Lost Ground, 2011:

Disparities in Mortgage Lending and Foreclosures

Executive Summary

Debbie Gruenstein Bocian,
Wei Li, Carolina Reid
Center for Responsible Lending

Roberto G. Quercia
Center for Community Capital,
University of North Carolina Chapel Hill

November 2011

Center for Responsible Lending

www.responsiblelending.org

As the nation struggles through the fifth year of the foreclosure crisis, there are no signs that the flood of home losses in America will recede anytime soon. Among the findings in this report, *Lost Ground, 2011,* we show that at least 2.7 million households have already lost their homes to foreclosure, and more strikingly, that we are not even halfway through the crisis.

Lost Ground, 2011 builds on the Center for Responsible Lending's longstanding efforts to document the severity and demographic dimensions of the foreclosure epidemic. In 2006, CRL published *Losing Ground,* which projected subprime foreclosures and the attendant costs to homeowners prior to the collapse of the housing market.[1] In 2010, we published *Foreclosures by Race and Ethnicity: the Demographics of Crisis,* which estimated completed foreclosures through 2009 and the disparate rates of foreclosure for different racial and ethnic groups.[2] Assessing the scope of the crisis remains daunting, since there is no single, nationwide source of information on the number of foreclosures, the demographics of those affected, or the neighborhood distribution of foreclosed properties. In this report, we use an expanded dataset to update our previous findings and extend the scope of our analysis.

The report addresses three key questions. First, we consider **who** has lost their home to foreclosure, and who is still at risk. We look at both the race/ethnicity and income of borrowers, and explore how the impact of foreclosures on different socioeconomic and demographic groups varies depending on where they live. Second, we look at **what** kind of mortgages different borrowers received to better understand the relationship between loan characteristics and defaults. Finally, we examine **where** the crisis has had the greatest impact, assessing which areas and types of neighborhoods have been most affected.

Top-Line Findings

The nation is not even halfway through the foreclosure crisis. Among mortgages made between 2004 and 2008, 6.4 percent have ended in foreclosure, and an additional 8.3 percent are at immediate, serious risk.

Foreclosure patterns are strongly linked with patterns of risky lending. The foreclosure rates are consistently worse for borrowers who received high-risk loan products that were aggressively marketed before the housing crash, such as loans with prepayment penalties, hybrid adjustable-rate mortgages (ARMs), and option ARMs. Foreclosure rates are highest in neighborhoods where these loans were concentrated.

The majority of people affected by foreclosures have been white families. However, borrowers of color are more than twice as likely to lose their home as white households. These higher rates reflect the fact that African Americans and Latinos were consistently more likely to receive high-risk loan products, even after accounting for income and credit status.

In brief, these are the key findings:

1. **We are not even halfway through the foreclosure crisis.** Among homeowners who received loans between 2004 and 2008, 2.7 million households, or 6.4 percent, had already lost their homes to foreclosure as of February 2011.[3] Strikingly, an additional 8.3 percent—3.6 million households—were still at immediate, serious risk of losing their homes. Affected families span all races, ethnicities, and income levels. It is notable that these serious delinquencies represent only a sub-set of likely foreclosures ahead, since they do not include foreclosures on loans originated outside our origination time frame or those that are not yet at imminent risk.

2. **Loan characteristics and foreclosures are strongly linked.** The study examines outcomes on different loan types and finds a pattern of higher foreclosures and delinquencies associated with specific mortgage characteristics. Loans originated by brokers, hybrid adjustable-rate mortgages ("ARMs," such as 2/28s), option ARMs, loans with prepayment penalties, and loans with high interest rates (a proxy for subprime mortgages) all have much higher rates of completed foreclosures and are more likely to be seriously delinquent.

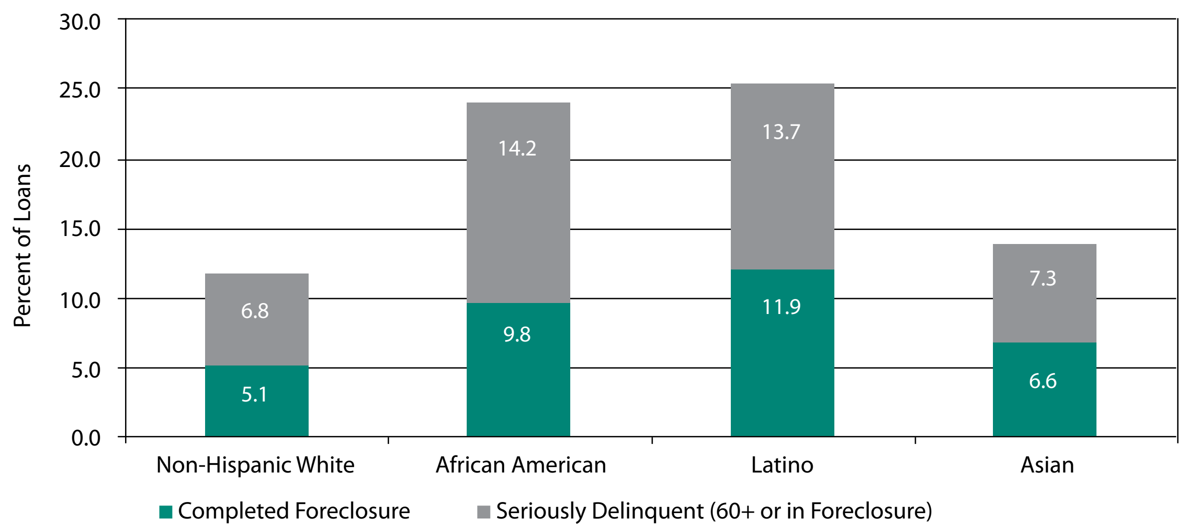
3. **Although the majority of affected borrowers have been white, African-American and Latino borrowers are almost twice as likely to have been impacted by the crisis.** Approximately one quarter of all Latino and African-American borrowers have lost their home to foreclosure or are seriously delinquent, compared to just under 12 percent for white borrowers. Asian borrowers have fared better as a whole than Latino and African-American borrowers, but they, too, have been disproportionately affected, especially in some metropolitan areas.

Loan Status (as of February 2011) by Loan Feature (2004-2008 Originations)

Loan Feature		Completed Foreclosures (%)	Seriously Delinquent (%)
Broker	Broker Originated	4.7	8.0
	Not Broker Originated	2.7	5.6
Hybrid or Option ARM	Hybrid or Option ARM	12.8	11.7
	Fixed Rate or Standard ARM	3.3	6.9
Prepayment Penalty	Prepayment Penalty	14.7	14.3
	No Prepayment Penalty	4.0	6.4
Higher-Rate	Higher-Rate	15.6	15.3
	Not Higher-Rate	4.6	6.9

Note: We define "hybrid" and "option" ARMs as loans with any one of the following characteristics: ARMs with interest rate resets of less than five years, negative amortization, or interest-only payment schedules. "Higher-rate" is defined as first-lien loans for which the annual percentage rate (APR) was 300 basis points or more above Treasury rates of comparable maturity.

Rates of Completed Foreclosures and Serious Delinquencies by Borrower Race and Ethnicity (2004-2008 Originations)



4. **Racial and ethnic differences in foreclosure rates persist even after accounting for differences in borrower incomes.** Racial and ethnic disparities in foreclosure rates cannot be explained by income, since disparities persist even among higher-income groups. For example, approximately 10 percent of higher-income African-American borrowers and 15 percent of higher-income Latino borrowers have lost their home to foreclosure, compared with 4.6 percent of higher-income non-Hispanic white borrowers. Overall, low- and moderate-income African Americans and middle- and higher-income Latinos have experienced the highest foreclosure rates.

5. **Loan type and race and ethnicity are strongly linked.** African Americans and Latinos were much more likely to receive high interest rate (subprime) loans and loans with features that are associated with higher foreclosures, specifically prepayment penalties and hybrid or option ARMs. These disparities were evident even comparing borrowers within the same credit score ranges. In fact, the disparities were especially pronounced for borrowers with higher credit scores. For example, among borrowers with a FICO score of over 660 (indicating good credit), African Americans and Latinos received a high interest rate loan more than three times as often as white borrowers.

Among borrowers with a FICO score of over 660 (indicating good credit), African Americans and Latinos received a high interest rate loan more than three times as often as white borrowers.

6. **Foreclosure rates by income groupings vary by housing markets.** In areas of the country that had weak or moderate housing price appreciation during the period leading up to the crisis, foreclosure rates are highest for low-income borrowers and lowest for higher-income borrowers. For example, low- and moderate-income borrowers have been most affected in cities such as Detroit, Cleveland, and St. Louis. However, in areas that had strong housing appreciation before the collapse, the opposite is true. In boom-market metropolitan areas located in California,

Nevada and Arizona, foreclosure rates are highest among middle- and higher-income borrowers. These patterns are consistent with the incidence of high-risk mortgages received by different groups of borrowers across the different housing markets.

7. **Impacts vary by neighborhood.** Low- and moderate-income neighborhoods and neighborhoods with high concentrations of minority residents have been hit especially hard by the foreclosure crisis. Nearly 25 percent of loans in low-income neighborhoods and 20 percent of loans in high-minority neighborhoods have been foreclosed upon or are seriously delinquent, with significant implications for the long-term economic viability of these communities.

Nearly 25 percent of loans in low-income neighborhoods and 20 percent of loans in high-minority neighborhoods have been foreclosed upon or are at high risk of default.

The findings presented in this report suggest that we are not even halfway through the foreclosure crisis, as millions of additional families are still at risk of losing their home. Meanwhile, Americans of every demographic group—all incomes, races, and ethnicities—have been affected. Our analysis shows that non-Hispanic white and middle- and higher-income borrowers represent the vast majority of people who have lost their homes. However, we also find that people of color and lower-income borrowers and neighborhoods have been disproportionately affected.

Our study provides further support for the key role played by loan products in driving foreclosures. Specific populations that received higher-risk products—regardless of income and credit status—were more likely to lose their homes. While some blame the subprime disaster on policies designed to expand access to mortgage credit, such as the Community Reinvestment Act (CRA) and the affordable housing goals of Fannie Mae and Freddie Mac (the government-sponsored enterprises, or GSEs), the facts undercut these claims.[4] Rather, dangerous products, aggressive marketing, and poor loan underwriting were major drivers of foreclosures in the subprime market.

The Dodd-Frank reforms, passed in July 2010, took the first vital step by strengthening mortgage protections, restricting the use of risky products and practices, and requiring lenders to consider each borrower's ability to repay a loan. These new rules will certainly have a positive effect on the success of future mortgages. Yet responding to today's battered housing market will require policy responses on a variety of other levels as well. In the short term, we need stronger measures to prevent additional foreclosures. Over the longer term, policymakers will need to consider how to rebuild the mortgage credit market, recognizing not only the current challenges but also the broader historical barriers to access to credit in this country.

For decades, owning a home has been the most accessible way to build wealth and gain a foothold in the middle class. Especially for lower-income families and middle-class borrowers of color, this crisis threatens to undo decades of economic, social and educational progress. But in our efforts to stabilize the housing market and prevent a future crisis, we must not create an environment where qualified borrowers are denied access to reasonably-priced mortgages. Future reforms—whether regulatory or legislative in nature—must prevent unfair and abusive lending practices while facilitating a stable supply of mortgage credit for all qualified borrowers.

ENDNOTES

1 E. Schloemer, W. Li, K. Ernst, and K. Keest (2005). "Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners," Research Report, Center for Responsible Lending.

2 D. Bocian, W. Li, and K. Ernst (2010). "Foreclosures by Race & Ethnicity: The Demographics of a Crisis," Research Report, Center for Responsible Lending.

3 Our results do not go beyond February of 2011, but all indications are that the foreclosure problem is not abating. For example, according to the Mortgage Bankers Association delinquency report, figures for the second quarter of 2011 show a rise in early (30-day) delinquencies, including late payments on prime, fixed-rate loans. One in 11 mortgage holders is 60 days late or more on their loan. The number of loans now at risk of default far exceeds the number of completed foreclosures. Given that relatively few of these loans are likely to recover and the high number of continuing delinquencies, it is clear that we are not yet halfway through the foreclosure crisis.

4 Both the CRA and the GSEs' affordable housing programs declined in market share during the peak of the housing bubble, as lenders willingly originated the subprime loans that Wall Street was demanding. See R. Quercia; A. Freeman; and J. Ratcliffe (2011). *Regaining the Dream: How to Renew the Promise of Homeownership for America's Working Families*. Washington, D.C.: Brookings Institution Press. A recent study by economists at the Federal Reserve Board finds that neither CRA nor the GSE housing goals had a significantly negative effect on outcomes. See R. Avery and K. Brevoort (2011). "The Subprime Crisis: Is Government Housing Policy to Blame?" Finance and Economics Discussion Series, Divisions of Research & Statistics and Monetary Affairs of the Federal Reserve Board.

About the Center for Responsible Lending

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

Visit our website at **www.responsiblelending.org.**

North Carolina
302 West Main Street
Durham, NC 27701
Ph (919) 313-8500
Fax (919) 313-8595

California
1330 Broadway
Suite 604
Oakland, CA 94612
Ph (510) 379-5500
Fax (510) 893-9300

District of Columbia
910 17th Street NW
Suite 500
Washington, DC 20006
Ph (202) 349-1850
Fax (202) 289-9009