are less likely to apply with prime lenders when applying for loans in integrated or segregated non-white neighborhoods. For home purchases, the prime lender application rate for whites is highest in predominately white neighborhoods at 78 percent, dropping to 69 percent in integrated neighborhoods, and 55 percent in segregated non-white neighborhoods. Similarly, the prime lender application rate for people of color is highest in predominately white neighborhoods at 49 percent, dropping to 29 percent in integrated neighborhoods and to 22 percent in segregated non-white neighborhoods. The pattern is similar for refinance loans.

Table 4 also shows that the relationship between access to prime lenders and the racial composition of the neighborhood cannot be explained simply by the income mix of the neighborhoods. If that were the case, prime lender application rates for applicants of a given race and income would be the same in all neighborhoods—e.g. high income whites would apply for prime loans at the same rate regardless of their neighborhood type. In fact, high and very high income whites and people of color show significant drops in prime lender application rates as the

share of people of color in a neighborhood increases. This shows that even high-income whites face obstacles to acquiring prime loans in high-minority neighborhoods.[8]

It is likely that the lack of prime lender branch locations in diverse and segregated neighborhoods makes it more difficult for all types of applicants to apply to prime lenders. The Twin Cities ranks last for large U.S. metropolitan areas in the number of bank branches per person in neighborhoods with over 50% people of color.[9] However, it is worth reiterating that differences by race are substantial regardless of the neighborhood type—applicants of color are much less likely than whites to access prime lenders, regardless of the racial composition of the neighborhood.

Race, Subprime Lending and Foreclosures

Subprime and predatory loans often lack transparency, have little oversight and accountability and are often unsustainable, which leads to foreclosure. Mortgage foreclosures are costly both to individual homeowners and to their communities. For instance, researchers in Chicago measured the impact of foreclosures on neighboring properties from 1997 to 1999. The estimate was that each conventional single family foreclosure resulted in a 0.9 percent decrease in the value of homes within 1/8 mile of the foreclosure. For the City of Chicago this equated to a loss of $598 million dollars in single family property values—a $159,000 loss to neighboring homes per foreclosure.[10] Re-scaling this estimate for Minneapolis and St. Paul in more recent years suggests that foreclosures in 2007 alone resulted in hundreds of millions of dollars in lost tax base in each city and a loss of roughly 2.5 percent of property tax revenues.[11] Borrowers who face foreclosures have difficulty making ends meet and cumulatively put great pressure on the broader community.

Nationally, foreclosures increased 55 percent between 2005 and 2007. Subprime loans contributed to over two-thirds of the growth.[12] The lending disparities by race and location revealed in the prior section are bound to mean that the costs of the foreclosure crisis still at work in the U.S. and the Twin Cities will be borne very unevenly. Not surprisingly, the effects have been greatest on communities of color. There is a strong relationship in Hennepin and Ramsey county neighborhoods between mortgage foreclosures, subprime lending and borrowers of color.

---

[8] Statistical analysis of denial rates also shows that loan denial rates are higher in high-minority neighborhoods even after controlling for the race and income of the applicant, the loan amount, the lender type (prime or not), gender of the applicant and neighborhood income.

[9] The.National Community Reinvestment Coalition, 2007 report "Are Banks on the Map?.

[10] Immergluck and Smith, 2006

[11] This calculation assumes that home values in Minneapolis and St. Paul were 85 and 77 percent of those in Chicago (reflecting median values reported in 2005-2007 by the Census); that values increased from 1999 to 2007 by roughly 100 percent (which is the increase in median values reported by the Census from 1999 though 2005-2007); and that effective municipal tax rates (taxes as a percent of market value) were 0.62 percent in Minneapolis and 0.32 percent in St. Paul (reflecting taxes on a median valued home). With these assumptions, the 2,943 foreclosures that occurred in Minneapolis in 2007 would have resulted in $814 million in lost tax base and $10.7 million in lost property tax revenues in total and $5.1million for the city government alone. The equivalent figures for the 1,928 foreclosures in St. Paul are $483 million in lost tax base and $5.2 million in lost revenues in total and $1.5 million for the city government alone.

[12] Wood, 2007, 23-4.

Maps 3 through 6 show this very clearly. Map 3 shows the location of sheriff's foreclosure sales in 2007. Minneapolis has the largest number of foreclosures, followed by St. Paul and the inner suburbs of Brooklyn Park and Brooklyn Center. The largest cluster of foreclosures is in North Minneapolis.

Map 4 shows that the areas with the most foreclosures are also areas where most mortgage holders are people of color. The neighborhoods with the highest percentages of mortgages held by people of color are in parts of Minneapolis, St. Paul, Brooklyn Park, Brooklyn Center and Richfield. The largest concentration, where over half the borrowers are people of color, is in North Minneapolis, the neighborhood with the greatest concentration of foreclosures.

Subprime loans are also most concentrated in neighborhoods with high percentages of people of color (Map 5). Various inner city neighborhoods, as well as parts of Brooklyn Center, Brooklyn Park and Richfield show high rates of subprime lending. North Minneapolis and neighborhoods that surround downtown Saint Paul have subprime lending rates that exceed 37 percent of all loans.

Map 6 shows foreclosure rates per 100 owner occupied housing units. As expected, the census tracts with the highest percentages of people of color and the highest subprime lending rates are also the tracts where foreclosure rates were the highest. Foreclosures rates were particularly high in North Minneapolis, where, in many areas, there was more than one foreclosure for every 10 owner-occupied units.

<u>Recommendations</u>

Simply passing consumer protection laws that ban the worst predatory practices that have occurred over the last ten years will not address the heart of the problem of lending and race in the Twin Cities. In order to ensure equality in mortgage lending, we need to first ensure access to fair credit and work to end racial segregation.

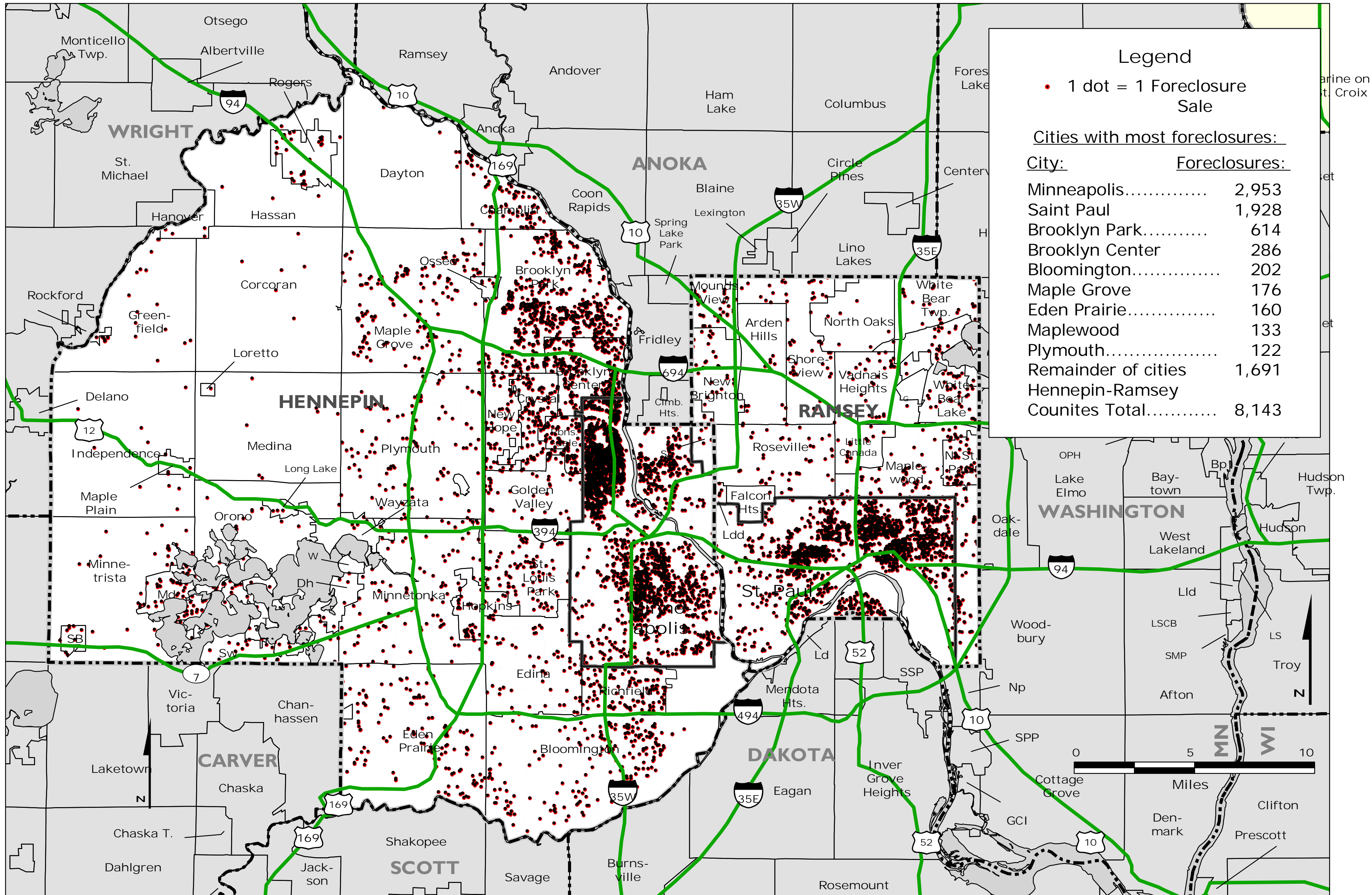
Fair Lending, ensuring that individuals and communities of color have equal access to prime credit, is an essential part of protecting the wealth and mobility of communities of color. Strengthening and Enforcing the Community Reinvestment Act and establishing Fair Housing Centers to monitor fair housing conditions will go part way to ending lending disparities. Likewise, reforming HMDA will allow researchers and community activist to more effectively monitor lending patterns.

Fair lending, however, in-and-of-itself will not end predatory practices in communities of color. Several prime lenders in the Twin Cities, most notably Twin Cities Financial (TCF) actually made a disproportionately large number of prime loans in North Minneapolis. But even homeowners who received loans on fair terms have been severely impacted by the foreclosure crisis as their homes lost equity and their neighborhoods became less stable.

Likewise, consumer protection laws only go part of the way in protecting against disparate lending. For example, in 2007 Minnesota passed two strong laws curbing many of the predatory

institute on race and poverty
Research, Education and Advocacy

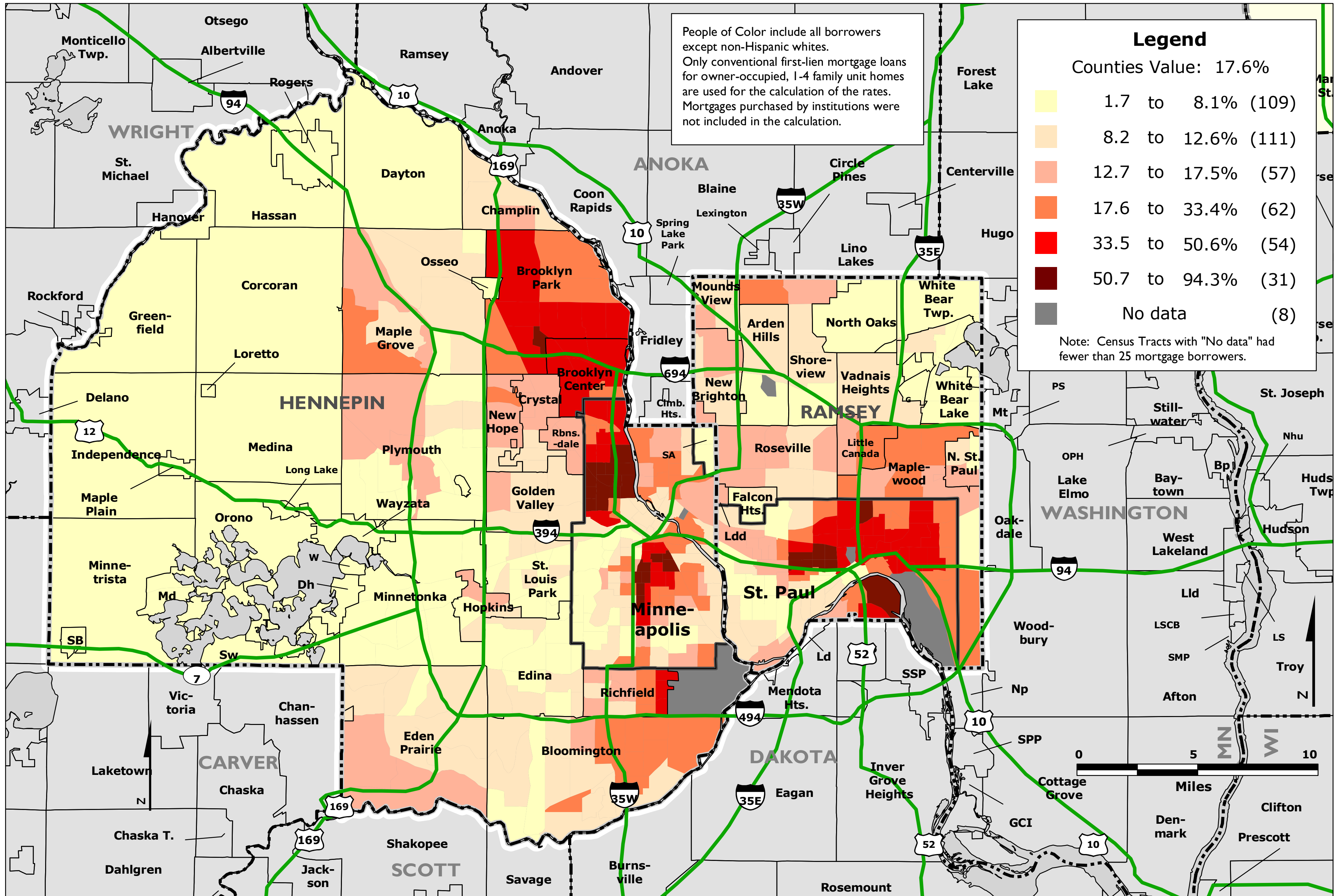
Map 3: HENNEPIN - RAMSEY COUNTIES
Sheriff Foreclosure Sales
by Address Location, 2007



Data Source: Housing Link, Hennepin and Ramsey County Sheriffs Departments.

institute on race and poverty
Research, Education and Advocacy

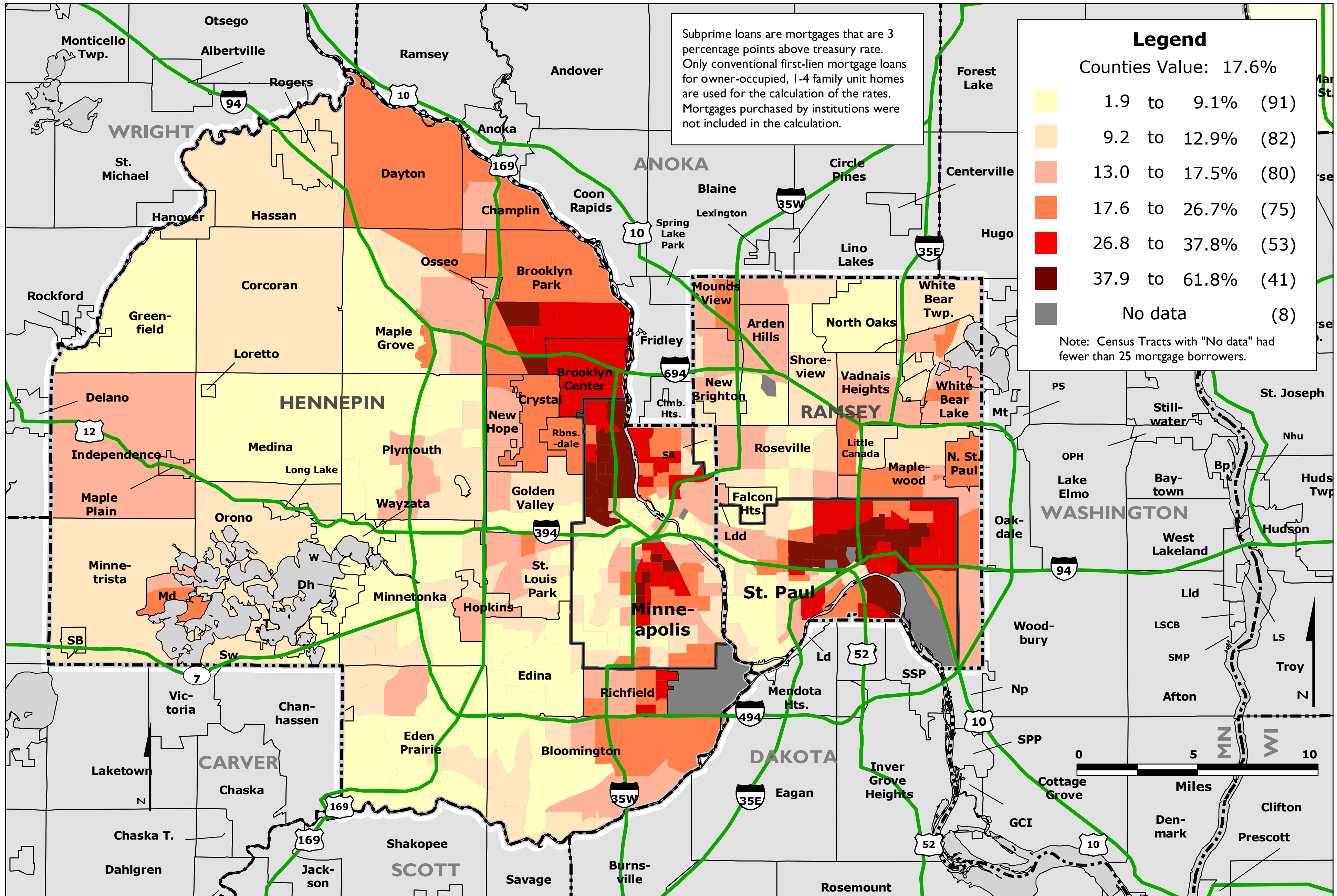
Map 4: HENNEPIN - RAMSEY COUNTIES
Percentage of Mortgage Loans Acquired by People of Color by Census Tracts, 2004-2006



Data Source: FFIEC, Home Mortgage Disclosure Act Data

institute on race and poverty
Research, Education and Advocacy

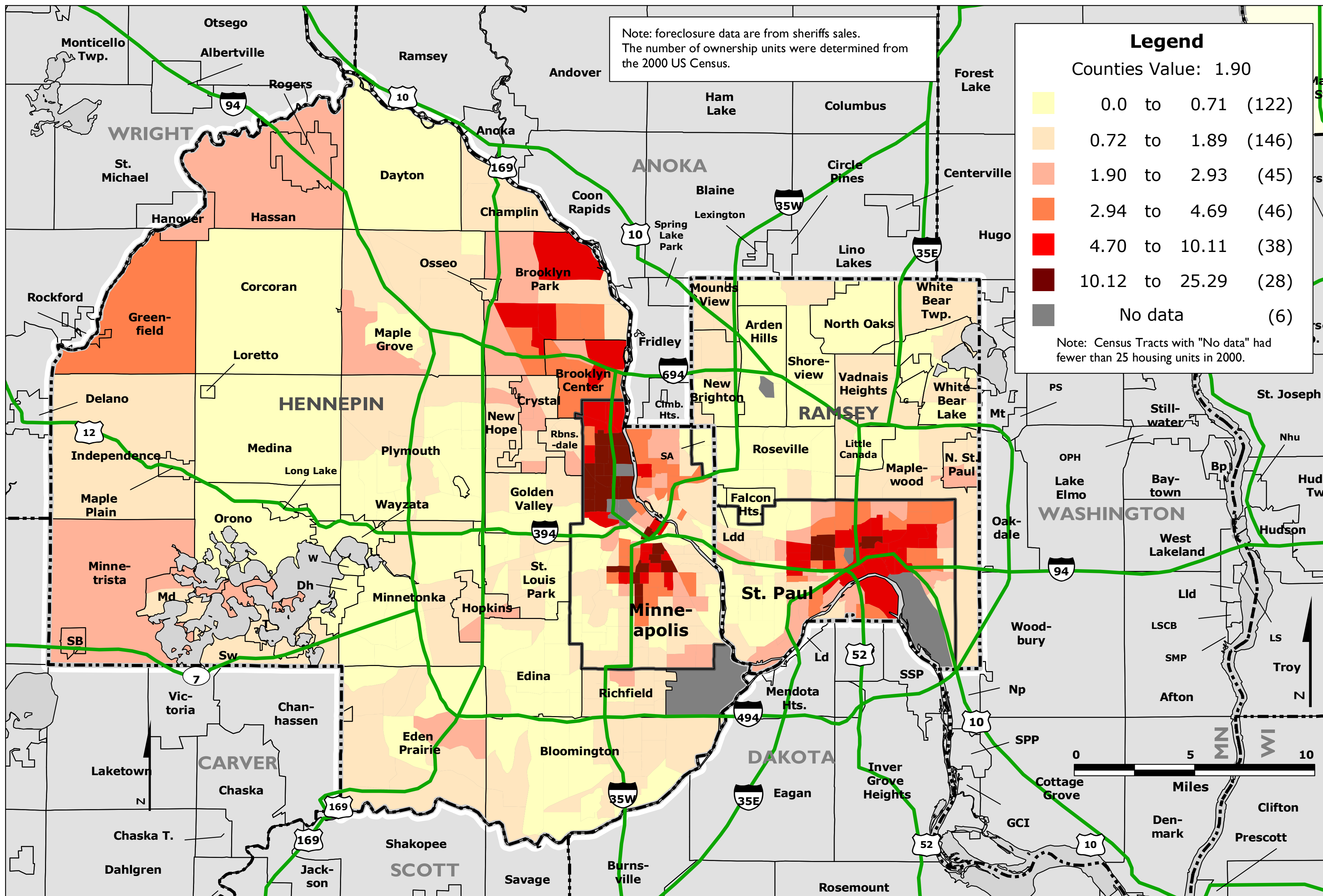
Map 5: HENNEPIN - RAMSEY COUNTIES Percentage of Mortgage Loans that are Subprime by Census Tracts, 2004-2006



Data Source: FFIEC, Home Mortgage Disclosure Act Data

institute on race and poverty
Research, Education and Advocacy

Map 6: HENNEPIN - RAMSEY COUNTIES
Foreclosures Per 100 Owner Housing Units
by Census Tracts, 2007



Data Source: Housing Link; Hennepin and Ramsey County Sheriffs Departments, U.S. Census Bureau.

lending practices that may have driven much of the foreclosure crisis in North Minneapolis.[13] In theory, these laws should reduce the impact of subprime and predatory lending on communities of color. However, limiting predatory lending does not mean that prime lenders will then start lending to communities of color. Racially targeted predatory lending is directly tied to the physical and social isolation of communities of color. These neighborhoods have historically been denied credit and have been targeted by subprime lenders because of the isolation of these communities.

Simply preventing "bad" loans in communities of color will not induce the market to make "good" loans. Racially and economically integrated neighborhoods are more likely to attract prime lenders. More bank branches in integrated neighborhoods will facilitate access to prime lenders and give subprime lenders market competition. Treating predatory lending as solely a consumer protection issues misses the larger civil rights implications of unfair lending. Predatory lending must be addressed as part of the larger problem of segregation and access to credit.

In the end, the entire Twin Cities region needs to work aggressively to end segregation. Segregation creates concentrated poverty, makes it more difficult for people of color to access prime lenders, and creates easy targets for predatory lenders.

Strengthen the Community Reinvestment Act. While conservative commentators have blamed the mortgage meltdown on the CRA, research shows that the CRA could not have been responsible for the lending crisis. Nonbank institutions not covered by the CRA were responsible for the vast majority of the increase in subprime lending. Federal Deposit Insurance Corporation Chairwoman Sheila Blair testified that "only one in four higher-priced first mortgage loans were made by CRA-covered banks during the hey-day years of subprime mortgage lending. The rest were made by private independent mortgage companies and large bank affiliates not covered by CRA rules."[14]

This research shows that a good part of lending disparities in segregated communities of color is related to access to prime credit. People in these communities are substantially more likely to seek loans from subprime rather than prime lenders, regardless of their income or race. While some of this reluctance to seek out prime lenders may have to do with historical experiences with discrimination, prime lenders are underrepresented in segregated communities. Instead, non-bank lenders have been able to sell subprime and sometimes predatory loans in these neighborhoods with little competition from prime lenders.

Ensuring access to CRA-covered banks, mostly prime lenders, should increase access to affordable, prime credit for people who live in segregated communities of color. Research shows that CRA banks were more likely to make prime loans in minority communities than non-

---

[13] The first bill prohibits mortgage brokers, who are licensed and regulated by the state, from equity stripping, making loans without regard to the borrower's ability to pay, and churning and flipping loans. 2007 Minn. Laws ch. 18. The law also creates a fiduciary duty on the part of the broker, requiring brokers to act in good faith and give borrowers loans on the best terms available. 2007 Minn. Laws ch. 18. The second bill prohibits both lenders and mortgage brokers from charging prepayment penalties on subprime loans, creates criminal penalties for mortgage fraud, and creates a private right of action to enforce most of the substantive provisions of Minnesota's statutes prohibiting unfair and predatory lending. 2007 Minn. Laws ch. 74.

[14] Remarks by FDIC Chairman Sheila C. Bair Before the Consumer Federation of America, December 4, 2008.

covered lending institutions.[15] Further, in the fifteen largest large metropolitan regions, regions with higher concentrations of CRA covered banks had lower foreclosure rates those with lower concentrations of CRA covered banks.[16]

People of color and people who live in segregated communities of color must have access to affordable credit from responsible lenders in order to build wealth and become part of the middle class. The CRA should be expanded to monitor and regulate the lending patterns of non-bank lending institutions. Rigorous enforcement of an expanded CRA will help provide equal access to fair credit—a necessary first step in ensuring equal opportunity for all Americans.

Fund a Regional Fair Housing Center. Regional Fair Housing Centers help ensure non-discrimination in housing, rental, and home lending markets through research and advocacy. These centers use trained test marketers to hold realtors, landlords, and banks accountable for discrimination. The Twin Cities lost its fair housing center several years ago, after the center lost funding. Since that time, there has been no systematic testing of Twin Cities markets for discriminatory practices. This means that there is no Twin Cities entity that is responsible for consistently ensuring that brokers, banks, real estate agents, and insurers are treating people equally. An ongoing commitment to a center of this sort is needed to ensure that the grossly disparate impact of the ongoing crisis in the region's housing and credit markets is not repeated in the future.

Expand HMDA. While HMDA data has been steadily improved over the years, further improvements could make it a much better source for monitoring discrimination in the mortgage market. In particular, lenders should be required to report data on the credit status of borrowers, the interest rates for all loans, and race data for mail, phone and internet applications. Likewise secondary market participants should be required to report race data.

[15] Traiger & Hinkley LLP
[16] See ibed.