U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Research in Focus

Supporting Scholarship in Housing and Community Development

Volume 2/Issue 1

Subprime Foreclosures Spotlight Concerns of Predatory Lending

Forty-one percent. That's how much home foreclosures increased during the first quarter of 2007 as compared to the same period the year before. And the foreclosures, most of which occurred in the subprime mortgage market, are continuing to negatively impact a housing market already facing declining home prices and sales. This has caused mortgage markets to tighten underwriting criteria and capital markets to pull back from mortgage securities backed by subprime loans. It is also reshaping communities which are now dotted by abandoned properties undergoing foreclosure. Consumer groups are also expressing concern that many of the households facing foreclosure may have been targets of predatory lending.

Subprime lenders target consumers who do not qualify for conventional mortgages due to poor or limited credit histories. These loans carry higher interest rates and less favorable terms because of the higher risk associated with lender origination. Subprime mortgages often are adjustable rate mortgages (ARMs) or require balloon payments at maturity, while the majority of conventional mortgages are fixed-rate loans.

The rise of the subprime market during the 1990s put homeownership within reach of more Americans, often serving consumers located in low-income and minority communities. The growth was fueled by legislative changes allowing for a greater variety and availability of mortgage products and the development of a secondary market for nonconforming loans. Between 1998 and 2005, the subprime market grew from $35 billion to $665 billion. And in 2006 subprime loans accounted for 23 percent of all mortgage originations (Center for Responsible Lending, *Losing Ground: Foreclosures in the Subprime Market and Their Costs to Homeowners*, December 2006).

Subprime Foreclosures *continued on page 2*

For Rutgers Student, DDRG is a Perfect Fit

Kristen Crossney

In 2004, Kristen Crossney was a second-year Ph.D. student at Rutgers University. She had previously completed a scholarly manuscript for the U.S. Department of Housing and Urban Development's (HUD's) Early Doctoral Student Research Grant (EDSRG) program and now wanted to dedicate a large amount of time to her dissertation. Funding was a priority for Crossney, and she soon realized that there were few funding sources that would allow her to focus her research efforts on her dissertation in the field of housing and community development.

Then, in October 2005, while presenting her EDSRG at the Association of Collegiate Schools of Planning (ACSP) annual conference in Portland, Oregon, Crossney discovered that she had been awarded a 2-year HUD Doctoral Dissertation Research Grant (DDRG). She was elated.

"It seemed a perfect fit for my interest in housing finance and its relationships to neighborhoods," she says. "The program allowed me to focus on my research, and I was able to complete my dissertation in a timely manner." Her DDRG grant also supported travel to conduct research and to present that research at two scholarly conferences: the 2005 annual meeting of the ACSP and the 2006 annual meeting of the Urban Affairs Association. "If I did not have the support of the EDSRG and DDRG programs, I likely would have had to narrow or change the focus of my dissertation or push my graduation date back," says Crossney.

For Rutgers Student *continued on page 3*

But the rapid increase in the subprime market and the drastic increase of subprime delinquencies and foreclosures make some wonder: *at what costs?* The Center for Responsible Lending estimates that 2.2 million households that purchased loans on the subprime market between 1998 and 2006 will lose their homes to foreclosure. The foreclosures are having a ripple effect beyond the consumer. Home prices are falling further in communities in which foreclosure activity has been most active. Mortgage companies are folding or have stopped subprime lending programs. And foreclosures are causing liquidity to dry up in other capital markets amid investor concerns of too much risk taking.

Many factors are at play in the increased foreclosure activity. As mentioned earlier, subprime loans are most often ARMs. As loan rates are reset, consumers face higher interest rates on properties that have lost value during the market downturn, making refinancing or selling a home to repay a loan more difficult. Lack of diligent underwriting standards in recent years has also contributed to the increased foreclosure numbers with even the riskiest consumers receiving loans that required little or no downpayment.

Predatory or abusive lending practices may also be contributing to the increasing numbers of foreclosures. Subprime borrowers, who by definition have difficulty obtaining traditional home financing, may be at risk of deceptive loan practices especially if they do not fully understand their loan's terms and costs. Predatory practices may include:

- Loan flipping, which occurs when a mortgage originator refinances a borrower's loan repeatedly in a short period of time, often charging higher fees and stripping a borrower's equity.
- Excessive fees being charged and packed into the loan amount without the borrower understanding the costs.
- Lending without regard to a borrower's ability to repay.
- The use of deceptive sales tactics, which can result in consumers losing equity in their homes.

Two Office of University Partnership grantees have looked more closely at the relationship between predatory lending and the subprime lending market. Both profiles lay the groundwork for future research on current events shaping the housing market. In *The Paradox of Predatory Lending: An Examination of Mortgage Lending in Philadelphia, Pennsylvania*, Doctoral Dissertation Research Grant (DDRG) recipient Kristen B. Crossney of Rutgers University examines the occurrence of predatory lending in Philadelphia, drawing on public mortgage and property data. The results of her research indicate that predatory lending could have the most devastating effects on those who have struggled the most to access the benefits of homeownership, and that predatory lending could be an unintended consequence of federal housing and mortgage policy. Subprime lenders were also most active in the census tracts containing predatory mortgages.

A study titled *Is Subprime Lending Leading to Reverse Redlining and Price Discrimination?* is research conducted by Early Doctoral Student Research Grant (EDSRG) recipient Abhishek Mamgain from the University of Southern California. In spite of all the concerns regarding the reverse redlining in subprime markets, very little empirical work has been done to assess the existence and prevalence of this form of discriminatory practice. This study fills this gap in the literature and also investigates the presence of reverse redlining and price discrimination in the Los Angeles County region by evaluating a pool of Home Mortgage Disclosure Act microlevel data for 2004 in conjunction with the U.S. Department of Housing and Urban Development list of subprime lenders and 2000 Census data.

For Rutgers Student *continued from page 1*

Research in Focus

Crossney's dissertation, *The Paradox of Predatory Lending: An Examination of Mortgage Lending in Philadelphia, Pennsylvania* (discussed more fully on page 4) examines the occurrence of predatory lending in Philadelphia, drawing on public mortgage and property data. Predatory lending was found to be significantly clustered, occurring in a distinct spatial pattern. Racial minorities seem to be affected more by predatory lending than are whites. The significant differences in neighborhood context variables suggest that areas with clusters of predatory activity are more challenged and economically disadvantaged. Socioeconomic differences between these two types of areas indicate that those affected are lower income. Subprime lenders were most active in tracts containing predatory mortgages.

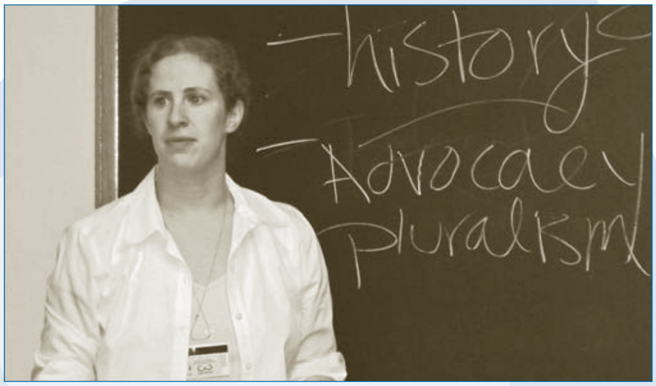
The results also indicate that predatory lending is likely affecting those who have struggled to access the housing and mortgage market as well as the benefits of homeownership and asset accumulation. The characteristics of areas experiencing predatory lending are remarkably similar to the target population of many government initiatives aimed at improving neighborhood quality and promoting homeownership, efforts which are likely hampered by the persistence of predatory lending.

Current Agenda

"The funding provided by DDRG, as well as the EDSRG, allowed me to focus on my dissertation, thus helping me to develop my current research agenda," says Crossney. Her current focus is on the relationship between housing and mortgage opportunities in the urban landscape. The two main lines of inquiry are the origins of modern mortgage and predatory mortgage lending. "Many of today's mortgage market failures are personifications of the early mortgage market, as well as the unintended consequences of regulation that sought to minimize imperfections in the market and improve borrowers' access and experience," says Crossney.

Crossney believes that her doctoral work helped develop her research design and analytical skills, thereby preparing her for either a career in academics or as a policy analyst. "I also think that my particular dissertation topic and experience with the DDRG has allowed me, as a teacher, to bridge theory and practice in the classroom," says Crossney. For the 2007–2008 academic year, she accepted a lecturer position at Temple University's Department of Geography and Urban Studies and taught courses in urban dynamics, brownfields, urban social geography and race, and class and gender in urban areas.

As a postdoctorate research fellow at the National Center for Neighborhood and Brownfields Redevelopment at Rutgers University, she has worked on a project to develop training modules



Kristen Crossney

to help community-based organizations working in low-income areas to become more involved and informed about the redevelopment of brownfields. Through the National Center for Neighborhood and Brownfields Redevelopment, she also worked with local government, nongovernmental organizations, and community-based organizations to help address the negative effects of brownfields and improve neighborhood-based planning efforts.

"I had a very positive experience with the DDRG program. I've recommended the program to my peers and have previously helped friends prepare their applications," says Crossney. "I encourage all potential grantees of the DDRG to take full advantage of this rich, unique opportunity to dedicate themselves to their dissertation. I suggest that they select a topic they are passionate about and relate their particular interests to a current issue or problem, thereby maximizing the likely impact of their research and findings."

Kristen B. Crossney currently serves as Assistant Professor in the Department of Geography and Planning at West Chester University of Pennsylvania. A summary of her dissertation *The Paradox of Predatory Lending: An Examination of Mortgage Lending in Philadelphia, Pennsylvania* appears on page 4.

The Paradox of Predatory Lending: An Examination of Mortgage Lending in Philadelphia, PA

by Kristen Crossney

For most U.S. households, the majority of wealth or assets exists as equity in the home. In the past decade, predatory lending—the practice of deceptively convincing borrowers to agree to unfair and abusive loan terms—has increased the risk to homeowners of foreclosure and bankruptcy. This risk increases when a homeowner is unfamiliar with loan processes or reasonable mortgage terms or when there is a language or social barrier that makes communication between the lender and homeowner challenging.

Unfortunately, it is difficult to make services or assistance available to victims of predatory lending because the at-risk population has not been examined using rigorous empirical research and documentation. Lack of information about the incidence and existence of predatory lending complicates the ability to provide such services and assistance. The number of potential clients and the location of predatory activity are unknown. If the at-risk population or distribution of predatory lending was better understood, then services and programs could target these people and areas to alleviate the consequences of predatory lending.

In her dissertation, Kristen Crossney examines the occurrence of predatory lending in Philadelphia. Crossney's dissertation poses three questions not fully explored in previous research:

1. Is predatory lending activity geographically clustered?
2. Who is at risk to predatory lending activity?
3. What is the effect of using different sensitivity levels in the loan-to-value ratio to classify predatory lending?

For this research, Crossney defined predatory lending as properties with loan-to-value ratios (LTVs) greater than 110. Nearest Neighbor Hierarchical Cluster Analysis (NNHCA) was chosen to answer research question 1. Independent Sample T-Tests were chosen to examine differences in the characteristics between areas experiencing predatory lending and those that are not. These results were used to answer research question 2. Research question 3 was addressed by considering how the results for research questions 1 and 2 changed as the LTV ratio was adjusted to different values. LTVs of 110, 120, 130, and 140 were considered. The first two questions are crucial to designing and directing initiatives aimed at preventing predatory lending and mitigating the potential consequences of abusive lending practices.

This dissertation offers a more detailed examination of the location of predatory loans and the characteristics of surrounding areas. These results inform efforts to mitigate the consequences and prevent future predatory lending. The identification of where and in what type of places predatory lending is occurring offers directions for identifying predatory lending victims.

NNHCA was chosen to test the first question. The results indicate that within Philadelphia, predatory lending is significantly clustered. The spatial distribution of properties with predatory loans indicates that certain areas of the city are more at risk than others. Areas closer to but outside of Center City appeared to have higher levels of activity than do peripheral areas. Independent Sample T-Tests reveal that tracts containing activity classified as predatory differ from other parts of the city in racial and ethnic composition, socioeconomic status, neighborhood context, and mortgage activity.

Who is at Risk?

This dissertation also draws on Independent Sample T-Tests examining differences in the mean values of census and Home Mortgage Disclosure Act (HMDA) data between areas experiencing predatory lending and other parts of the city. These results were used to address the second research question. Areas experiencing predatory lending tended to have larger, increasing minority populations, declining white populations, and residents of lower socioeconomic standing. Also, housing values are lower and vacancy rates are higher.

T-tests examining the underlying differences in HMDA data from 1993 to 2000 indicate that, overall, mortgage activity varies between tracts identified as predatory and other parts of the city. The results support the literature concerning the nature of predatory mortgages and the types of areas likely experiencing this negative lending behavior. Differences in mortgage activity across the city suggest that there very well may be a wide variety of loan characteristics that are not always to the benefit of the borrower and may be considered predatory.

With respect to question 3, the results of the NNHCA and T-tests are relatively consistent. Results indicate that the three methods used to estimate property value and the four LTVs defining predatory lending activity are not dramatically different in Philadelphia. The comparability

Dissertation Summary continued on page 6

EDSRG Scholarly Manuscript

Is Subprime Lending Leading to Reverse Redlining and Price Discrimination?

Abhishek Mamgain

U.S. mortgage markets have significantly expanded credit availability among low-income and minority households during the past decade. One of the primary reasons for this expansion is subprime lending, which has made it possible for borrowers with lower credit-worthiness to access mortgage credit. This inclusion of borrowers that were previously excluded from credit markets along with booming property prices has led to significant growth in the subprime market and a more complete mortgage market. Simultaneously, it has led to concerns regarding fairness of lending, particularly those related to the targeting of minority neighborhoods (reverse redlining) and pricing discrimination. Resolution of such concerns is especially important. If subprime lenders are targeting low-income minorities for higher cost subprime mortgages, they might cause a disproportionate amount of harm to the most vulnerable sections of society.

Despite the concerns regarding reverse redlining in subprime markets, very little empirical work has been done to assess the existence and prevalence of this form of discriminatory practice. *Is Subprime Lending Leading to Reverse Redlining and Price Discrimination?* fills this gap in the literature and also investigates the presence of reverse redlining and price discrimination in the Los Angeles County region. It does this by evaluating a pool of Home Mortgage Disclosure Act microlevel data for 2004 in conjunction with the U.S. Department of Housing and Urban Development subprime lenders list and 2000 Census data. In a significant departure from earlier studies, this study examines the subprime market as one dominated by specialized lenders and not as a continuum of the prime market. Therefore, this study evaluates a pool of subprime originations separately to uncover the relative differences in subprime originations and pricing for low-income minority households in comparison to low-income non-Hispanic white households.

The study confirms that even in the Los Angeles County region, most subprime borrowers are minority and low-income households, and significant proportions of both subprime home purchases (55 percent) and refinance mortgages (80 percent) are concentrated in high-minority tracts (in which minority concentrations comprise more than 50 percent of total population). Thus, there is a fair amount of consensus regarding higher concentrations of subprime mortgages among low-income minority households and tracts. However, the concentration does not imply that lenders are targeting the minority households (discriminating) or indulging in any unfair lending practices. On the contrary, such a concentration can be expected since most of the subprime loans are utilized by first-time homebuyers, minorities, and low-income borrowers that have lower credit scores.

In spite of higher concentrations of subprime originations in tracts with high-minority concentration, the study did not find support for disproportionate targeting of low-income minorities in the Los Angeles County area. The study found that low-income minority households were as likely to originate subprime home purchase and refinance mortgages as low-income non-Hispanic white households. Furthermore, household and loan characteristics were the primary determinant of subprime originations in high-minority tracts, implying that some concerns regarding reverse redlining based on race have been exaggerated.

Although household and loan characteristics are the primary drivers of the rate spread, the study found that low-income African American and Asian households might be receiving higher rates for similar subprime mortgage products compared to non-Hispanic white households (no such relationship was found for subprime *refinance* originations). However, race might not be the only reason for such differences in pricing. Differences might arise from other borrower and property-related risk factors. Further research on this topic will greatly benefit from the inclusion of variables such as credit scores, household debt, and others that can better explain borrower and neighborhood-level risk characteristics.

Furthermore, the study found evidence that low-income minority households are more likely to use prime refinance mortgage products, suggesting upward mobility of subprime borrowers that are refinancing out of the subprime mortgage after gaining some equity in their homes. Overall, this study suggests that there is limited support for targeting of minority households and pricing discrimination in high-

EDSRG Scholarly Manuscript *continued on page 6*

U.S. Department of Housing and Urban Development
Office of University Partnerships
451 Seventh Street, SW
Washington, DC 20410–3000

***Dissertation Summary** continued from page 4*

of these results for the 12 different definitions suggests that the exact definition used for predatory lending is not as important as selecting a well-informed definition.

The paradox of predatory lending is that those most in need of political support from benefits of homeownership are those most likely to suffer the damaging effects of predatory lending. The characteristics of areas experiencing predatory lending are remarkably similar to the target population of many government initiatives aimed at improving neighborhood quality and promoting homeownership—efforts likely to be hampered by predatory lending. Lower education and income levels suggest that this portion of the population likely has less financial stability and that the consequences of predatory lending will likely compound this already vulnerable population.

***EDSRG Scholarly Manuscript** continued from page 5*

minority tracts in the Los Angeles County region. Thus, contrary to popular belief, race does not play a significant role in subprime mortgage underwriting, and the subprime market remains an important source of mortgage credit for low-income and credit-impaired minority households seeking to achieve and maintain homeownership.

Abhishek Mamgain is currently pursuing a Ph.D. in Planning at the University of Southern California. He received a 2005 Early Doctoral Student Research Grant (EDSRG) from the Office of University Partnerships. The preceding is a summary of his EDSRG scholarly manuscript *Is Subprime Lending Leading to Reverse Redlining and Price Discrimination?*

HUD's Office of University Partnerships (OUP) provides grants to institutions of higher education to assist them and their partners with the implementation of a broad range of community development activities including neighborhood revitalization, housing, and economic development. It also provides grants to doctoral candidates to develop and conduct applied research on policy-relevant housing and urban development issues. This newsletter, *Research in Focus,* highlights the accomplishments of grantees in OUP's Doctoral Dissertation Research Grant and Early Doctoral Student Research Grant programs. It includes a variety of articles on past and current grantee dissertations and research.